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<u>TOPIC</u>

APPOINTMENT OF BOARD OF DIRECTORS TO STATE OWNED ENTERPRISES IN KENYA: TOWARDS A STRICTER REGULATORY FRAMEWORK

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A THESIS SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF MASTER OF LAWS (LL.M) OF THE UNIVERSITY OF NAIROBI

DATED…………………………………DAY OF …………………………..2013

DECLARATION

I, **ELIJAH NJAGI IRERI**, do hereby declare that this is my original work and has not been submitted and is not currently being submitted for a degree in any other University.

SIGNED:…………………………………………….
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This thesis has been submitted with my approval as the University of Nairobi Supervisor,

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God bless you all.

DEDICATION

This project is dedicated to my family and children who have given me inspiration to go back to class by saying daddy you can make it and to my reader Dr. J. Gakeri for the invaluable comments.

LIST OF ABBREVIATIONS

AGM	Annual General Meeting
BOD	Board of Directors
CACG	Commonwealth Association for Corporate Governance
CCG	Centre for Corporate Governance
CEO	Chief Executive Officer
CGD	Centre for Governance and Development
CMA	Capital Market Authority
DGIPE	Department of Government Investments and Public Enterprises
EGP	Economic Governance Programme
GCGC	German Corporate Governance Code
GOK	Government of Kenya
ICCLR	International Company and Commercial Law Review
ICGN	International Corporate Governance Network
IMF	International Monetary Fund
KEPC	Kenya External Telecommunication Corporation
KPTC	Kenya Posts and Telecommunication Corporation
KVDA	Kerio Valley Development Authority
OECD	Organization for Economic Co-operation and Development
PIC	Parliamentary Public Investments Committee

PPP Public-Private Partnerships

SCA State Corporations Act

SCAC State Corporations Advisory Committee

SOE State Owned Enterprises

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Companies Act 1962, Chapter 486 of the Laws of Kenya.

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Parke v. Daily News Ltd, 1962 Ch. 927.

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Re City Equitable Fire Insurance Co. Ltd, [1925] Ch 407.

Re Lee, Behrens and Company Ltd, (1932) 2 Ch. 46.

Re Smith v. Fawcett Ltd, [1942] Ch. 304.

Trevor Price and Another v. Raymond Kelsali, (1957) EA 752.

ABSTRACT

State Owned Enterprises (SOEs) play a very important role in Kenya's economy, as they provide affordable services and employment to the citizens. As business entities, they need to be run efficiently and effectively by the board of directors (BOD). Being the most important management organ of a SOE, BOD should be composed of persons of integrity, appointed on merit, experienced and qualified with independent minds to make business decisions that are in the best interest of the corporation. The poor performance of a majority of SOE in Kenya is a testimony to the quality of the boards constituted.

It is in this context that the appointment procedure of board members should only allow those who are competent to join the board. Clearly too, this process is a very important indicator of how a SOE is likely to perform. The practice in Kenya since independence has been that the President or the line Minister had the power under the State Corporations Act to appoint persons to boards of SOEs. No guidelines existed for such appointments in terms of qualifications and relevant experience. The process was therefore subjected to executive control, leaving room for political affiliation, nepotism and tribalism as criteria for appointment to the board. This study examines how failure to incorporate good corporate governance in the appointment process of BOD, contributed to poor performance of SOEs.

TABLE OF CONTENTS

Page

Declaration……………………………………………………………………………………...ii

Acknowledgments…………….………………………………………………………………….iii

Dedication………………………………………………………………………...............iv

List of Abbreviations……………………………………………………………......................v

Table of Statutes………………………………………………………………….....................vii

Table of Cases…………………………………………………………….................................viii

Abstract…….……………………………………………………………………………………..ix

Table of Contents…………...………………………………………………….........................xi

CHAPTER ONE

INTRODUCTION TO THE APPOINTMENT OF DIRECTORS IN STATE OWNED ENTERPRISES (SOE) IN KENYA

1.1. Background to the Study…….…………..……………...………………………….................1

1.2. Statement of the Problem……...……………..…………………………………...........11

1.3. Theoretical Framework…………………………….……………………….............12

1.4. Literature Review…………………………….………………………………………...18

1.5. Research Objectives…………………………………………………….......................21

1.6. Justification……………………………………………………………..………….....21

1.7. Hypothesis…………………………………………………………….................22

1.8. Research Questions…………………………………...22

1.9. Research Methodology…………………………………..………………………22

1.9.1. Sample Size and Sample Frame...23

1.9.3. Data Type and Collection Procedure...23

1.9.2. Research Instruments..23

1.9.4. Data Processing and Analysis...23

1.10 Chapter Breakdown……………………………………………………………..24

CHAPTER TWO

OVERVIEW OF STATE OWNED ENTERPRISES IN KENYA

2.0. Introduction…………………………………………………………………….26

2.1. Politicization of the Appointment Process……………………………............................26

2.2. Impact of Irregular Appointment..28

2.3. Poor Legal Framework and Indebtedness...29

2.4. Diversity and Gender Mainstreaming in Board Appointment..33

2.5. Supplementing the Private Sector……………………………….…………………35

2.6. Donor Agencies Stringent Conditionalities……………………….......................................36

2.6. Conclusion……………………..…………………………………….……………...37

CHAPTER THREE

KENYA'S LEGAL FRAMEWORK ON THE APPOINTMENT OF BOD AND THE EFFECT OF THE NEW CONSTITUTION

3.1. Introduction………...……………………………………………………………………..39

3.2. How the BOD is formed in a SOE..40

3.3. Legal Framework Governing Appointment of BOD...42

3.4. The Office of the President..43

3.4.1. State Corporation Advisory Committee (SCAC)..44

3.4.2. The Inspectorate of State Corporations (ISC)..45

3.5. Ministry of Finance...45

3.6. Gaps and Weaknesses in the Legal and Regulatory Framework…………………………...46

3.6.1. Politicization of the Appointment Process..47

3.6.2. Diversity in Appointment of BOD..49

3.6.3. Gender Mainstreaming in Appointment of BOD in Kenya: Women on BOD……..……52

3.7. Effect of the New Constitution (2010) on Appointment of Directors to SOE Boards.........56

3.8. Conclusion...59

CHAPTER FOUR

FINDINGS AND ANALYSIS OF DATA ON APPOINTMENT OF BOD IN SOE

4.0. Introduction……………………………………………………………..…………...61

4.1. Target Population ………………………………………………….…………..64

4.2. Findings...………………………………………………………………………...64

4.2.1. Whether the Process of Appointment of BOD in Kenya is Publicised...............................65

4.2.2. Whether the Appointment of Board Members to SOE is competitive...............................66

4.2.3. Whether BOD in SOE'S Possess the Requisite Qualifications and Expertise..................67

4.2.4. Importance of Training New Board Members Appointed to SOES in Kenya...................68

4.2.5. Whether Persons Sitting in SOE'S Boards Should Sign Performance Contracts................69

4.2.6. Whether Ranking of SOES is an Incentive to Encourage Better Performance..................70

4.2.7. Whether Diversity in Appointment of Board Members Will Improve Performance……71

4.2.8. Whether the New Constitution Will Lead to Better Corporate Governance of SOE……72

4.3. Conclusion..73

CHAPTER FIVE

COMPARATIVE ASPECTS OF SELECTED CASE STUDIES

5.1. Introduction…...………………...……………………………………….……..…74

5.2. Best Practices in other Jurisdictions..74

5.3. Executive as the Appointing Authority in the UK...75
5.4. The Oversight Role of Parliament in South Africa..76
5.4.1. Annual Reports..77
5.4.2. Roles of different Parliamentary Committees...77
5.4.3. Portfolio Committees..78
5.5. Diversity in the Board..78
5.6. Conclusion…..………………………………………………………………………79

CHAPTER SIX

CONCLUSION AND RECOMMMENDATIONS

6.1. Conclusion………………..…………………………………………………………….81
6.2. Recommendations………..……………………………………………………………85
6.2.1. Legislation to Consolidate and Harmonize Laws in the Appointment Process................85
6.2.2. Amendment of laws that regulate SOE..85
6.2.3. De-politicization of the appointment process..86
6.2.4. SOE to be Peer Reviewed by ICPSK on Corporate
Governance Principles in Appointment and Removal of BOD...86
6.2.5. Full implementation of the Constitution...87
Appendix 1: Letter of Introduction..88
Appendix 2: Questionnaire..89
Bibliography...92

CHAPTER ONE

INTRODUCTION TO THE APPOINTMENT OF BOARD OF DIRECTORS IN STATE OWNED ENTERPRISES IN KENYA

1.1. Background to the Study

The phrase "State Owned Enterprises (SOE)" in Kenya, applies to a wide range of bodies that operate in the state dominated sector of the economy.[1] A SOE is an enterprise over which the state has significant control, whether wholly with a full majority or a significant minority ownership.[2] This definition comports with that given by Section 2 of the State Corporations Act,[3] which defines a State Corporation as a body that is:[4] defined that way by statute; a body corporate established by an Act of Parliament; a bank or other financial institution or other company whose shares or a majority of whose shares are owned by government or by another state corporation and a subsidiary of a state corporation.

SOE have been in existence in Kenya since the colonial times with almost similar objectives like those obtaining currently.[5] The background will examine the development of SOE from the pre-independence times through to the post independence period, while assessing how the appointment processes of board members has impacted on the development and performance of SOE.

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[1] C. Harmse, 'Provision of Public Utilities: The Kenyan Experience', 2004) 39 (3) *Journal of Public Administration* 383 at 384.

[2] Agata Waclawick – Wejman, 'Corporate Governance of State Owned Corporations in Poland' (2005) available at www.msp.gov.pl/download.php?s=2&id=670 (accessed on May 22, 2011).

[3] State Corporations Act, 1987 (Chapter 446 of the Laws of Kenya). The Act's preamble states that it is an Act of Parliament to make provision for the establishment of State Corporations.

[4] Centre for Corporate Governance Development, '*A Decade of Parastatal Waste*: *A Study of the Audited Accounts of State Corporations over the Period from 1993 to 2002'* at 25 available at <http://www.cgd.or.ke/publications.asp > (accessed April 30 2011) .

[5] Barbara Grosh, *Public Enterprise in Kenya: What Works, What does not, and Why?* (Lynne Rienner Publishers: Boulder, 1991) at 11.

1.1.1. SOE during the pre-colonial period

The concept of SOE was muted by the colonial Government as they were considered more efficient in providing essential services especially those from the public sector and monopolies.[6] Leaving monopolies in private hands was considered dangerous as it would have led to exploitation of the citizens. SOE's were also seen as important tools for correcting market failure in essential services but also doubled up as tools for excluding Africans from the economy.[7] Major SOE at this time included those that provided infrastructural services (natural monopolies), crop marketing boards, that were organized to benefit white farmers and those who participated in the manufacturing sector under the Industrial Development Corporation (IDC).[8] The first SOE was Uganda Railways in 1903, Coffee Board of Kenya (CBK) in 1920, Kenya Cooperative Creameries (KCC) in 1925, Uplands Bacon Factory in 1941, Kenya Meat Commission (KMC) in 1950, Wheat Board of Kenya in 1952, Pyrethrum Marketing Board (PMB) in the 1950S, East African Airways (EAA) in the 1950s, Industrial Development Credit (IDC) later ICDC in 1954, Cotton Lint and Seed Marketing Board of 1955 and Maize Marketing Board of 1960.[9]At independence, they were seen as vehicles for the indigenization of the economy.[10]

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[6] Ibid.

[7] Ibid. at 12.

[8] Ibid.

[9] Ibid.

[10] A key feature of these SOEs is that many were established to ensure supplies of goods and services to all corners of the country and therefore assist in economic development, especially in marginal areas. The Kenya government used generous financial support and technical assistance provided by bilateral, multilateral donor and private lenders and international lenders to strengthen its hold on the economy through establishment and strengthening of SOEs. An important aspect of this expansion was the creation of key parastatals such as KPTC; KPLC; Agricultural Finance Corporation, KPA, Kenya Airways (now privatized), Kenya Commercial Bank (partly privatized), National Bank of Kenya and Kenya Reinsurance Corporation.

1.1.2. SOE post independent Kenya

When Kenya attained independence in 1963, it established several new and reorganized old SOE to further the implementation of economic development plans.[11] At this time SOE contributed 11.2% of the general GDP, rising to 14.4% in 1971.[12] The new Government used state powers to assist Africans accumulate capital. It can therefore be said that, the post-colonial state gave the indigenous population the advantages denied during the colonial period.[13] Since the 1960's, the African population used the legislative process to gain a foothold in the commercial sector to the disadvantage of other racial groups.[14]

> In practice, the shift from special assistance to protectionism can be seen in every field where the Government tried to foster African capitalism except those fields where it moved directly to the creation of monopoly without more ado. The effect of this was to create a new stratum of the African petty bourgeoisie, ensconced within the general system of protection and monopoly, in such a way as to serve and complement foreign capital not to replace it.[15]

African traders were for the first time given preferential access to aspects of the economy (land and trade) through a system of licensing.[16] By 1975, the Kenya National Trading Company (KNTC) was set up as a corporation to Africanize distribution of merchandise in Kenya. It was granted distribution rights to a wide range of goods to indigenous wholesalers (sugar, rice, maize, salt, soap, cement and tools).[17]

[11] Grosh op. cit. note 5 at 12.
[12] Ibid.
[13] Nicola Swainson, *The Development of Corporate Capitalism in Kenya 1918-1977* (Heinemann: London, 1980) at 186.
[14] Ibid. at 187.
[15] Colin Leys, *Capital Accumulation, Class Formation and Dependency: The Significance of the Kenyan Case* (Queens University: Kingston, Canada, 1975) at 149.
[16] First Legislation was Trade Licensing Act of 1967, which excluded non-citizens from trading in rural from central-urban areas and specified a list of goods which were to be restricted to citizen traders only.
[17] Swainson op cit note 13 at 187.

1.1.3. **Why SOE and not Government Departments?**

SOE were seen in the general context of political and economic objectives[18] especially development in the agricultural sector.[19] First, as a major source of employment and diversification of production would help the country to stop relying on one cash crop only for foreign currency. SOEs were also seen as a solution to providing services where either the public sector was unable or unwilling to provide. This policy represented Kenya's version of African Socialism set out in the Sessional Paper No. 10 of 1965.[20]

The purpose of establishing SOE was to continue the old lending role of Government through Agricultural Finance Corporation (AFC) and Industrial and Commercial Development Corporation (ICDC).[21] Secondly, it was to provide an institutional framework for joint ventures with overseas capital which comprised development authorities (National Irrigation Board (NIB) and Agricultural Development Corporation (ADC) established by the Ministry of Agriculture pursuant to Agricultural Act.[22] Thirdly, it envisaged to give assistance to Africans to enable them participate in trade and commerce (National Trading Corporation and National Property Company. The function of the latter was to re-orient wholesale trade from Asian hands into African hands and buy up suitable sites in good shopping areas and lease them to Africans. The latter two showed the Government's reluctance in getting directly involved in establishing SOE,

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[18] The Kenya and Uganda Development Plans', (1966) *East African Economic Review* at 19.
[19] W G Friedmann and J F Garner ed., *Government Enterprise: A Comparative Study* (Columbia University Press: New York, 1976) at 265.
[20] "African Socialism and its Application in Planning in Kenya" a statement of the political philosophy of the Government of Kenya and described as an extension in detail of the 1963 Elections of the Manifesto of the Kenya African National Union and the Constitution of Kenya.
[21] Friedmann and Garner op cit note 19 at 267.
[22] Ibid.

they were created by ICDC as wholly owned subsidiaries acting under powers contained in the Companies Act.[23]

The reason for establishing SOE rather than entrusting them to Government departments were varied. It was opined that being commercial entities, with revenue producing functions, performance could be assessed through the yardstick of profitably, thus it was more efficient to administer it as a business.[24] However many SOE did not have well defined social service and public utility objectives, since Government Departments provided services with a commercial undertaking. For example KNTC was designed to facilitate African participation in trade and therefore had to balance purely commercial considerations against diverse public interest matters.[25] Diffusion of objectives led to a blurring of roles between Government business when a SOE is given wide terms of reference. This led to SOEs developing either into businesses or a regulatory agency.[26]

SOE were also perceived to be more efficient than Government departments especially when a Government branch is not functioning well as in the case of National Irrigation Board (NIB).[27] This was in addition to being viewed as improving on civil service efficiency and as a solution to difficult administration problems. Beside the relative weakness of the local government had to be supplemented by SOE for such purposes as housing and libraries.[28]

Be that as it may SOE were not found to be more enterprising than Government departments. For example in the case of the ICDC in 1967, the Minister's powers were expanded to enable him

[23] Chapter 486, Laws of Kenya.
[24] Friedmann and Garner op cit note 19 at 268.
[25] Ibid.
[26] Ibid.
[27] Irrigation Act, No. 13 of 1966.
[28] Friedmann and Garner op cit note 19 at 269.

initiate schemes of development for implementation by the corporation.[29] In so doing, the corporation was not only sluggish and lacked drive, but the Minister for Agriculture was criticized in 1965 for spending time moving from one board to the next before coming up with a decision.[30] They also paid higher salaries than the civil service for doing the work they used to do before. It was also observed that there were more safeguards against nepotism and other abuses in the civil service than in SOEs.[31]

Some SOE were formed to meet the wishes of foreign sources of capital, technical assistance and trade as a form of foreign direct investment (FDI).[32] This arose from a desire for grants, loans or investments to be handed directly to a corporation on which they would be represented rather than to a Government department. Foreign Governments with centrally planned economies preferred making trade agreements with SOE as they were considered more efficient and had the management capacity to administer their loans and agreements.[33] With time, the proliferation of SOE distracted rather than added to administrative efficiency. For such SOE, an expatriate could be appointed to head it as CEO, but not a ministry. Likewise, it was possible for a foreign funded SOE to be contracted to a foreign company.[34]

1.1.4. Africanization of trade and commerce

Trade and commerce during the colonial period had been monopolized by the white settlers who used SOE such as the Credit Development Corporation (CDC) that had been formed in 1954.[35] SOE that came up after independence sought to reverse this trend by establishing the AFC and

[29] Debate on the Kenya Industrial Development (Amendment) Bill 1967, Second Reading, May 22, 1967.
[30] House of Representation debate on Second Reading, Agricultural Development Corporation Bill, March 23, 1965, speech by Mr. Ngala-Abok (MP).
[31] Friedmann and Garner op cit note 19 at 270.
[32] Ibid.
[33] Ibid.
[34] Ibid.
[35] Ibid.

ICDC (which replaced the CDC) whose sole objective was the provision of credit facilities to African traders.[36]

The blue print for economic development of the new state was encapsulated in the Sessional Paper No. 10, titled "African Socialism and its Application to Planning in Kenya", which outlined the Governments' commitment to rapid economic growth and equitable distribution of wealth:

> The most important of these policies is to provide a firm basis for rapid economic growth. Other immediate problems such as Africanization of the economy, education, unemployment, welfare services and provincial policies must be handled in ways that will not jeorpardize growth. If growth is given up in order to reduce unemployment, a growing population will quickly demonstrate how false that policy is, if Africanization is undertaken at the expense of growth, our reward will be a falling standard of living.[37]

SOE were established to specifically pursue this policy, for example the ICDC was charged with the task of financing local trading and industrial enterprises. In the period 1965-1971, it lent out Ksh. £2.5 million to indigenous traders, between 1974-1975, 1087 traders and industrialists received Ksh. £2.7 million.[38] The bulk of these loans were however given to powerful politicians. Small scale traders in opposing this move viewed it as using official position as a way of advancing personal business interests.

It was felt that, "under African Socialism, the power to control resource use resides with the state," besides providing for the means of achieving these three goals.[39] In a bid to realize these goals, the Government embarked on strengthening SOEs which paid off since Kenya's economy in the first decade of independence grew at a rate of 6.8%. However in the 1980s, the economy

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[36] Swianson op cit note 13 at 187.
[37] Republic of Kenya, 1965 at 18.
[38] Leys, op cit 1975 at 157.
[39] Sessional Paper No. 10 of 1965.

started declining and reached 0.3% in the 1990s.[40] Among the reasons given for the decline was that money allocated to manage SOE's was used to pay wages of a bloated workforce in addition to rewarding political cronies.

The Ndegwa Committee Report of 1971 gave civil servants approval to engage in business sometimes having conflicting interests especially when it came to trading with the same SOE one worked for. According to Cowen this contributed in a large part to corruption within SOE:

> The Africanization and expansion of state apparatuses, accompanied by the sweeping away of the restrictions which prohibited state employees or their wives from engaging in accumulation in private enterprises, accelerated the process of straddling between permanent state employment and accumulation in the private sector.[41]

The Kenya Government was heavily involved in the economy through SOE. Out of a total of 240 SOE in 1995, 51 were wholly owned by the Government, in 36 of them, the Government had majority shareholding, while 153 were Government owned through holding companies.[42] In terms of contribution to the economy, in 1990, SOE contributed 11% of the total GDP and offered jobs to many people. Today 15% of the total public employees work for SOE but at a very high cost to the economy, since due to mismanagement, many SOE are a drain on the taxpayer virtually depending on the state to be bailed out.

1.1.5. Decline of SOE

The Government through Sessional Paper No. 10 had laid down elaborate general principles to govern SOE and enable them run as business ventures. First, they were to be run efficiently in whatever line of business they were engaged in. Secondly, they needed to be financially solvent

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[40] Centre for Corporate Governance and Development op cit note 4 at 6.

[41] M P Cowan and K Kinyanjui, *Some Problems of Capital and Class in Kenya,* Discussion Paper, IDS, Nairobi, 1977 at 16.

[42] Ibid. at 25.

and thirdly, they needed to foster growth and development of the private sector among indigenous traders which was expected to be efficient and commercially viable.[43]

From the outset, not everything went according to plan owing to the political nature of appointment of board members, allegations of nepotism and corruption.[44] Demands to Africanize SOE became even louder and in response, African managers were promoted much more quickly without training or experience which had the effect of compromising efficiency. Other demands came up such as cross-subsidies, which were readily granted, coupled with import substitution policy involving areas Kenya never had a comparative advantage.[45]

The Ndegwa Committee Report of 1971 by allowing civil servants to maintain business interests with SOE while holding Government jobs began a trend that would later lead to the decline of SOE.[46] This amounted to conflict of interest which in the colonial days would have been curtailed by a code of regulations that prohibited public servants from engaging in private business.[47] By 1977, the performance of SOE had begun declining and accelerated thereafter. By 1979, many SOE were not in any position to run as business entities, a Government report termed them as "personalized institutions" that constituted "a serious threat to the economy" it was a matter of time before they would collapse.[48] The reasons for decline include the death of Jomo Kenyatta who was replaced by Daniel Arap Moi under whom, SOEs were run by CEOs who were less qualified and experienced in running SOE.[49] But as Oliver observes "because they

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[43] See generally, Republic of Kenya, Sessional Paper No. 10 of 1965: African Socialism and its Application to Planning in Kenya.
[44] Gross op. cit 16.
[45] Ibid.
[46] Ndegwa Committee Report….
[47] Swainson, op cit note 19 at 191.
[48] David Himbara, Myths and Realities of Kenyan Capitalism (1993) 31 (1) *African Journal of Modern African Studies* 93 at 100.
[49] Roger Tangri, *The Politics of Patronage in Africa: Parastatals Privatization and Private Enterprise* (James Currey: Oxford, 1999) at 20.

were government enterprises, economic systems were tilted in their favor, at the expense of farmers who formed the main body of private enterprise producers".[50] Besides it has been observed by Tangri that:

> In largely state run African economies, most of the important economic policy decisions have been made by politicians and government officials. And the way Government leaders have made economic decisions and economic allocations has been strongly politicized. The way contracts, licenses and foreign exchange have been allocated, as well as the way investment projects and their location have been determined, have all been based, to a marked extent, on political calculations. Political motives such as those of maintaining political control as well as how political concerns can best be promoted have constituted key considerations in the making of economic decisions. Political interventions and manipulations in the economic realm have posed major obstacles to the achievement of development goals, they have underlain economic decline and deterioration on the continent. Economic and administrative factors have also contributed to Africa's macroeconomic problems but it is political ones that are given the greatest attention. Understanding the political dynamics influencing state economic decisions provides an important explanation regarding the poor economic performance of African countries.[51] It is also valuable in understanding he political obstacles that have to be overcome if recovery is to be promoted.[52]

The story of SOE in Kenya is depressing indeed over the period 1993 to 2003.[53] The Auditor General-Corporations has documented that out of 100 reports of SOE examined, only 8 showed good performance. Further out of 130 SOE reviewed over that period, only 23 had a clean bill of health. Even the best performing SOE were not spared either and could only manage 4 reports with a clean bill of health over a period of 10 years. In the period under review, CDG estimates that up to 54 billion may have been lost, 14 billion irrecoverable while 40 billion showed signs of being recovered.[54] To illustrate this point, the amount of money lost by Kenya Posts and Telecommunications Corporation over the same period was over 24 billion, National Social Security Fund, 13 billion, National Cereals and Produce Board, over 3 billion, Kenya Ports

[50] Roland Oliver, *The African Experience* (London, 1991) at 241.
[51] Richard Sandbrook, *The Politics of Africa's Economic Stagnation* (Cambridge University Press: Cambridge, 1985) at 20-29.
[52] Tangri op. cit note 40 at 5.
[53] Centre for Corporate Governance and Development op cit note 4 at 11.
[54] Ibid.

Authority and Kenya Railways Corporation, over 2 billion each.[55] The narrative of this period known as "a decade of parastatal waste" is described as that of loss, fraud, theft and gross mismanagement of SOE.[56]

1.1.6. Current status of SOE

Existing SOEs were established in the 1960s and 70s. By 1990, the Kenya government held equity in 250 commercial enterprises with majority shareholding in more than half of them.[57] However, to date, most SOEs have been privatized, the government remains with minority shareholding in others. The researcher is of the view that the codification of corporate governance principles in the Constitution[58] is a significant step forward and a represents a paradigm shift in the corporate governance of SOE.

1.2 Statement of the Problem

SOE have performed dismally since independence mainly due to the poor appointment criteria of BOD. Reports of Auditor General (Corporations) are replete with mismanagement, theft and outright abuse of office.[59] For example in the period 1993-2003, a report by the Parliamentary Investment Committee (PIC), showed that out of 125 SOE, only 25 were properly managed. This is mainly because appointment of BOD was heavily politicised. In making the appointments, the guiding principle was not based on criteria with regard to experience and minimum academic qualifications. Without guidelines, political patronage, cronyism and other extraneous reasons were used to appoint members to boards of SOE. With the law being silent on the criteria of appointment of BOD, a loophole was created through which unqualified, inexperienced and

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[55] Ibid.
[56] Ibid.
[57] Ibid.
[58] Article 10, Chapter 6 and Article 232, Constitution of Kenya 2010.
[59] Centre for Corporate Governance and Development op cit note 4 at 27.

corrupt people found there way to the boards of SOE. Therefore the poor performance of SOE was not quite unexpected.

Besides the poor appointment procedure, Corporate Governance Code[60] has not been made a mandatory requirement for SOE, since many of them were not listed on the Nairobi Stock Exchange (NSE). This study will evaluate how the appointment of directors contributed to poor performance of SOE in the years under review. Notwithstanding the current legal and regulatory framework, this discourse will shed light on what needs to be done to enable SOE be in accord with international best practices in corporate governance.

1.3 Theoretical framework

The agency theory explains how best to organize relationships in which one party (the principal) determines the work of another party (the agent).[61] The agent performs some tasks that are in the principal's interest but not necessarily in the agent's interest.[62] The principal can achieve these effects either through moral suasion or through the provision of incentives.[63]According to Mwaura,[64] an agency relationship arises whenever one individual relies on another and that, in such a case, the person undertaking the duties is the agent and the affected party is the principal.

In the case of a company, the principal is usually the shareholder while the agent is the director. As such, given that shareholders rely on directors to run a company efficiently in order to

[60] Private Sector Initiative for Corporate Governance, *Principles for Corporate Governance in Kenya and a Sample Code of Best Practice for Corporate Governance* (Private Sector Corporate Governance Trust: Nairobi, 1999).

[61]Agung Wicaksono, *Corporate Governance of State Owned Enterprises: Investment Holding Structure of Government – linked Companies in Singapore and Malaysia and Applicability for Indonesian State Owned Enterprises* (Unpublished Dissertation, The University of St. Gallen, Graduate School of Business Administration, Economics, Law and Social Sciences, (HSG), 2008).

[62]Joseph Heath and Wayne Norman, 'Stakeholder Theory, Corporate Governance and Public Management: What Can the History of State- Run Enterprises Teach us in the Post-Enron Era?', (2004) 53 (3) *Journal of Business Ethics* 247 at 265.

[63]Ibid.

[64] Centre for Corporate Governance and Development op cit note 4 at 11.

maximize profits, any misconduct on the part of directors imposes agency costs[65] on shareholders. Another proposition argued by the theory is that under conditions of incomplete information and uncertainty, two agency problems arise: adverse selection and moral hazard. Adverse selection describes a condition under which the principal cannot ascertain whether the agent had accurately represented his ability to do the work for which he/she is paid for. Moral hazard on the other hand depicts the condition under which the principal unsure whether the agent has applied his best effort optimally. It arises when the agent's action is not being observed or supervised by the principal.[66]A manager, for example, may exercise a low level of effort, waste corporate resources or take inappropriate risks.[67]

Berle and Means[68] argue that as firms grow, it becomes increasingly difficult for the original owners to maintain their majority shareholdings, thus shares become dispersed among a large number of small shareholders.[69] The consequence of dispersal, is the usurpation, by default, of power by the firm's managers (those who ran the day to day affairs of the firm) and a rise in the agency costs. The managers are viewed as having an interest that is not necessarily in line with those of the shareholders. For example, whereas owners prefer profits being returned to them in the form of dividends, managers would prefer to either reinvest the profits or to further their own privileges in the form of higher salaries. Removed from the pressures of shareholders, managers

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[65]The costs resulting from managers misusing their position, as well as the costs of monitoring and disciplining them to try to prevent abuse, have been called "agency costs."
[66] Wicaksono op cit note 61.
[67] Ibid.
[68] Adolf A. Berle and Gardiner C. Means, *The Modern Corporation and Property* (New York: Macmillan, 1982) at 27.
[69] Mark S, Mizruchi, Berle and Means revisited, 'The Governance and Power of Large US Corporation' available at www-personal.umich.edu.> (accessed on September 23, 2011).

are viewed as a self-perpetuating oligarchy, unaccountable to the owners whom they are expected to represent.[70]

Jensen and Meckling subsequently shed more light on the agency cost conundrum in their seminal article on the theory of the firm.[71] They defined an agency relationship as a contract under which one or more persons (principals) engage another person (agent) to perform some service on their behalf which involves delegating some decision making authority to the agent.[72] If both parties to the principal/agent relationship are utility maximizers, there is good reason to believe that the agent will not always act in the best interests of the principal. The principal can limit divergences from his interest by establishing appropriate incentives for the agent and by incurring monitoring costs designed to limit the aberrant activities of the agent.[73] In addition, in some situations the principal pays the agent bonding costs to guarantee that he will not take certain actions which would harm the principal or to ensure that the principal will be compensated if he does take such actions.

Agency cost is the sum of monitoring costs, bonding costs and residual loss, which are incurred by the principal to control and provide incentives to an agent.[74] This exposes the generality of the agency problem, which involves inducing an "agent" to behave as if he were maximizing the "principal's" welfare. It exists in all the organizations and in all cooperative efforts at every level

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[70] Mark S, Mizruchi, Berle and Means revisited, 'The Governance and Power of Large US Corporation' available at www-personal.umich.edu.> (accessed on September 23, 2011).
[71] Michael C. Jensen and William H. Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure', (1976) 3 *Journal of Finance and Economics* 305 at 320.
[72] Ibid.
[73] Ibid.
[74] Ibid.

of management in firms, universities, in governmental authorities and SOE, in unions and in relationships normally clarified as agency relationships.[75]

In fact, it has been argued that agency problems in SOEs are more acute than in the private sector due to the peculiar character of the State as the owner. For example, SOEs cannot give their managers an ownership stake in the operations they run. This is largely because they are governed by multiple agents, namely managers and the State or public officials.[76] Voters who elect public officials are considered to be the principals of the state. [77] Due to the multiplicity of agents, there is poor performance by SOEs because the management is accountable to and monitored by a shifting coalition of interest groups, consisting of politicians, bureaucrats, labour unions and a plethora of other stakeholders.[78] As Stieglitz suggests:

> The ambiguity of objectives provides the managers further discretion to pursue their own interests. In the private sector, there is an overriding concern: profits. In the public sector, there may be multiplicity of objectives; economic (such as employment) as well as non-economic (such as national security). Managers can always claim that the reason they are losing money is not that they are inefficient or incompetent, but that they have been pursuing other goals. And it is virtually impossible for an outsider to judge the validity of those claims.[79]

This is because, although the directors are appointed by the State, the State is not the principal because it derives its mandate from the voters. Consequently, both the State and the directors are agents of the voters, which make it difficult for directors to act in the best interests of SOEs because the State sometimes requires them to pursue political interests in order to meet the

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[75] Ibid.
[76] Prajapati Trivedi, 'Designing and Implementing Mechanisms to Enhance Accountability for State Owned Enterprises, Perspective in Public Enterprises: Unresolved Challenges and New Opportunities "Publication based on the Expert Group Meeting on Re-inventing Public Enterprise and their Management 27-28 October 2005, Department of Economic and Social Affairs Division for Public Administration and Development Management United Nations New York, 2008 at 43, available at <unpan1.un.org/intradoc/groups/public/.../un/unpan022073.pdf> accessed on (April 22,2011).
[77] Catherine Gicheru, 'MPs Watchdog Finds More State Looting', *Daily Nation*, August 16, 2001.
[78] Maria Vagliasindi, '*Governance Arrangements For State Owned Enterprises*', (2008) Policy Research Working Paper 4542, Sustainable Development Network, The World Bank at 4.
[79] J Stieglitz, *The Economic Role of the State* (Basil Blackwell: Oxford, 1898) at 258.

expectations of a strategic element, the electorate.[80] This arises where public officials (agents) who appoint board members demand the appointment of persons who they feel will act in their best interests politically (their tribesmen or friends), as a reward even when they do not possess the right skills and expertise required to run SOE.[81]

A number of institutions and organizations in the governmental structure are mandated by law to have an oversight role over the functioning of SOE.[82] These institutions include Parliament, Ministry of Finance, the Office of the President and the parent ministry. Parliament consisting of elected Members of Parliament (MP's), has a general oversight function through its Public Accounts Committee (PAC) to hold SOEs accountable on behalf of the people. The Parent Ministry is charged with the responsibility of managing the sector and hence needs to supervise the SOE. Moreover, the Ministry of Finance has overall oversight responsibility over all SOEs whenever public funds are invested. In its supervisory role, the Ministry of Planning makes sure that public funds are used for the intended purpose. The risk of interest and conflicting objectives are inherently present.[83]

The Ndegwa Committee,[84] noted that there is the absence of an inter-ministerial co-ordination on major policy issues relating to SOE. Generally representatives from the various ministries represented in the SOE boards do not speak the same language during board meetings.[85] This gives way to confusion and delayed decision making. It is tantamount to: "a manager told to

[80] World Bank, *Bureaucrats in Business: The Economic and Politics of Government Ownership* (Washington: World Bank Group1995) at 15.
[81] However, the common law position is that a director need not bring with him any special skill to the company he sits in but that if he does possess a special skill, then they ought to apply that special skill in executing their mandate.
[82] Trivedi op cit note 76 at 44.
[83] Organization for Economic Co-operation and Development, *OECD Comparative Report on Corporate Governance of State Owned Enterprises* (Paris: OECD 2005) at 7.
[84] Republic of Kenya, *Ndegwa Commission Report* (Government Printer: Nairobi, I97I) at 13-14.
[85] Ibid.

serve two masters (a little for the equity holders, a little for the community) has been freed of both and is answerable to neither. Faced with a demand from either group, the BOD can appeal to the interests of the other."[86]

The public interest theory holds that SOEs are essentially meant to provide services to the people at reasonable prices. Therefore, when those entrusted with the duty to oversee SOEs fail, for this reason public choice theorists argue that politicians and bureaucrats are typically poor overseers of SOEs.[87] Like ordinary people, their self-interest overwhelms their public interest and therefore they seek to attain, exploit and maintain power.[88] Directors are supposed to work in public interest when exercising control over SOEs, using government policies to ensure that SOEs are efficiently, competitively and sustainably managed. Towards this, public choice theorists view politicians as being motivated by factors such as salaries, prerequisites of the office, public reputation, power and patronage.[89] For example, politicians may take steps to forestall the closure of an unprofitable SOE located in their electoral constituency in order to boost their re-election prospects.[90] However, the public choice theory is limited because there is little room for public officials or politicians who adhere to particular ideologies or who may adopt goals that transcend the interest of any particular group or coalition groups. Though it indicates the

[86] F Easterbrook and D. Fischel, *The Economic Structure of Corporate Law* (Harvard University Press: Cambridge, 1981) at 31.
[87] Ibid.
[88] Public choice theory was originally articulated by Nobel laureate James Buchanan, The Economics of Politics (London Institute of Economic Affairs: 1978).
[89] Vagliasindi op cit note 78.
[90] Ibid.

importance of the power seeking motivations of decision makers, it tells us little about how their motivations are developed or altered over time.[91]

1.4 Literature Review

Whereas the appointment and removal procedure for BOD in SOE in developed countries is well outlined and enforced in their corporate governance codes of conduct, this has not been the case in Kenya. Few studies have been done to explain how the appointment of board members contributes to poor performance. This is partly because the corporate governance code is not a legal requirement as SOE are not obligated to adopt it.

The clearest indication that poor appointment of board members contributed to poor performance was encapsulated in the Ndegwa Committee in 1979 which was appointed by President Moi[92] to review and make recommendations with regard to urgent financial, administrative and operational problems facing SOE. The Committee found widespread evidence that all was not well among SOE "there is clear evidence of prolonged inefficiency, financial mismanagement, waste and malpractices in many parastatals."[93]

Among other things, the committee found out that poor performance of SOE was illustrated by a poor return on investment. Other causes of decline included poor selection of BOD and lack of financial control. It is around these two issues that the recommendations of the Committee rotated, little mention was however made of under capitalization, ineffective Government supervision and Government regulations that robbed SOE of autonomy to run as viable business ventures and therefore improve performance.

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[91] Joseph R. A. Ayee, '*Public Sector Management in Africa*', African Development Bank, Economic Research Working Paper No. 82 November 2005 at 7.
[92] Republic of Kenya, *Committee of Review of Statutory Boards Report* (Government Printer: Nairobi, 1979) at 3.
[93] Ibid.

The Ndegwa Committee was followed by the 1982 Working Party on Government Expenditure[94] which found even more problems in SOE.

> Examples of unsound poorly controlled investment can readily be found in such areas of activity as fertilizer, sugar, textiles, and power alcohol. The amounts involved are of such magnitude that if they had been directed toward development of essential infrastructure, several districts could have been radically transformed in terms of both production and employment.[95]

The Working Party found the only evidence of poor performance being financial mismanagement.[96] This explains the financial difficulties experienced by the Government in 1982, however responsibility for the poor financial performance was laid on the Government, but no recommendation on how to alleviate the problem was offered. The most fundamental recommendation of the Working Party was Government divesture from loss making SOE "The Government should direct a parastatal to carry out policy related activities which might not be financially sound without providing explicit subsidies for those activities."[97]

The Centre for Corporate Governance and Development makes an analysis of PIC reports for the period 1997 to 2003, which shows that SOE were saddled with financial distress. It was showed that out of 140 SOE, a large number were technically insolvent and survived on the generosity of creditors, bankers and the Kenya Government. As an illustration, the Kenya Railways had a deficit of ksh.124 million in 1990, which rose to 4.45 billion. The PIC attributed this to inefficiency, ineptitude and corruption. The NSSF had an accumulated deficit of 9.4 billion. Many SOE were also unable to service their loans.

The reasons advanced for this state of affairs was the emergence of SOE as centers of political patronage. This is due to the erosion of corporate governance by the laws and political

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[94] Republic of Kenya, *Report and Recommendations of the Working Party on Government Expenditures* (Government Printer: Nairobi, 1982) at 42.
[95] Ibid..
[96] Ibid. at 41.
[97] Ibid. at 49.

environment. This was in addition to bad laws, weak supervisory mechanisms and the culture of impunity. However this report was limited in 3 fundamental respects: first the report focuses on only one decade, the period between 1997 and 2003. Secondly, the appointment procedure forms a very small segment of the study. Thirdly, it has not benefited from the constitutional reforms currently in play. However it provides a lot of background information for this study.

According to Ouko[98] and Mogaka,[99] directors are such an important segment of a SOE that only persons of good caliber, credible with the requisite skills and expertise should be selected to promote the objectives and performance of a SOE.[100] This arises from the directors duty of skill and care owed to the corporation, in *Re Equitable Insurance Co,*[101] it was held that a director need not exhibit a greater degree of skill than maybe reasonably expected from a person of his knowledge and experience. Beside, a director need not give continuous attention to the affairs of the company. However in *Flagship Carriers Ltd v. Imperial Bank Ltd,*[102] justice Hewett took a subjective view and said that directors should be liable for breach of duty of skill and care based on business judgment.

However the authors have taken a broader view of the directors' duties in a SOE, according to the agency problem and not being managers of their own investment, they are likely to act in self interest. The absence of clear and identifiable owners leads to competing and conflicting interests. The legal framework is also seen as another contributor to poor performance due to the beauracracy that make it difficult for SOE to give incentives that would facilitate in increasing

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[98] Austin A O Ouko, *Corporate Governance of Parastatals: A Critique in the Context of the New Constitution* (Unpublished LLM Thesis: University of Nairobi, 2010).

[99] Danstan Omari Mogaka, *Public Enterprises and the New Constitution: Towards a Better System of Corporate Governance* (Unpublished LLM Thesis: University of Nairobi, 2011).

[100] The Capital Markets Act, Guidelines on Corporate Governance Practices by Public Listed Companies in Kenya, Gazette Notice No. 3362 of 2002 guideline 3.1.3 at 484.

[101] [1925] Ch. 407.

[102] High Court Civil Case No. 1643 of 1999 (Unreported).

gains, cu costs and become efficient. Further the fact that SOE cannot be threatened with bankruptcy makes them lethargic to improve performance.[103]

1.5 Research Objective

1. The general objective of the research is to investigate the legal and regulatory framework governing the appointment and removal of members of the board of directors in state owned enterprises in Kenya.

1.6. Specific objectives

1. To assess the extent to which the process of appointment and removal of directors has contributed to poor corporate governance in SOE's.
2. To identify factors that have contributed to poor corporate governance of SOE.
3. To identify reforms that are needed in the State Corporations Act which governs the appointment and removal of BOD in SOE, in order to improve corporate governance

1.7. Justification

A thorough review of the laws relating to the appointment and removal of to the BOD in Kenya, in SOEs shows they do not have an even and uniform criteria for appointments. A keen examination of the State Corporations Act[104] and the Companies Act[105] shows inconsistency in the appointment process. This apparent lacuna is a pointer to the necessity of the law governing SOEs in Kenya to provide for the appointment of skilled, experienced and efficient directors to

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[103] David Robinett, The Challenge of SOE: Corporate Governance for Emerging Markets; (World Bank Corporate Governance Department, May 2006), available at http://rru.worldbank.org/Documents/Other/CorpGovSOE.pdf (accessed on 20 June 2013) at 4.
[104] Wejman op cit note 2.
[105] Chapter 486, Laws of Kenya.

the board. This will ensure the maintenance of public confidence, protection of stakeholder interests and ultimately growth of the economy. The SCA empowers the President or the Minister in charge of an SOE to appoint its board of directors.[106]

1.8. Hypothesis

1. The SCA, which is the legal and regulatory framework governing the constitution and appointment of board of directors in SOEs, is weak in terms of safeguards to ensure that only competent directors are appointed to the boards of SOEs.

1.7 Research Questions

1. How has the procedure of appointment and removal of BOD in SOE contributed to their poor performance?
2. What reforms are needed in SOEs, to improve appointment and removal process of directors and enhance there performance?

1.9 Research Methodology

This is a qualitative research both in the conduct of the study and the writing. Research will primarily rely on library research comprising of primary and secondary materials or sources which will include the new Constitution, national legislations, OECD Guidelines on State Owned Enterprises, OECD principles of corporate governance, the CMA Guidelines on Corporate Governance Practices by Public Listed Companies in Kenya, Private Sector Initiative for Corporate Governance -Principles for Corporate Governance in Kenya and Sample Code of Best

[106] Section 6, SCA.

Practice for Corporate Governance. Secondary materials will include text books, articles, journals, internet sources and newspaper articles. Data collection will involve the use of questionnaires.

1.9.1. Sample size and sample frame

The sample size was three hundred (300) respondents who participated in the survey through filling of questionnaires a sample of which is given later in this discourse. The response from each group of the respondents was collected and treated distinctly. In so doing, the sample was more representative of the entire Kenyan population and has greater precision.

1.9.2. Research Instruments

The main research tool for this study was the questionnaire. The questionnaire first underwent a pilot test to see whether or not it would be valid and relevant to the purposes of the research. The pilot test was done a week to the actual study. This was meant to provide sufficient time for modification if a need arose and relate it with the purposes and objectives of the research.

1.9.3. Data type and Collection Procedure

The study made use of both primary and secondary data. Primary data is information that was obtained first hand from respondents. In gathering primary data, questionnaires which have both open and close ended questions were administered to the chosen respondents.

1.9.4. Data analysis

Editing of the filled questionnaires was done to ensure that the data was complete and consistent. This involved discarding or disregarding questionnaires whose response was obviously wrong.

The research made use of Microsoft Excel in capturing the data collected. This is shown in the form of charts and tables.

1.10 Scope and Chapter Breakdown.

Chapter One is an introduction to the appointment and removal of BOD in SOE in Kenya. It examines the background to the problem of poor performance of SOE and the statement of the problem. The main objective of the research is to find out why SOE have performed poorly since independence. The research question this study will ask is why SOE have consistently under performed in spite of the huge investment by the state? The study proceeds on the hypothesis that the poor appointment process under the SCA is responsible for the poor performance of SOE. The justification for the study is that the only remedy for SOE is adoption of good corporate governance. In addition the chapter has a literature review, conceptual and theoretical framework, methods of research to be used and a chapter summary.

Chapter Two gives an assessment of problems affecting SOEs in Kenya namely: a poor legal framework for the appointment of BOD and hence poor performance of SOEs, politicization of the appointment process, absence of oversight, interrelated agencies that are controlled by the executive, prevalence of corruption and mismanagement without accountability. Poor performance coincided with imposition of structural adjustment programmes which starved the SOE of much needed funding.

Chapter Three examines the legal framework for the appointment and removal of the BOD in Kenya and the reforms envisaged under the new Constitution. An over view of the appointment process shows that it was devoid of criteria, selection was based on grounds other than merit.

Diversity was not encouraged in board composition as women were excluded. Interference by the executive arm of government in appointment of BOD forms the focal point of the chapter. Political patronage became the overriding criteria for appointment to the board.

Chapter Four is data analysis by the study and especially in regard to a survey carried out by use of questionnaires. The findings of the survey are also given.

Chapter Five is a comparative analysis of good corporate governance practices from other jurisdictions and the lessons that Kenya can learn from European models.

Chapter Six is the conclusion and recommendations on which way for Kenya's corporate governance in SOE.

CHAPTER TWO

ASSESSMENT OF PROBLEMS FACING STATE OWNED ENTERPRISES IN KENYA

2.0 INTRODUCTION

This chapter gives an assessment of problems that face SOE and the factors that have contributed to poor corporate governance in SOEs in Kenya. This will be discussed in the context of the appointment and removal of the BOD and impact of irregular appointment of directors on the performance of SOEs. The problems highlighted include politicization of the appointment process, corruption, impunity, mismanagement of state corporations' assets and the effect of the donor agencies' conditionality's.

The irregular appointment of BOD contributes to poor performance of SOEs.[107] This is due to the fact that persons appointed to the board fail to act in the best interests of the corporation by engaging in activities detrimental to the corporation.[108] However, the research recognizes that irregular appointment and removal of persons from BOD, is not the only cause of the poor performance of SOEs.

2.1 Politicization of the appointment process

It is a feature of SOE in Kenya that the appointment of BOD is guided by politics, ethnicity and patronage. That explains why directors are usually perceived to be political aides of prominent politicians, whose appointment is part of the reward system for patronage.[109] In many cases,

[107] Kiarie Mwaura, 'The Failure of Corporate Governance in State Owned Enterprises and the Need for Restructured Governance in Fully and Partially Privatized Enterprises: The Case of Kenya', (2007) *31Fordham International Law Journal* 34 at 1.
[108] Ibid.
[109] Gakuu Mathenge, 'MPs Plot to Oust Parastatal Chiefs Who Hold Party Posts', *Daily Nation* (Kenya September 19, 2010) at 21.

appointments to the BOD have been made without due regard to the requirements of the SCA and the State Corporations (Performance Contracting) Regulations on appointment of chief executives.

The Communications Commission of Kenya CEO (Charles Njoroge) was dismissed through a court order since his appointment had been un-procedural.[110] Proof of political interference in board appointment is also seen when Professor Anyang' Nyongo in one incident disregarded the recommendations of the Kenya Medical Training College board which had recommended for the extension of Dr Timothy Kingondu's term. Instead, he (the Minister) advertised the job, on the strength that position would be filled competitively. Similarly, the current Minister for Heritage, Mr. Ole Ntimama once rejected the recommendation of the NGO Co-ordination Board to renew the term of Mr. David Isoe as chief executive and instead appointed a former Permanent Secretary Peter ole Nkuraiya to the position. The then tourism Minister, Mr. Najib Balala, appointed his close political adviser, Mr. Kenneth Ombongi, to head the Kenya Utalii College without advertising the position.

Irregular appointments have been made because Ministers exceed their powers by not admitting that their duties end at the policy formulation level and forgetting that heads of SOEs have been given their jobs by the statutes creating the SOEs.

Depending then on the manner a particular director has been appointed, and especially if one was appointed as a favour, such an appointee is threatened with sacking for failure to strictly adhere

[110] Paul Ogemba, 'Court Annuls Appointment of CCK Boss,' *Daily Nation*, May 17, 2012: Information Minister, Samuel Pogishio, in 2011 had ignored the Communication Commission of Kenya board's recommendation not to re-appoint Mr. Njoroge.

to the orders of the line Ministers or someone higher up the rank, which greatly contributes to the poor corporate governance of SOE's. [111]

It is, therefore, evident that the Office of the President and the parent ministries wield a lot of influence over the appointment of BOD to SOE's and their Chief Executives.[112] This deprives state corporations of autonomy and eventually contributes to their poor performance.

2.2 Impact of irregular appointment of BOD

The impact of politicizing appointments to SOE boards is that politically appointed boards will bow to pressure or interests of those who appointed them to these positions rather than act in their respective SOEs' best interests, so as not to risk losing their jobs.[113] In the case of *Australian Growth Resources Corporation Pty Ltd v. Van Reesema,*[114] it was held that any exercise of improper purpose can be set aside even though the directors may honestly believe that they wre acting in the best interest of the firm. This is usually the case even when such political interests will result in mismanagement of the assets of the SOEs.

The reason for political influence in appointments of Chief Executives and their boards is that such politicians are in most cases aiming at controlling SOE for political reasons.[115] This leads to

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[111] Symonds Kichamu Akivaga, Anti-Corruption Politics in Post-KANU Era, In Ludeki Chweya and John Kithome Tuta, '*Control of Corruption in Kenya: Legal Political Dimensions 2001-2004* (Claripress:Nairobi, 2005) at 243.

[112] Consider the 2008 struggle between the Communications Commission of Kenya on who was to be Chairman.
[113] Honourable Kiraitu Murungi submitted to the House once that the parastatal heads who were looting parastatals were not doing it alone and although they have big titles like executive director and managing director, they do not really have much power over the parastatals they head. It is the political godfathers who appoint such parastatal heads who exercise the real power over parastatals. He went on to say that most politically correct but corrupt transactions are usually sanctioned at a very high level.

[114] (1988) 13 ACLR 261.
[115] An example can be drawn of the managing director of the Kenya Tea Development Authority, as it was before privatization, whose case was pending in Court for misappropriating about half a million of farmers' money. During

poor performance of SOEs, corruption and misappropriation of public funds. In *Re Benham & Co.*[116] the court held that any benefit to the company must of necessity promote the prosperity of the company, benefits procured through corruption by directors' amount to breach of their fiduciary duty. As a consequence, the PIC Committee in its 11th report noted that most appointments to BOD have not measured up to the expected requirements.

The effect of this is that SOE cannot maximize their full potential in terms of production, returns and provision of services. This partly explains why SOEs continue to operate under financial constraints occasioned by mismanagement and/or imprudent commercial arrangements. This leaves the government with the challenge of privatizing SOE so as to enhance their viability.[117]

2.3. Poor legal framework and indebtedness

Kenya's regulatory framework for the appointment of directors is still based on the common law where no special skills are required.[118] Thus, line Ministers in the past took advantage of this fact that there is no statutory provision requiring directors to have expertise and experience in the management of SOE[119] to appoint boards where the appointees lack the necessary skills.[120] When this happens, the performance of SOE goes down.

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investigations, it was discovered that most of the contracts that had been awarded by the Kenya Tea Development Authority were given to companies which had connections with powerful politicians.

[116] (1853) 25 Ch. 572.
[117] The Seventeenth PIC report on the Accounts of State Corporations (2010)1 noted that Nzoia and Chemilil Sugar Companies financial performance was wanting and recommended that the government speed up their privatization.
[118] *Re City Equitable Fire Insurance Co. Ltd*. [1925] Ch 407.
[119] Kiarie Mwaura, 'Regulation of Directors in Kenya: An Empirical Study', (2002) 13(12) *I.C.C.L.R* 465-479.

[120]A good example was the appointment in 2009 of Najib Balala's personal political adviser, Kenneth Ombongi a history lecturer at Nairobi University, to head the Kenya Utalii College. This was despite the fact that he had little to do with management and knowledge of the hospitality industry to bring any much needed change to the institution. When questioned, Najib Balala, the then Tourism Minister arrogantly stated that he saw nothing amiss with appointing a friend as "such was the practice now in government."

An opinion has been expressed to the effect that directors with nothing to offer in terms of skills and experience should be replaced with well qualified individuals in the boards.[121] This is notwithstanding the fact that they are usually cronies of Ministers and highly placed politicians.

This is why re-appointment of some of the directors responsible for the collapse of SOEs to other directorships is a common practice.[122] For instance, despite the public outcry and prosecution that followed the investigation of the former Managing Director (MD) of the Kenya Posts and Telecommunications (KPTC), Mr. Kipng'eno Arap Ng'eny, for masterminding the loss incurred by the corporation, he was retired in 1993 and appointed to head the Kerio Valley Development Authority.[123] According to the 1990/91 Auditor General's Report on the Kenya Posts and Telecommunication, the MD was responsible for a number of fraudulent dealings.[124] This was not in the best interest of the company and according to the holding in the case of *Evans v. Brunner Mond and Company Ltd,*[125] such a director would be liable for a breach of duty.

In 1985, the corporation lost nine million Kenya Shillings after making payments to a firm of advocates to wind up the former Kenya External Telecommunications Corporations (KETC). The payment was made despite the fact that KETC was in the process of being merged with KPTC. The winding-up process was rendered a sham when the two companies merged. In another incident in 1990, the corporation had failed to remit to various public authorities statutory deductions from staff salaries amounting to about 170 million Kenya Shillings.[126]

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[121] Centre for Corporate Governance and Development op cit note 4 at 27.
[122] Ibid..
[123] Ibid.
[124] Ibid.
[125] [1921] Ch. 359.
[126]Kiarie Mwaura, 'Disqualification of Directors in Kenya', (2003) *54 Northern Ireland Legal Quarterly* 118 at 135.

Recommendations made by the PIC for the prosecution, surcharging or in the alternative barring public officers adversely mentioned for involvement in corrupt practices during their tenure from sitting as board members has never been carried out. Besides serving in high positions in the government,[127] some have been re-appointed to various boards of state corporations. [128]

There is no doubt that irregular appointment of BOD has a negative impact on their performance based on the fact that failure to take action against errant directors will contribute to the downfall of a SOE. This arises from the impunity they enjoy, confident that no action can be taken against them. This is against the legal position in *Trevor Price and Another v. Raymond Kelsali,*[129] that directors are not allowed to make secret profits. The Seventeenth PIC Committee Report observed that several state corporations continued to operate under financial constraints occasioned by mismanagement and/or imprudent commercial arrangements.[130]

The Committee took evidence from Nzoia and Chemelil sugar companies and noted that their financial performance was wanting due to indebtedness. The Committee also noted that the companies were operating on a going-concern basis and were awaiting approval from the Cabinet for restructuring of their debts and eventual privatization.[131]

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[127] Ibid.

[128] Examples include; Oluoch Kanindo (South Nyanza Sugar Company Limited) and Lawi. Kiplagat (Milling Corporation of Kenya Limited) Alfred Kiptanui Keter (Cereals and Produce Board), Harun Lempaka (Mwea Rice Mills Limited), Cyrus Maina (Teachers Service Commission).

[129] (1957) EA 752.

[130] Seventeenth Report of the Public Investments Committee on the Accounts of State Corporations (Vol. 1)2010, available at <http://www.parliament.go.ke/index-php?option.com (accessed on 10/2/2012).

[131]Ibid.

A recommendation by the Ndegwa Commission's Report[132] that allowed civil servants to double up as merchants, politicians and businessmen contributed to the failure in corporate governance of SOE. The effect of which was to encourage conflict of interest where directors traded with the organizations they headed. As such, a situation has arisen where appointments to boards of SOEs and chief executive positions of SOEs, of persons who double up as political party officials, trustees, branch and National Executive Committee officials. Such directors are forced to spend time shuttling between their offices and political functions.[133] This paper argues that due to the political nature of their work in their various positions, such appointees are thinly spread and cannot be effective as board members. They also lack the requisite diligence required by virtue of holding a multiplicity of positions.[134] This leads to the SOEs they are in charge of performing poorly.

SOE could benefit from best practices encapsulated by the Capital Markets Act, Guidelines on Corporate Governance Practices by Public listed Companies in Kenya.[135] The Act recommends that all listed companies when making appointments to their boards should only consider persons of good calibre, credibility and who have the necessary skills and expertise to exercise independent judgment on issues that are necessary to promote a company's objectives and performance in its area of business.

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[132]The committee was a commission of inquiry on public service structure and remuneration. The commission was constituted January 15, 1970 by the former president H.E. Jomo Kenyatta to investigate the organization and structure of the public services and to recommend reforms whichever desirable. It published its report in May 1971(Report of the Commission of Inquiry - Service Structure and Remuneration Commission).

[133] Ben Turok, 'Control in the Parastatal Sector of Zambia', (September, 1981) 19(3) *The Journal of Modern African Studies* at 422.

[134] Past examples of such parastatal heads and board members who held other positions include; Former Nominated MP, Julia Ojiambo(Chairperson, Kenya Plant Health Inspectorate Service Board and chair of the Labour Party of Kenya, Jimmy Angwenyi, PNU vice chairman and Kenya Electricity Distribution Company Director, Philip Okundi, CCK Chairman and chairman of the ODM election board, Paul Sang, Nyayo Tea Zone board chairman and Bureti Kanu branch chairman). This is as at 2010.

[135] Gazette Notice No. 3362 of 2002, Guideline 3.1.3 at 484.

This can be interpreted to infer that, appointing authorities follow this particular guidelines so that a director's duty of care and skill can be met and ensure accountability in subsequent dealings. This is due to the fact that a director is obliged to do as much as could be expected from someone as incompetent and foolish as he happens to be.[136] This means that a director is required to exhibit a degree of skill and care that may be reasonably expected from a person of his knowledge and experience.[137] Therefore, when appointing authorities entrust persons who do not meet the qualifications for positions to the board, the appointees cannot be held liable for honest mistakes of judgment even when the SOEs they head incur heavy losses and are faced with collapse.

2.4. Diversity and gender mainstreaming in board appointment

Diversity can be viewed as a focus on the influence of different cultures, educational levels, ages, gender, regional backgrounds, sexual orientation and ethnicity on quality, product development and other core business issues.[138] The Guidelines on Workplace Diversity booklet[139] defines diversity to include gender, age, language, ethnicity, cultural background, sexual orientation, socioeconomic background, personality, religious beliefs, family responsibilities and cognitive style.

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[136] Mackenzie, 'A Company Director's Obligations of Care and Skill', (1982) *Journal of Biblical Literature 460* at *475*- 476.

[137] This test contains an objective element because the director could be held liable for failing on a particular occasion to live up to the standard of which he or she is in face capable of reaching, but the stronger element in the proposition is the subjective one meaning that directors can never be required to achieve a standard higher than that which he or she is personally capable of reaching.

[138] Thomas, R Roosevelt, *Beyond Race and Gender: Unleashing the Power of Your Total Work Force by Managing Diversity,* (AMACOM: New York, 1991) at 15.

[139] Part of a series titled "*Working Together*" issued by the Public Service and Merit Protection Commission of Australia following the passage of the Public Service Commission Act 1999.

Workplace diversity, therefore, involves recognizing the value of individual differences and managing them in the workplace. It also involves how people' perceptions affect their interactions.

Diversity is relevant to board composition because it has the capacity to influence work relations by offering greater perspectives on business issues and opportunities as well as a wider range of ideas and solutions. The lack of diversity in board composition is a major problem affecting the performance of our SOEs.

This confirms the underlying criteria of appointment based on ethnicity and political patronage, with a bias towards men.[140] The absence of diversity will have a negative impact, on the performance of the SOE to which they are so appointed.[141]

Diversity cannot be discussed without reference to gender, a close scrutiny of SOE in Kenya shows that board composition is mainly homogenous besides showing signs of patriarchy. This means that women or female representatives in boards of SOEs are few and not well represented. This in effect illustrates the fact that on the issue of appointments, little attention is placed on gender diversity. Mijntje Luckerath – Rovers argues that a homogenous board is more likely to operate as a group and may experience the symptoms of group think, be they conscious or sub-conscious and this could bring about certain three risks namely: excessive self- esteem, the creation of tunnel vision and a strong pressure within the group to come to an agreement.[142]

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[140] Samuel Siringi, 'Ministers Disregard Rules Over Key Jobs', *Daily Nation* (Kenya May 19, 2009) at 4.

[141] Consider the case of Tourism Minister Najib Balala appointing his personal political adviser, Dr. Ombongi, in 2009 to head the Kenya Utalii College. Dr. Ombongi was a History lecturer at the University of Nairobi and critics argued that he had little knowledge to do with management and expertise in the hospitality department to bring change to the ailing institution.

[142] Luckerath – Rovers,Mijntje, 'A Comparison of Gender Diversity In the Corporate Governance Codes of France, Germany, Spain, The Netherlands and The United Kingdom', (April6, 2010) available at SSRN://http:/ssrn-com/abstract =1585280 (accessed on 12/2/2012).

To illustrate this point, the collapse of Enron, was attributed to mismanagement at the board level, absence of diversity and approval of conflicted transactions and at the same time opting for risky disclosure practices. The company had only one female board member which contradicts the theory that better decisions are made by boards that have some diversity to allow consensus building.[143]

2.5 Supplementing the Private Sector

One of the reasons for the poor performance of SOEs is that some of their objectives, as set out by the Kenyan government, are to foster private sector activity rather than their own growth.[144] As such, this often results in a conflict of objectives and which is regarded as a source of inefficiency.

The need to assist the private sector partly undermines the efficiency and solvency of SOEs, since the need to have high profits is rarely on the agenda SOEs.[145] Although SOEs are not solely driven by profits maximization the way private companies do, they have additional functions of fostering public, social and national interests. In so doing, SOEs are not measured by profitability, which explains why they are regarded by neo-classical law and economic theorists as the main cause of their inefficiency as it deprives them the incentives to increase gains, cut costs and operate efficiently.[146]

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[143] James S. Fishkin, *The Voice of the People: Public Opinion and Democracy* (New Haven: Yale University Press, 1995) at 166 – 81.
[144] Mwaura op cit note 107 at 6.
[145] Fishkin op cit note 143.
[146] Ravi Ramamurti, 'Performance Evaluation of State-Owned Enterprises in Theory and Practice,' (1987) 33 (7) *Management Science* 876 at 883.

2.5 Donor Agencies Stringent Economic Conditionality's

The problem that SOEs face is with regard to the stringent conditionality's imposed by the IMF World Bank. The IMF for example has the following guidelines that states are required to comply with before being given grants:[147] adoption of policies of fiscal and budgetary austerity, exchange rate devaluation in essence, "getting the prices right", stimulating investment instead of consumption, massive privatization of industries in major utilities, blanket application of the free market policy which means a unilateral cancellation of all tariff restrictions by the country on the receiving ends of the loans, cuts on public expenditure, prioritizing external debt service and import liberalization.[148]

The World Bank (WB) and the International Monetary Fund (IMF) are the leading donor agencies. The function of IMF is to provide support to countries facing acute imbalance between their external payments and receipts. The World Bank on the other hand is dedicated purely to poverty reduction and improving the living standards of people. However, the common goal of these two institutions is the promotion of economic growth and reduction of unemployment. State Corporations get funding from these agencies through the government in the form of guaranteed loans.

The criticism levied against these conditionality's is that, too many conditions are imposed on debtor countries in a time frame that is not always realistic. This is in addition to, the questionable assumptions these conditions are based. Much more importantly, the agencies

[147] Ahmed Swapan Mahmud, 'International Financial Institutions (IFIs)–The Major Barrier to Change in the Aid System,'available at http://www.realityofaid.org/userfiles/roareports/roareport_205559c731.pdf (accessed on 12/2/2012).

[148] B Drum, 'Privatization in Africa', (1993) 28 (1) *Columbia Journal of World Business* 144 at 150.

impose conditionality's that do not conform to Kenya's political and economic conditions thus resulting into higher probability of failure and deviations.[149]

2.6 Conclusion

This chapter has given an overview of the factors that have contributed to poor corporate governance of SOEs in Kenya. This has not only led to their poor performance but in some instances, total collapse of the said institutions.[150] They include: a weak legal framework, corruption, politicisation of the appointment process, poor or weak oversight institutions and the involvement of the donor community in imposing structural adjustment programmes and cutbacks on balance of payment disbursements.

SOE in Kenya have performed poorly because of a weak regulatory framework that gave the executive (the President) discretionary powers in among other things creating SOE, appointing the chairmen and the BOD. These powers extended to exempting some SOE from the Exchequer and Audit Act. The effect of this law is that it led to the President and line Ministries appointing political cronies, retired civil servants who were unqualified to sit on the BOD. As a consequence the appointees had one objective to satisfy those who appointed them which encouraged corruption, impunity and poor corporate governance. This was however made worse by a judiciary (appointed by the President) that failed to prosecute those accused of corruption, abuse of office and malpractices in SOE thus encouraging impunity.

Poor oversight has equally contributed immensely to poor performance and corporate governance of SOEs. The principle oversight institutions to SOEs include the Office of the

[149] Migai Akech, *Privatization and Democracy in East Africa: The Promise of Administrative Law* (E.A.E.P: Nairobi, 2009) at 27.
[150] Collapse of the Uchumi Supermarkets Limited was attributed to a dysfunctional board.

President, the Ministry of Finance, Controller and Auditor General and Parliament. The Office of the President cannot provide oversight to SOE since as the creating and appointing agency, this would amount to a conflict of interest. The Ministry of Finance's oversight role involves supervising all SOE and as a consequence it is represented on the board of all SOEs. The Ministry suffers the same disability as the Office of the President largely because the minister is appointed by the President. Thus he cannot discharge his mandate different from that assigned by the Office of the President. Parliament generally plays an oversight role by acting as a check on the exercise of executive powers. The Parliamentary Investment Committee (PIC) could play an important role oversight role but however, it is largely partisan notwithstanding all its reports are normally ignored.

It is regrettable that poor corporate governance coincided with Structural Adjustment Programmes (SAP) which brought about donor conditionalties to bear on further balance of payments disbursements. SOE suffered disproportionately because they depended on state grants to survive. As a result, SOEs were required to be answerable to more than one principle, i.e. the government and the donor community led by the International Monetary Fund (IMF) and the World Bank (WB). This divided attention further led to not only poor performance but corporate governance as well. This is coupled by the fact that SOE have mixed objectives of profit maximization/public interest, there poor corporate governance is therefore not an accident. Chapter three explores current legal framework governing the appointment and removal of boards of members, factors that influence the appointment of persons to boards of SOEs as well as gaps and weaknesses in the legal and regulatory framework.

CHAPTER THREE

KENYA'S LEGAL FRAMEWORK ON THE APPOINTMENT OF BOD TO SOEs AND THE EFFECT OF THE NEW CONSTITUTION

3.1. INTRODUCTION

The dismal performance of SOE has been attributed to poor corporate governance and especially the poor appointment procedure of BOD.[151] Measured against some of the well performing SOE, the calibre of those appointed to steer the BOD determines the success or otherwise of a SOE.[152] Although SOE play a very significant role in the economic development of the country, SOE have become fertile ground for political patronage, tribalism, cronyism and a place where rejected and non performing civil servants find a soft landing.[153] "The tragedy in Kenya is that those who have mismanaged the Government, the development, finance institutions, and even state corporations are those who continue to circulate in and out of Government as Ministers, Assistant Ministers, and advisers and so on."[154] However the appointment procedure of BOD to SOE was characterised by political considerations, controlled by the Office of the President, regulated by various laws that were not harmonized and the absence of clear guidelines to determine the experience, integrity or academic qualifications for one to be appointed.

All SOE have a BOD that should ideally be equipped with complementary skills and oversight duties which should lead to better business outcomes. Most corporate governance guidelines

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[151] John Nellis, Public Enterprises in Sub-Saharan Africa*, in Barbara, Grosh. Public Sector Enterprises in Kenya: What Works, What doesn t Work and Why 7* (London: Boulder and Company,1991) at 11.
[152] Republic of Kenya. *African Socialism and its Application to Planning in Kenya. Sessional Paper No. 10 of 1965* (Nairobi: Government Printer, 1965) at 18.
[153] Ibid.
[154] Centre for Corporate Governance Development op cit note 4 at 25.

recognize the fact that the board is the focal point of corporate governance.[155] The BOD is ultimately accountable and responsible for the affairs and performance of the SOE. [156] As such, the composition and structure of the board and methods of appointment have a direct bearing on performance of a company.[157]

This chapter evaluates the legal and regulatory framework in the appointment of BOD for SOE in Kenya. In addition to that the composition and factors that influence the appointment of boards other than legal provisions such as politics, gender and diversity will be investigated. This will be done against the background that the provisions of the Constitution of Kenya 2010, if fully implemented would reshape the existing framework on the directors' appointments. This is pursuant to its provisions on the values and principles of public service. The gaps in the legal and regulatory framework will also be examined.

3.2. HOW THE BOD IS FORMED IN A SOE

The boards of SOE are formed in three principle ways: the first one consists of those formed by line ministries.[158] Directors in this class are appointed pursuant to the provisions of the enabling legislation (parent statute). That notwithstanding, appointments under this rubric are done on grounds political patronage, tribalism and cronyism without consideration of ones qualifications

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[155] Examples of corporate governance guidelines recognizing the fact include; the OECD principles on corporate governance (2004), principles of corporate governance in Kenya prepared by the private sector initiative for corporate governance (1999), the Capital Markets Act, guidelines on corporate governance practices by public listed companies in Kenya (2002), the South African King's Committee report on corporate governance (1994).

[156] Guideline 2.1.1, King Committee Report on Corporate Governance, 1994 (South Africa).

[157] Ibid.

[158] Section 6 (e), State Corporations Act, 1987.

or experience.[159] This is because such appointments are procured through lobbying of Ministers and their close associates.[160]

The second category of boards comprises those boards where the government has controlling shareholding (commercial and financial institutions). Boards here are chosen according to the provisions of the company's Act.[161] Here the selection of the board members is regulated by the memorandum of association (MOA) and articles of association (AOA) of the firms during the annual general meeting. Corporations in this category have adopted good corporate governance practices as they shown to be efficient and effective. In this category are SOE like Kenya Airways, Safaricom, Mumias Sugar Company to mention but a few, which have been benchmarked against the best on the market. The Government's power to appoint board members is only proportional to the number of shares held.

In the third category are those boards where directors are elected by the stakeholders, such as line ministries especially those established under the various crops Acts and regulatory agencies like the Electricity Regulatory Board (ERB). The government appoints the boards in this category as part of its constitutional mandate to protect the public interest.[162] However the office of the President plays the most important in the appointment of BOD.

The poor performance of SOE illustrates that the powers of the President to appoint and remove directors is not only bad but unsustainable as well, because it leads to poor corporate governance. The office of the President has oversight over SOE, a function it is ill equipped to perform owing

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[159] Mogaka op cit note 99 at 38.
[160] Ibid.
[161] Section 9 and 14, Companies Act (Chapter 486 of the Laws of Kenya).
[162] Centre for Corporate Governance Development, op cit note….

to conflict of interest.[163] The powers of the President to exempt SOE from the provisions of the SCA and Exchequer and Audit Act, creates a loophole that denies the PIC the mandate to examine the accounts of the exempted corporations.[164] SOE exempted from SCA have shown evidence of fraudulent dealings, delay in the preparation of financial and audit reports and poor expenditure controls.[165]

3.3. LEGAL FRAMEWORK GOVERNING APPOINTMENT OF BOD

The appointment of BOD to a SOE should ideally be done through a managed and effective process to ensure that a balanced mix of proficient individuals is selected and who should add value and bring independent judgment to bear on the decision-making processes.[166] The Ndegwa Committee recommended the criteria for appointments to the BOD be based on ability, judgment, experience and integrity.[167]

In Kenya, SOEs are primarily governed by the State Corporations Act[168] and the Exchequer and Audit Act.[169] However, there is a plethora of other statutes that establish state corporations and that seek to regulate the respective state corporations such as Kenya Anti Corruption and Economic Crimes Act, Cap 65 of the Laws of Kenya (2003), Companies Act 1962 (Cap 484), Government Financial Management Act, Cap 412B of the Laws of Kenya 2004, Public Audit

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[163] Mogaka op cit note 99 at 40.
[164] Ibid. at 41
[165] Ibid.
[166] Private Sector Initiative for Corporate Governance, 'The Principles of Corporate Governance in Kenya and Sample Code of Best Practices for Corporate Governance' available at www.ecgi.org accessed on August 12, 2011.
[167] Ndegwa Committee Report. The committee was a commission of inquiry on public service structure and remuneration. The commission was constituted January 15, 1970 by the former president H.E. Jomo Kenyatta to investigate the organization and structure of the public services and to recommend reforms whichever desirable. It published its report in May 1971 and presented the same to the president.
[168] Chapter 446, of the Laws of Kenya.
[169] Chapter 412 (Revised Edition 2009) of the Laws of Kenya 1987.

Act number 12 of 2002, Public Officer Ethics Act, Act Number 4 of 2003, Public Procurement and Disposal Act, Act Number 3 of 2005.

The current legal framework for the appointment of BOD shows a number of characteristics that fly in the face of good corporate governance. The entire process was controlled by the President, who would either appoint board members directly or indirectly through the power vested on him by the Constitution (Permanent Secretaries). The office also controlled other oversight institutions (SCAC, ISC, PIC, PAC, Auditor General and the Attorney General), whose effect was to remove the element of accountability from SOE.

3.4. THE OFFICE OF THE PRESIDENT

The Office of the President was vested with wide powers under the State Corporations Act[170] (SCA) and the Exchequer and Audit Act[171] to supervise all matters relating to SOE. Under the SCA, the holder of the office of the President could establish a SOE,[172] assign ministerial responsibility,[173] appoint chairpersons of BOD[174] and give directions of a specific or general nature[175] to the board. In addition the President had powers to revoke the appointments earlier made and constitute new boards if the need arose.[176]

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[170] Chapter 446 of the Laws of Kenya.
[171] Chapter 412 of the Laws of Kenya.
[172] Section 3, State Corporations Act.
[173] Ibid. Section 4.
[174] Ibid. Section 5.
[175] Ibid. Section 6.
[176] Ibid. Section 7.

3.4.1. STATE CORPORATION ADVISORY COMMITTEE (SCAC)

Section 3(1) of the SCA, gives the President power to establish state corporations.[177] The Act also envisages the BOD performing key functions in the management of corporations.[178] The SCA further provides that the State Corporations Advisory Committee (SCAC) may advise the President or Minister on the appointment, removal or transfer of officers and staff of SOEs, the secondment of public officers to SOE and the terms and conditions of the same.[179] This in effect creates an opportunity for control of SOEs by the executive.

The SCAC is an advisory committee with no real legal oversight authority. However, although the principal statute governing the process of appointment of Heads and Board members of state corporations is the SCA, a multitude of other Acts of Parliament, Orders, Regulation, and Circulars regulate the process of appointment of board members to various SOEs. For instance, there is a conflict where some statutes creating an SOE provide that the appointment of CEO should be the preserve of the line Minister and this negates the power given to the board whereas the SCA is clear that the CEO should be appointed by the board. [180]

When not appointing the directors directly, the office of the President also controlled all institutions that gave oversight, advisory and inspectorate services to SOE. Members of State Corporation Advisory Committee (SCAC),[181] whose role is to review and investigate SOE and

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[177] This section provides that, 'The President may, by order, establish a state corporation as a body corporate to perform the functions specified in the order.'

[178] Section 15, SCA which provides that: A board shall be responsible for the proper management of affairs of a state corporation and shall be accountable for the moneys, the financial business and the management of state corporations.'

[179] Ibid. Section 27.

[180] Ibid. Section 5(3).

[181] Section 27, State Corporation Act 1987.

make recommendations to the office of the President were appointed by the President.[182] This body lacked the requisite autonomy and independence to play an oversight role since they were presidential appointees.

3.4.2. THE INSPECTORATE OF STATE CORPORATIONS (ISC)

The Inspectorate of State Corporations is a body created under Section 18 of the State Corporations Act, whose members are also appointed by the President. The role of this agency is to advice the government on all matters affecting the effective running of the Public Enterprises.[183] This is done through the compilation of periodic reports to the Minister and the Auditor General (Corporations).

3.5. MINISTRY OF FINANCE

The Ministry of Finance had the overall mandate of implementing recommendations of the Parliamentary watchdog committees (Public Investment Committee (PIC) and Public Accounts Committee (PAC). [184] The Permanent Secretary (PS) in charge of treasury is represented either on every SOE's board. His recommendations to the Attorney General to prosecute directors involved in misappropriation of funds went unheeded. This is partly because, to do so, the Government would be admitting failure, thus failure to implement watchdog recommendations is not surprising.[185]

The oversight role of the Treasury is compromised by a number of factors. Firstly, the Permanent Secretary who is the accounting officer of the Ministry of Finance is a civil servant who is

[182] Ibid.
[183] Section 19, State Corporations Act 1987.
[184] Centre for Corporate Governance and Development op cit note 4 at 43.
[185] Ibid.

appointed by the President under Section 111 of the Constitution. He therefore serves at the pleasure of the President[186] and thus lacks the independence to supervise the BOD. Secondly the Permanent Secretary at Treasury represents the ministry on all Public Enterprises boards and is a party to the boards‘decisions and thus the Treasury cannot escape blame for the abuse of office, wastage of public funds and misappropriation so often blamed on Public Enterprises BOD.[187] The effectiveness of the PS due to his attendance in too many boards is also in question since some of the boards are regulatory in nature such as Electricity Regulatory Commission (ERC)

3.6. GAPS AND WEAKNESSES IN THE LEGAL AND REGULATORY FRAMEWORK

There is increasing evidence that a country's legal system plays a significant role in determining the success of its corporate governance system. The findings of this research have shown that good corporate governance is associated with countries with a strong legal system. In Kenya, the appointment, removal and oversight over SOEs is controlled by the executive who use it to reward political cronies. This is at odds with good corporate governance which envisages merit based appointment process that is accountable and transparent. Although the country is making efforts to train its directors, it remains questionable whether Kenya can achieve good corporate governance.

Politicization of appointment processes exposes SOE to financial scandals since directors are at variance with market forces. Corporations have often been used as instruments of personal aggrandizement, fraud, bringing the Kenyan economy to its knees[188] as the examples of NSSF and CMC illustrated. As if that is not bad enough, owing to the inefficiency of the legal system

[186] Constitution of Kenya 1992 (Amended), Section 25(1)
[187] Grosh op cit note 5 at 34.
[188] An example is the Golden-berg scandal which cost Kenya approximately $4 billion, roughly 10% of its gross domestic product (GDP).

corruption and political interference, investigations into the solvency of SOEs have not borne much fruit. As a result the perpetrators of fraud and mismanagement of public resources have not been prosecuted.

3.6.1. POLITICIZATION OF THE APPOINTMENT PROCESS

Although the SCA is the principal statute regulating appointments, discipline and removal of the BOD, there is no clear guidelines on the qualifications, selection and appointment processes of members to these boards. This ambiguity has created an avenue for possible abuses in appointments based on political considerations at the expense of merit.

It would be expected that all public appointments be governed by the overriding principle of meritocracy, by a deliberate and well informed choice of individuals who through their abilities, experience and qualities match the need of the public body in question.[189] Failure to do so leads to an erosion of good corporate governance and performance of the corporations in question.

Despite the provisions of the SCA and regulations regarding board appointments, line Ministers have at times used tribalism in appointing directors even where they do not possess the requisite academic qualifications and experience.[190] Unfortunately, there is no statutory provision requiring directors to have expertise and experience in the management of SOEs.[191] Directors appointed in this manner lack the objectivity and independence of judgment when making critical decisions pertaining to SOEs as they are answerable to the appointing authority and not the BOD. They are more likely to act as individual representatives of the appointing authority, a

[189] Office of the Commissioner for Public Appointments, (UK) Code of Practice for Ministerial Appointments in Public Bodies, August 2005, p.9.
[190] Siringi op cit note 140 at 1.
[191] Mwaura op cit note 119 at 470.

task which is often at odds with bringing efficiency and effectiveness in the management of SOE.

The majority of serving BOD in SOEs is composed of ex-civil servants with little or no business experience.[192] The push for some of the appointments made to the BOD is made on ethnic grounds, this is demonstrated by the clamour by Members of Parliament from the Coast region who at one time demanded for the appointment of the Managing Director of the Kenya Ports Authority to come from the coastal communities.[193]

Additionally, the powers given to the President and the line Ministers to appoint SOE directors have heavily politicized the boards,[194] in violations of the provisions of the Public Officers and Ethics Act 2003. The excessive powers accorded to the President and line Ministers (executive influence) in making appointments have led to the erosion of efficiency in the running of SOEs owing to the appointment of incompetent directors to sit in SOE boards. As such, there is evidence that links directors who were responsible for the collapse of some state corporations not only being appointed to other directorships but being appointed cabinet ministers as well.

The involvement of stakeholders in board appointment seems not to have added much value. For example, it is normally the Central Organization for Trade Unions (COTU) Secretary General who takes up the directorship in all SOEs boards where the organization has been allotted a slot to appoint a representative. It is not actually physically possible to attend many board meetings or immerse oneself in the details of that many enterprises. As such, the director is forced to make technical appearances in the meetings since he/she does not have time to scrutinize the papers

[192] King Committee Report on (1994) (South Africa) at 25.
[193] *Daily Nation*, (Kenya September 3, 2008) at 7.
[194] Ibid.

other than a casual glance then off to another board meeting.[195] This raises the question of whether stakeholders' participation will effectively add value to SOE boards as they were intended.

Political interference can be restricted in the nomination of SOE boards and increasing their independence and professionalism by putting in place a structured nomination process, making sure that the ultimate selection criterion is competence.

3.6.2. DIVERSITY IN APPOINTMENT OF BOD

The concept of diversity in appointing board members has not been well articulated in Kenya's legal system. The Guidelines on Workplace Diversity in Australia,[196] defines diversity to include gender, age, language, ethnicity, cultural background, sexual orientation, socio-economic background, personality, religious beliefs, family responsibilities and cognitive style.

When discussing diversity, it is important to move beyond race and gender and put emphasis on the unique talents, experience, knowledge, skills and insights that a person possesses and brings to bear on the management style. Diversity can also be viewed as a focus on the influence of different cultures, educational levels, ages, gender, regional backgrounds, sexual orientation and ethnicity on quality, product development and other core business issues.[197] Workplace diversity therefore, involves recognizing the value of individual differences and managing them in the workplace for productive use. It also involves how people perceive themselves and others since those perceptions affect their interactions. The diversity of the board mentioned in Section 2.1.4 of the CMA Guidelines is a matter of interest to Kenya's corporate governance strategy.

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[195] Sunny Bindra, 'Before Joining Any Board of Directors, Ask Yourself Why?' *Business Daily* (Kenya April 12, 2010).

[196] Part of a series titled "Working Together" issued by the Public Service and Merit Protection Commission of Australia following the passage of the Public Service Commission Act 1999.

[197] Thomas, R Roosevelt, *Beyond Race and Gender: Unleashing the Power of Your Total Work Force by Managing Diversity,* (New York: AMACOM, 1991) at 35.

Diversity is important in the appointment of BOD because of the influence it has on work relations. For example it would offer a SOE greater perspective on business issues and opportunities as well as a wider range of ideas and solutions, therefore the benefits of incorporating diversity in making appointments to SOE boards cannot be overemphasized. Eshiwani points out that a typical dysfunctional board will denote a lack of corporate culture and given its broad regional composition, a lack of national values such as hard work and integrity in the doing of business.[198]

As discussed in the foregoing section, if the President and line Ministers are responsible for appointing directors to SOE boards, they should embrace diversity in appointments and avoid nepotism and political expediency. The benefits that are attendant to diversity would include: greater improvement in the performance of SOE,[199] reduced cases of mismanagement,[200] increased levels of innovation since a diverse BOD has a broader range of different backgrounds and perspectives. Diversity also gives the board a wider range of ideas and insights to draw on in decision making and policy formulation. In addition it would offer a deep understanding of the needs of a wider spectrum of people as a consequence of broader representation.[201] Additionally, where diversity is incorporated in BOD, it would build the relationship of the SOEs' with the community, enhance the contribution of board and lead to improvement in the quality of programs, products and services of SOE.

[198] Eshiwani, 'Director Liability in the Wake of Uchumi (Collapse)', *Institute of Directors* (Kenya), July 14, 2006 .
[199] Centre for Governance and Development op cit note 4 at 6.
[200] Ibid.
[201] Ibid.

There is a sense in which SOEs can borrow from some of the most successful organizations in the private sector that truly value diversity and recognize it in the way they do business.[202] They focus on inculcating and embedding the principles of diversity in their culture and management systems. Competitive management practice is also another benefit that would be realized if diversity in board appointments would be considered. This is due to the fact that such SOEs would have productive and fulfilling workplaces which would help them attract and retain employees. In turn, this would lead to savings in recruitment and training costs, as well as maintaining corporate knowledge and expertise.

Diversity will provide opportunities for different viewpoints since diversity would bring in a larger pool of ideas and experiences from which an SOE can draw from to meet its objectives and goals effectively. It is important to note that in embracing diversity in board appointments, the appointing authority will be reflecting on the expectations of the new Constitution and the community about a fair, inclusive and productive public service.[203]

The new Constitution[204] addresses the issue of diversity by prohibiting the state from discriminating against anyone either directly or indirectly on any ground[205] and further prohibits any person from directly or indirectly discriminating against another person on the grounds specified beforehand.[206] Further, Article 27 (6) obliges the State to take legislative and other measures including affirmative action programmes and policies designed to redress any

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[202] Loden, Marilyn, *Implementing Diversity: Best Practices for Making Diversity Work in Your Organization*, (St. Louis: Mcgraw-Hill, 1995) at 21.

[203] Article 232, Constitution of Kenya 2010.

[204] Article 27 of the Constitution (2010) on Equality & Freedom from discrimination.

[205] Article 27(4) of the Constitution (2010) prohibits discrimination on the grounds of race, sex, pregnancy, marital status, health status, ethnic or social origin, colour, age, disability, religion, conscience, belief, culture, dress, language or birth.

[206] Article 27 (4), Constitution (2010).

disadvantage suffered by individuals or groups because of past discrimination. The Employment Act of 2007[207] also prohibits against discrimination on any grounds in employment.

Pursuant to these provisions, it is clear that the new Constitution embraces diversity and to effect the true spirit of the Constitution, the President and line Ministers should in their future appointments of persons to the board to be well guided and incorporate diversity and shun making appointments as a reward to friends[208] or political allies and nepotism.

Kenya can borrow from the Australian Public Service Act of 1999 (APS)[209] and the Public Service Commissioners Directions on how to develop and incorporate diversity programs in board appointments. The Act lays down the Australian Public Service values that are aimed at achieving diversity in appointments and employment. However, it is crucial to note that perceptual, cultural and language barriers need to be overcome for diversity in boards of SOE to be effective. Incorporating diversity in board composition would also in the long run enhance the independence of SOE boards because it would prevent the appointment of cronies who are allied to politicians and who lack the requisite expertise.

3.6.3. GENDER MAINSTREAMING IN APPOINTMENT OF BOD IN KENYA: WOMEN ON BOD

Gender does not mean women, but due to a history of gender discrimination in favor of men that is fuelled by a patriarchal society, a discussion of women on BOD becomes critical as a component of diversity. Although Article 27 of the Constitution provides for the equality of both

[207]Cap 226 of the Laws of Kenya.

[208] Najib Balala's appointment of his friend and political adviser to head the Kenya Utalii College.

[209] The APS provides a workplace that is free from discrimination and recognizes and utilizes the diversity of the Australian Community it serves (s. 10(1) (c).

genders, this has not always been the case. However, it is necessary to address it as an issue on its own since diversity encompasses so much more than gender as has been outlined beforehand. Throughout the world, women are recognized as a powerful force for growth and development. The current Home Secretary and Minister for Women and Equality in the United Kingdom, Theresa May once said that:

> Inclusive and diverse boards benefit from fresh perspectives, new ideas and broad experience. A company with a board that reflects the people it serves is better able to understand its customers, and there is growing evidence that companies with more women on their boards outperform their male-dominated rivals.

A new study prepared by Ontario's Richard Ivey School of Business[210] and the Wellesley Center for Women[211] concludes that corporations benefit from the presence of women on the board of directors. An article[212] by Wellesley Center for Women in part stated that:

> We find that women do make a difference in the boardroom. Women bring a collaborative leadership style that benefits boardroom dynamics by increasing the amount of listening, social support, and win-win problem-solving. Although women are often collaborative leaders, they do not shy away from controversial issues. Many of our informants believe that women are more likely than men to ask tough questions and demand direct and detailed answers. Women also bring new issues and perspectives to the table, broadening the content of boardroom discussions to include the perspectives of multiple stakeholders. Women of color add perspectives that broaden boardroom discussions even further.

The drawback however, is that in the past, there has been gender inequality in employment both in the private and public sector. In both instances women employees are fewer as compared to their male counterparts. The composition of women and men in BOD is not an exception and follows that pattern. The Permanent Secretary in the Ministry of Trade and Industry (2007),

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[210] Available at <http://www.bis.gov.uk/news/topstories/2011/Feb/women-on-boards> (accessed on 19/1/2012).
[211]Available at <http://www.negotiationlawblog.com/wellesley Study pdf > (accessed on 19/1/2012).

David Nalo, noted that, gender inequality is a serious economic issue in Kenya and addressing it would lead to improved outcomes not only for women, but for families and the society as a whole.

It has been argued that where a BOD is male dominated, there is a risk of group think which eliminates a diverse approach to issues in decision making as well as lack of variety. It is therefore necessary for line Ministers and the President to consider having a gender balance in appointments to SOE boards. This would assist in eliminating group thinking as it has been scientifically proven that men and women often have a different way of approaching various issues. Fortunately, the new Constitution in its Article 27 (8) provides that the state shall put in place legislative measures to implement the gender mainstreaming which envisages that not more than two-thirds of the members of elective or appointive bodies shall be of the same gender. This provision provides an avenue for women to be appointed to sit on boards of SOEs.

Various studies have put forth the following competitive advantages as the rationale for companies both in the private and the public sector to consider increasing the number of women sitting in the BOD:[213] First, there is better performance during financial crises, more so if the crises is linked to excessive risk taking, this is backed by studies that have demonstrated that women are more cautious, and, choose less risky orientations and more prudent options.[214] Secondly, women are better at governance and according to a Conference Board study, boards hosting more women pay more attention to regulating conflicts of interest, monitoring risk and

[213]Available at <http://www.proposal/board-of-directors/1571> (accessed on 19/1/2012).
[214]Victoria Pynchon, 'Note to Board of Directors: *Women Make a Positive Difference'*, available at <www.mediate.com/articles/PynchonVbL20080211A.cfm> (accessed on 19/1/2012).

financial control, and maintaining good relationships with investors and other stakeholders of the corporation.[215]

Thirdly, women on boards present a better decision-making process since they are receptive to different viewpoints and more emphasis on the long term, which generates enriched debates and sound decision making which leads to better financial performance.[216] This is great departure from men who tend to put more weight on short term impact of decisions. Fourth and much more importantly, a study by the McKinsey Consulting Group shows that corporations with more women on their board report a better return on equity.[217] Lastly, having women on boards creates a better image for investors, that is why the number of women on a board is one of the criteria used in evaluating the performance of corporations and in assessing corporate social responsibility.[218]

State Corporations (Performance Contracting) Regulations on their part empower boards of SOEs to recruit chief executives of SOEs. The line Minister's role is to choose the chief executive of an SOE from a list of three names recommended by the board. The BOD is allowed to consult with the State Corporations Advisory Committee[219] in making recommendations on

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[215] Ibid.

[216] Aleksandr Shkolnikov, 'Women and Corporate Governance', available at www.cipe.org/blog/2011/01/27/women-and-corporate-governance/#-T55Aj7P/rSk (accessed on 19/1/2012).

[217] Ibid.

[218] Available at <www.bis.gov.uk/assets/biscore/business-law/docs/w/11-75-Women-on-Boards> accessed on 19/1/2012).

[219] SCAC falls under the office of the President and is established under section 26 of the SCA. It consists of a chairman, permanent secretary to the treasury, Director of personnel management, Inspector –General (Corporations) and eight other members appointed by the president. Its mandate includes advising on the matters and performing any functions it is required to perform under the Act including to review and investigate the affairs of state corporations and make such recommendations to the President as it may deem necessary, to advise the President on the establishment, reorganization or dissolution of state corporations amongst other functions.

persons to be appointed as chief executive of any SOE. The Public Officers Ethics Act (2003), on its part requires SOE directors and employees to be politically neutral.[220]

3.7. EFFECT OF THE NEW CONSTITUTION (2010) ON APPOINTMENT OF DIRECTORS TO SOE BOARDS

The new Constitution heralds a new dawn that if implemented envisage reshaping the legal and regulatory framework governing the appointment of SOE and chief executives. The president's excessive powers over SOE have been removed, together with the power to issue directives to boards of SOEs and appoint chief executives. The new Constitution requires all appointments to SOE's boards to be based on fair competition and merit.[221]

The Constitution of Kenya contemplates transparency, accountability and participation of Kenyan citizens in governance as the guiding national principles and values that have to bind public officers and state organs, in making and implementing decisions.[222] The cabinet ministers will now be accountable to the public in all the appointments they make.

Chapter six of the new Constitution has been wholly dedicated to leadership and integrity of state officers in which category SOEs fall. Article 73(2) lays down the guiding principles of leadership and integrity as:

> Selection on the basis of personal integrity, competence and suitability, or election in free and fair elections; objectivity and impartiality in decision making and in ensuring that decisions are not influenced by nepotism, favouritism, other improper motives or corrupt practices; selfless service based solely on the public interest demonstrated by honesty in

[220] Section 16, Chapter 183 of the Laws of Kenya.
[221] See Article 232 (g) of the Constitution (2010).
[222] Ibid. Article 10.

the execution of public duties; the declaration of any personal interest that may conflict with public duties; accountability to the public for decisions and actions and discipline and commitment in service to the people.

Further, the conduct of State Officers is clearly laid down by the provisions of Article 75 of the Constitution (2010). Article 79 obliges Parliament to enact legislation to establish an independent Ethics and Anti-corruption Commission for purposes of ensuring compliance with, and enforcement of the provisions of Chapter Six. This has already been done and if this commission takes its job description seriously, then arbitrary appointments as has been previously observed will be a thing of the past.

Going by these specific and clear provisions of the Constitution, then if fully implemented, appointments to SOE's boards will be carried out in a transparent and fair than was previously the case. Moreover, as the Constitution is the supreme law of the land, its provisions must be adhered to strictly. When it is contravened, any interested or affected party can challenge future appointments of directors that are done without due regard to the laid down legal provisions.

Parliament has been given the mandate to vet all appointments to key state organs.[223] However, although the new Constitution marks a good starting point in reforming the institutions, it is doubtful whether these provisions will comprehensively overhaul the current system of appointments to directorships due to the deep vested political and financial interests. This in a

[223] Article 132 (2), the Constitution of Kenya 2010.

large part will be possible if there are guarantees that the appointment and vetting will not be based on political expediency with horse trading among and between political parties.

There is a danger of ending up with the same people being re-appointed to directorships on the basis of their experience. However, Article 118 of the Constitution could provide a safeguard to horse trading as it requires Parliament to conduct its business in an open manner and facilitate participation and involvement in its legislative and other business.

This study holds the view that, the substance of Article 165 of the Constitution gives the High Court of Kenya jurisdiction to hear and determine any matter relating to interpretation or contravention of any of the provisions of the Constitution. The lack of fair competition and merit could constitute sufficient grounds for the public to challenge irregular appointments of BOD in the constitutional court. Kisero aptly sums up these new constitutional provisions when he notes:

> I support the provision of the Constitution that stipulates that all future political appointments will be vetted by Parliament. This is a good starting point. We must rid boards of state owned enterprises of individuals with nothing to offer in skills and experience. We must replace these people, who are usually cronies of ministers with well –functioning professionals in these boards. Nominations of boards should be transparent, clearly structured and based appraisal of skills and competences. [224]

In order to curb politicization of appointments to BOD in SOE, directors are barred from holding office in political parties under the new Constitution. Additionally, retired civil servants cannot hold more than two concurrent remunerative positions as chairman or directorship of SOE as has

[224] Jaindi Kisero, 'Government should learn a lesson from Kenya Re fiasco', *Daily Nation* (Kenya April 21, 2010) at 12.

been the case previously.[225] The impunity witnessed in the past where directors responsible for the collapse of SOE were not only appointed to other directorships but to cabinet as well, will be a thing of the past. This is pursuant to Article 75 of the Constitution which bars them from holding any public or state office.

3.8. CONCLUSION

As demonstrated by the foregoing, board composition and independence are important indicators of good corporate governance. The inefficient and ineffective management of SOEs in Kenya can be attributed to among other things, poor appointment criteria caused by a weak legal framework, politicization of the appointment process, lack of diversity,

The performance of SOE can be measured against the manner of appointment of its directors. The composition of the BOD of Public Enterprises consists of the Chairman, the Chief Executive Officer (CEO), the Permanent Secretary (PS) of the parent ministry, the Permanent Secretary of Treasury[226]and seven other members not employees of the corporation, three of whom are 38 appointed by the line Minister.[227] Under Section 6(1A and B) of the State Corporations Act (SCA), the President is vested with the powers to appoint the Chairman and CEO of the Public Enterprises. The Permanent Secretary of Treasury and the line Ministers are appointed by the President under the Constitution.[228] Ministers being important players in Public Enterprises management are also appointed by the President.[229] As public servants they do not enjoy security

[225] Article 77(3), Constitution of Kenya 2010, provides that: a retired state officer who is receiving a pension from public funds shall not hold more than two concurrent remunerative positions as chairperson, director or employee of a company owned or controlled by the state or state organ.
[226] Centre for Corporate Governance Development op cit note 4 at 25.
[227] Section 6(1), State Corporations Act 1987.
[228] Section 22, the Constitution of Kenya 1992.
[229] Ibid. Section 16 (2).

of tenure since they serve at the pleasure of the President'[230] Executive interference is so extensive that: the President may also give directions of a general or specific nature to a board with regard to the better exercise and performance of the functions of the state corporation and the board shall give effect to these directions.[231] Where the President and line Ministers select persons without the required qualifications and expertise, SOE end up with board members who are lacking the requisite education, training, job experience and professional relevance end up pursuing narrow personal and political interests. This has had a detrimental effect on the managerial capacity of the boards and morale of competent staff.

In the appointment of the BOD, the President and line Ministers are not guided by issues of diversity. This is true especially with regard to gender mainstreaming which is currently a constitutional requirement, Article 27 (8) of the Constitution is illustrative: "…not more than two thirds of members of elective or appointive bodies shall be of the same gender." The effect of this is that the BOD have been denied the skills that would have improved performance of SOEs, reduced cases of mismanagement and increased levels of innovation since a diverse BOD has a broader range different backgrounds and perspectives. The following chapter shows practically how politicization of the appointment process caused by a poor legal framework, disregard for the law in gender mainstreaming has contributed to poor corporate governance and hence performance of SOE

[230] Ibid. Section 25(1).
[231] Section 7(1), State Corporation Act 1987.

CHAPTER FOUR

FINDINGS AND ANALYSIS OF DATA ON APPOINTMENT OF BOD IN SOE

4.0 Introduction

The previous 3 chapters have outlined how the appointment of board members affects the performance of SOE due to an inadequate legal framework. This chapter examines the actual findings of the field work against certain set criteria that relate to the appointment of board members in SOE. This is against an overview of SOE examined in chapter 2 which showed that the poor performance of SOE in Kenya is attributed to the absence of good corporate governance practices in part due to the poor appointment and removal procedure of members to the BOD of SOE.[232] This arises largely due to the fact that the executive especially the President had wide latitude in the appointment of the BOD.[233] The power to appoint and remove members of the BOD of SOE is an important channel of political influence by the executive.[234] Notwithstanding the provisions of the SCA on the appointment of directors, political patronage and ethnicity are the pillars that guide appointment of persons to boards of SOEs as well and chief executives.[235]

Be that as it may, it would be expected that Parliament, whose constitutional mandate is to check on the excesses of the executive would use its power to curb some of the abuses enumerated above. That has not happened, recommendations of PIC are more often than not enforced by the office of the Attorney General.[236] When the PIC reports are adopted by the National Assembly, the onus of implementing its recommendations falls on the Treasury. Given that most of the

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[232] Centre for Corporate Governance Development op cit note 4 at 25.
[233] Section 3, State Corporations Act, 1987.
[234] Yingyi Qian, Enterprise Reforms in China: Agency Problems and Political Control (1986) 4 (2) *Economics of Transition* 427 at 440.
[235] Centre for Corporate Governance Development op cit note 4 at 36.
[236] Ibid.

reports' findings and recommendations are a catalogue of failures by the Treasury to manage, control and safeguard public funds,[237] it is not surprising that most are not implemented. In the Treasury memoranda that accompany the PIC reports, the Treasury invariably *'notes'* the recommendations and says that implementation shall follow. In its 7th Report, the PIC recommended the prosecution of named SOE heads and ordered that these be finalized by 31st December 1997. With the possible exception of Alfrick Birgen,[238] no SOE head has been successfully prosecuted and convicted. Recommendations relating to the financing and staffing of the audit function have suffered the same fate as have those that require Treasury to tighten control over expenditure of state corporations to avoid over expenditure not implemented. The reports continued to catalogue unbudgeted expenditure and violation of procurement regulations. Perhaps, though, the failure of the PIC is a reflection of a weak Parliament since its recommendations have not acted up on by the executive. As a watchdog committee, the failure to implement its recommendations reflects badly on the powerlessness of Parliament.[239]

There is a conspicuous absence of diversity (women representation) on the boards. Statistics obtained from the Nairobi Stock Exchange (NSE) illustrate the total dominance of directorship by one gender. 34% of the 57 companies listed on the Nairobi bourse do not have a woman on their board at a time when CMA is pushing for the mandatory gender caps.[240] Women occupy only 54 out of the 449 seats on the boards of the NSE listed companies. The Kenya Institute of Management (KIM) blames the reliance on old BOD networks for directorship appointments

[237] Section 11 of the State Corporations Act requires the submission of annual estimates by state corporations to the Minister and Treasury for approval, while section 12 provides that no annual estimates or proposals are to be implemented without the approval of the Minister with the concurrence of the Treasury.
[238] Centre for Corporate Governance Development op cit note 4 at 27.
[239] Ibid.
[240] David Herbling, 'More than a Third of NSE Firms Lack Women Directors,' *Business Daily,* January 14, 2013.

since boards have traditionally been made up of retired males of similar backgrounds who recruit from a network of friends. Only Kenya Re-Insurance and Uchumi Supermarkets have women chairing their boards.[241]

The result has been that the Structure of SOE Boards and Management has remained the same over the years. Reforms at the board level directly depend on changes in the overall political governance of the country.[242] Currently, there are three ways in which boards are set up. First, some boards are constituted by line Ministers: these include those that run Educational institutions and development agencies. Secondly, boards of companies in which the Government has a controlling stake such as those in some commercial and financial institutions are chosen according to the provisions of the memorandum and articles of the firms. Thirdly, some SOEs boards elected by stakeholders including the responsible line Ministry is one of them.[243] These include boards established by the various crops acts and of regulatory agencies such as ERB.[244]

The appointment of the first category boards is infected by cronyism and patronage.[245] The government rarely specifies mandatory professional qualifications; academic qualifications are usually set at a minimum. Appointments are secured by lobbying ministers or their close associates. There is significant external influence in the composition of the boards in second and third categories. In category two boards, the government's clout is proportional to the size of its stake. Moreover, the performance of the board can be easily and effectively bench-marked against the competition especially in finance and trade. The third category board has two

[241] Ibid.
[242] Centre for Corporate Governance Development op cit note 4 at 29.
[243] Ibid.
[244] Ibid.
[245] Ibid.

weaknesses: the government share of board positions and the potential capture of the board by private interests. Private interests are keen to capture regulatory agencies and in some boards the governments appointed members outnumber those appointed by other stakeholders.

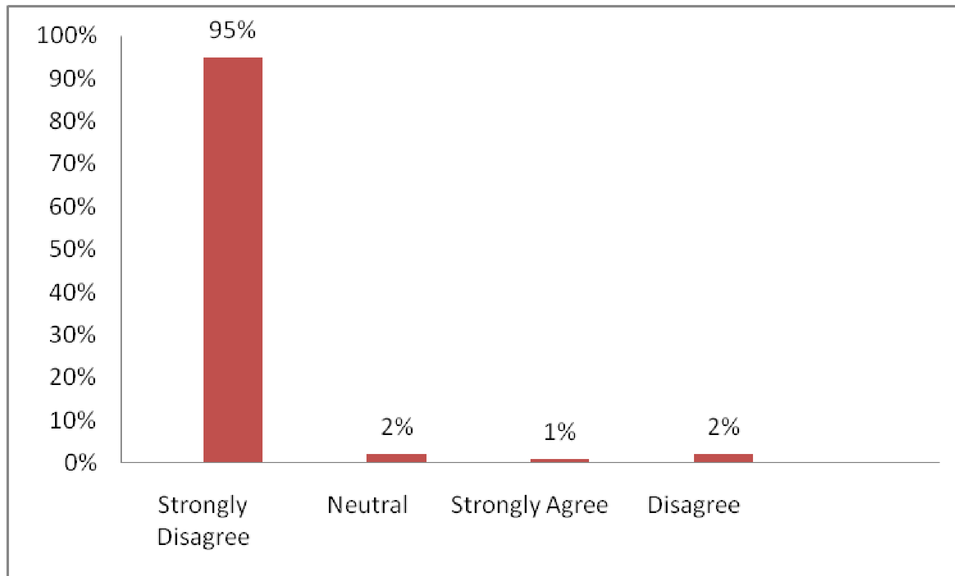
4.1 Target population

This study targeted respondents who comprised of corporate governance experts, lawyers, human resource experts, members of state corporation boards and skilled professionals. The target population is representative of be people who are well versed with the issue of board appointments from across the board.

4.2. FINDINGS

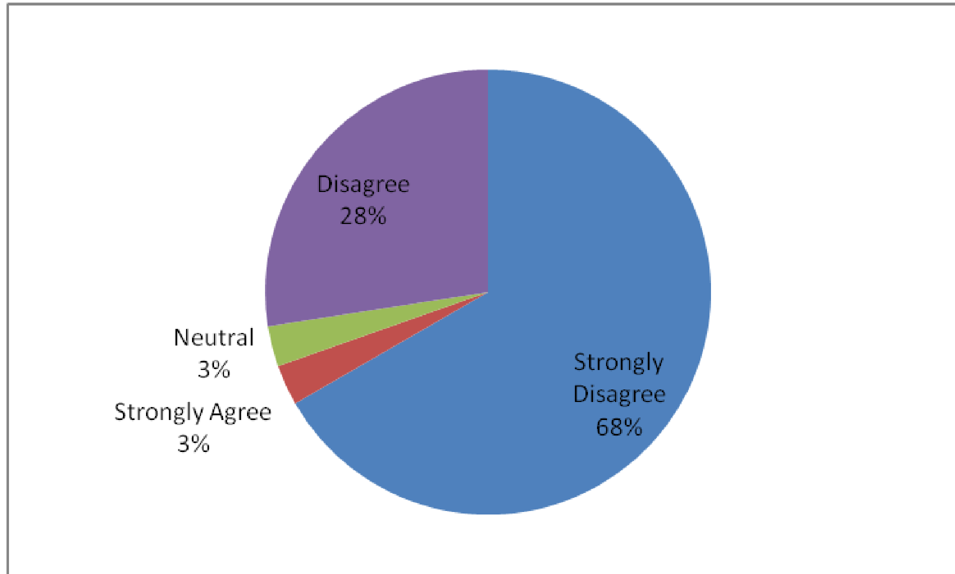
The findings of the survey are shown through bar graphs and pie charts representing the views expressed by the respondents on the various issues raised in the questionnaire.

4.2.1: Whether the process of appointment of boards of directors to SOEs in Kenya is publicized



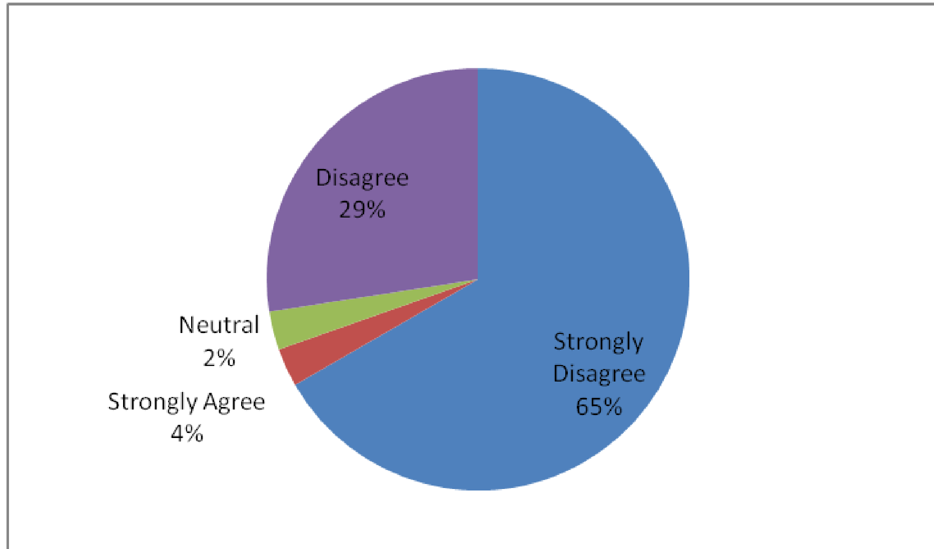
On this question, the response was in favour of the fact that majority of the respondents strongly disagreed with the notion that appointment to board positions in SOEs was publicized. This is consistent with the current practice where board positions are never advertised, although it is not a legal requirement. Instead the President and the line Minister select persons on grounds that can be described as lacking transparency.

4.2.2 Whether the appointment of members to SOEs in Kenya is competitive



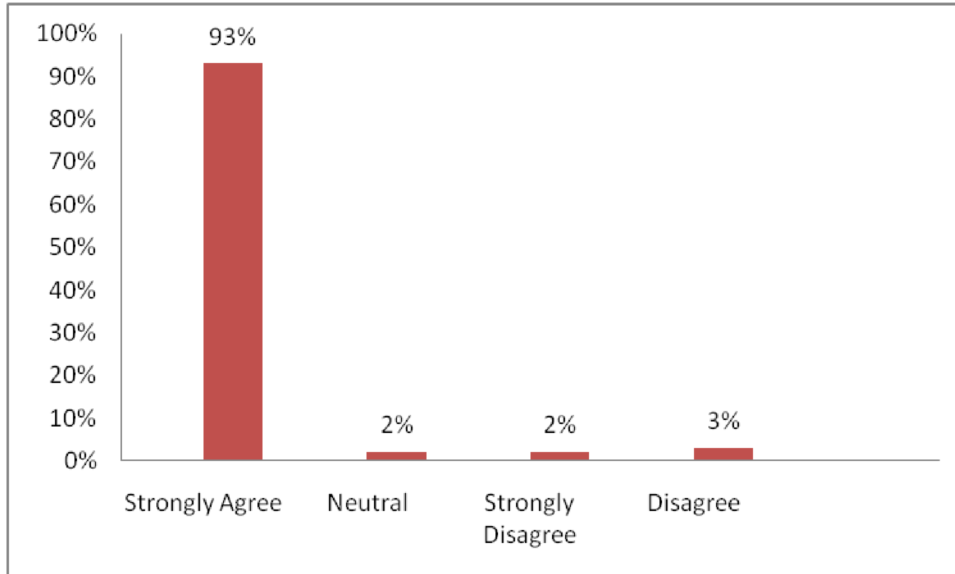
A high percentage of the respondents (68%) strongly disagree while 28% disagree with the view that the appointment of board members to SOEs is not competitive as depicted in this pie chart. 3% are neutral while only 3% strongly agree that the appointment process of board members is competitive.

4.2.3 Whether the BOD in SOEs possess the requisite qualifications and expertise



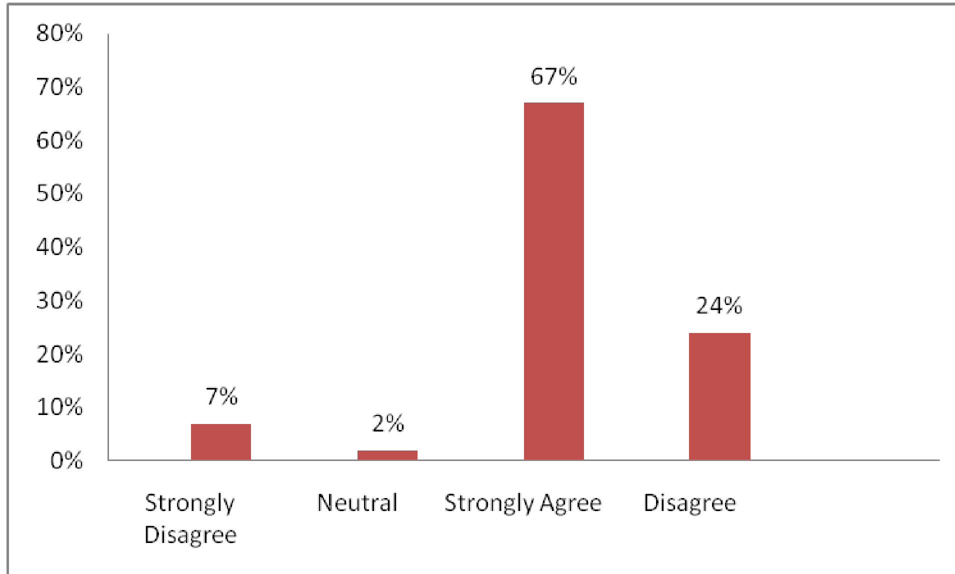
Shows that a high percentage of respondents (65%), strongly disagree with the view that board members possess the right qualifications and are experienced for the post of director. 29% disagreed with the question, 4% were not sure either way or they did not know, while only 3% agreed with it.

4.2.4 Importance of training new board members appointed to SOEs in Kenya



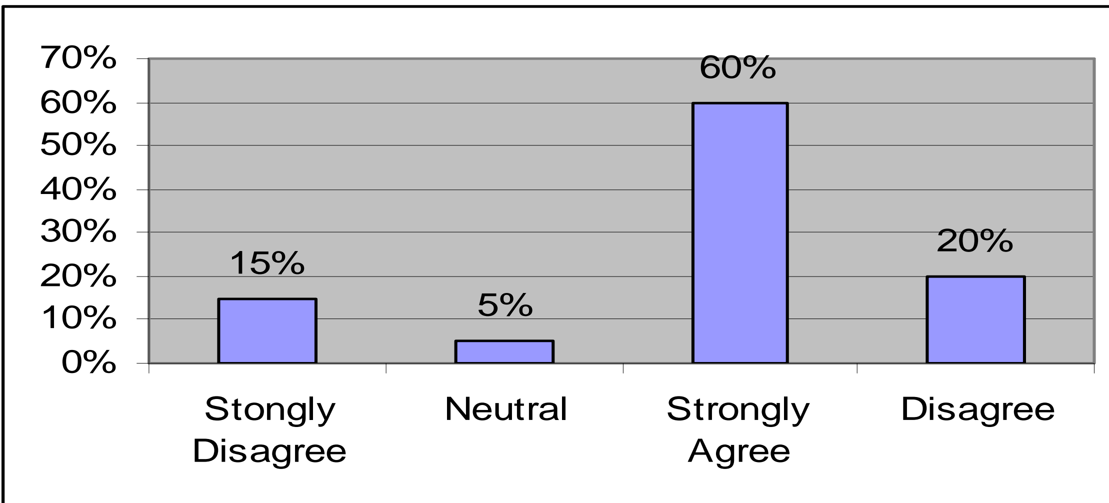
An overwhelming percentage of the respondents (93%) agreed to the fact that it is important for new members of BOD to undergo training as a step towards improving his/her out put as a board member. 2% were either not sure or did not know, 2% strongly disagreed with the question while 3% disagreed.

4.2.5 Whether persons sitting in SOE boards should sign performance contracts



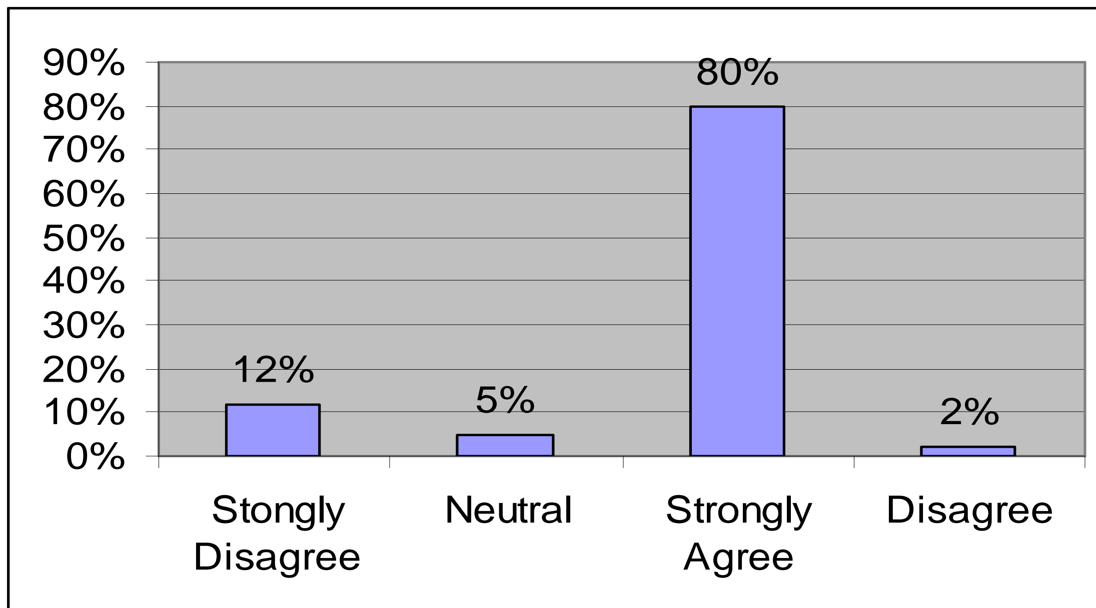
The absence of criteria for measurement of performance of BOD was seen as a major contributor to dismal performance of SOE. Respondents were asked whether board members should sign performance contracts, 67% strongly agreed with this view, 24% disagreed, 7% strongly disagreed while only 2% were neutral.

4.2.6 Whether ranking of SOEs is an incentive to encourage better performance



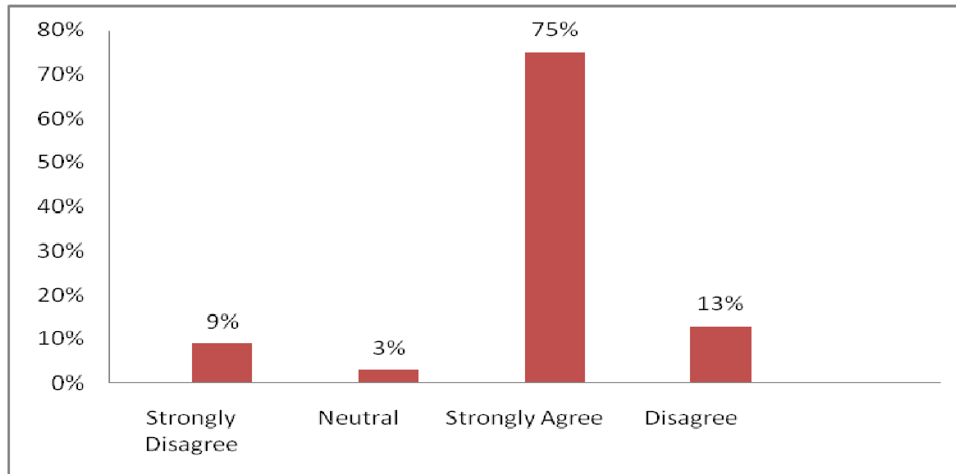
Healthy competition has been known to improve performance, so a question as to whether a ranking of SOE would act as an incentive towards better performance was put to respondents. 60% of the respondents strongly agreed with the question, 20% disagreed, 15% strongly disagreed while 5% were neutral or did not know.

4.2.7. Whether diversity in appointment of board members will improve performance



Evidence from other jurisdictions shows that diversity on the board has improved performance of SOE due to the unique skills brought on board. Therefore a question as to whether diversity in appontment of BOD should be a mandatory requirement. 80% of respondents strongly agreed with the question, 12% strongly disagreed, 5% were not sure while 2% totally disagreed.

4.2.8. Whether the new Constitution will lead to better corporate governance of SOE



The overwhelming passage of the Constitution during the referendum showed the amount of faith Kenyans had on its impact not only on there lives in general but in the appointment of public officers especially BOD of SOE. Article 10 and 232 and Chapter 6 of the Constitution of Kenya are mandatory reguirements for all persons who wish to be appinted as state officers.[246] Respondents were asked to comment on whether implementation of the the Constitution would lead to not only better corporate governance but improve performance as well.

[246] Article 20 (1), Constitution of Kenya 2010, provides that: “The Bill of Rights applies to all law and binds all State organs and all persons.”

4.3. CONCLUSION

The chapter was based on the findings of the survey and as analysed above, the majority of the respondents were of the opinion that a lot needs to be done with regard to the appointment criteria to board positions in SOEs. Those who responded to question nine of the questionnaire noted that politics, tribalism and nepotism are key considerations when the line Ministers and the President make board appointments to SOEs. However, a majority are of the opinion that chapter six of the Constitution on integrity will ensure that only people of integrity will get appointed to the board in conformity with constitutional requirements. Chapter five investigates how other jurisdictions have dealt with the appointment of the BOD and the lessons Kenya can learn from them in instituting reforms in the legal framework governing the appointment of the BOD to SOEs in Kenya.

CHAPTER FIVE

COMPARATIVE ASPECTS OF SELECTED CASE STUDIES

5.1. INTRODUCTION

This chapter explores international best practices in good corporate governance and lays down a comparative analysis with other jurisdictions, especially with regard to board appointments, role of the executive and oversight mandate of parliament in the appointment process. Focus shall be placed on best practices in UK South Africa as well as endeavor to integrate the best practices into the Kenyan model on the appointment of directors in SOE. The chapter also examines the lessons that Kenya can learn in the governance of SOE from the two jurisdictions.

5.2. Best Practices in other Jurisdictions

> All public appointments should be governed by the overriding principle of selection based on merit, by the well-informed choice of individuals who through their abilities, experience and qualities match the need of the public body in question.[247]

In other jurisdictions, governments have recognized the need to enhance public confidence in the integrity of the political processes around public sector appointments. Towards this they have established transparent processes with a high degree of independence, with emphasis being given to merit- based appointments. The following is an analysis of best practices in two jurisdictions namely: the UK and South Africa on the four criteria of the executive as the appointing authority, diversity, role of Parliament and the structure of the board.

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[247] Office of the Commissioner for Public Appointments, (UK) Code of Practice for Ministerial Appointments in Public Bodies, August 2005 at 9. Cited in *'Reforming State Corporations'* by Petronella Mukaindo Ass. Law Reporter, Laws of Kenya Department, The Bench Bulletin (Issue 17-October-December 2011), p32.

5.3. Executive as the appointing authority in the UK

The United Kingdom on its part has a comprehensive appointment process that is relatively systematic and transparent. It is based on a set of principles and a code of practice for public sector appointments. These principles are: openness and transparency, proportionality, probity, merit and independent scrutiny.[248] The system requires all appointments to be advertised and a shortlist be compiled by a panel that is overseen by an independent assessor. The Commissioner for Public Appointments is required to conduct regular annual audits on appointments made by organizations that fall within the ambit of the Commission for Public Appointments in order to assess compliance with the Code of Practice.[249]

There is the office of the Cabinet Appointments and Honours Committee should be consulted on the majority of appointments to public sector boards. Ministerial involvement in appointments is also set out such that although Ministers are involved in agreeing to the appointment criteria and the processes to be followed and can nominate candidates at the commencement of the process, they must take no further part in the process until the decision stage. This is limited to selection from candidates put forward by the selection panel or department who meet the criteria.[250]
The Commissioner for Public Appointments is required to conduct regular annual audits on appointments that fall within his ambit in order to assess compliance with the code of practice.[251]

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[248] See the UK Code of Conduct in Corporate Governance; Organization for Economic Co-Operation and Development (OECD), *Corporate Governance of State Owned Enterprises: A Survey of OECD Countries* (OECD: Paris, 2005) at 134.
[249] Office of the Commissioner for Public Appointments op cit note 247.
[250] Ibid.
[251] Ibid.

5.4. The Oversight Role of Parliament in South Africa

The Constitution of South Africa empowers the National Assembly and Provincial Legislatures with an oversight role over their respective Executives. Section 55(2) of the Constitution deals with the powers of the National Assembly, and states that the National Assembly must provide for a mechanism that, first ensures that all executive organs of state in the national sphere of government are accountable to it; and second to maintain oversight of the national executive authority, including the implementation of legislation, and any organ of the state.

Section 42(3) of the Constitution empowers the National Assembly with the power to scrutinize and oversee the executive action. In addition, Section 92(3) (b) of the Constitution requires that Members of the Cabinet must provide Parliament with full and regular reports concerning matters under their control. The challenge facing members of Parliament is to improve the capacity of the policy/parliamentary Committees to hold Departments and SOE's to account for their performance, using their strategic plans, budget documents and annual reports as the basis.
The Public Finance Management Act (PFMA) gives effect to financial management that places a greater implementation responsibility with managers and makes them more accountable for their performance. It is left to the Minister/MEC or the Executive (Cabinet) to resolve management failures. The National Assembly and the provincial legislatures are vested with the power to oversee the SOE and the Executive.

Parliament exercises its role through evaluating the performance of SOE's by interrogating their annual financial statements. The Standing Committee on Public Accounts (SCOPA) reviews the annual financial statements and the audit reports of the Auditor-General. The Portfolio

Committee on the other hand exercises oversight over the service delivery performance of SOE's and, as such, reviews the nonfinancial information contained in the annual reports of SOE's and is concerned with service delivery and enhancing economic growth.

5.4.1. Annual Reports

Annual reports allow Parliament to evaluate the performance of a Department after the end of the financial year. With regard to Departments prior to the year 2000, there was no oversight over nonfinancial service delivery performance, and Departments only tabled their financial statements and Audit Reports, rather than an annual report. However, reforms since the enactment of the PFMA and Public Service Act require the Minister of each Department, who might also be the Executive Authority of a SOE, to table an annual report in the legislature within 6 months of the end of each financial year. Section 65 of the PFMA requires the Executive Authority to table the annual reports for SOE's for which they are responsible by 30 September, which is six months after financial year-end of the SOE. This implies that annual reports should be tabled by Parliament a month after the accounting officer has received it from the SOE. Because it would be impossible for the National Assembly to exercise proper oversight over their Executives by reviewing all performance aspects of the 35 National Departments and 250 National Public Entities, Parliamentary Committees were established to facilitate the oversight role. This division of labor enables the committee members to become experts in different fields, and spend more time doing the actual oversight work.

5.4.2. Roles of different Parliamentary Committees

The Public Accounts Committee and the Standing Committee on Public Accounts (SCOPA) fulfils the responsibility of reviewing the audit reports of the Auditor General. This Committee plays an important and specialized role of being the protector of public monies. In fulfilling this

role the Committee focuses on the following: Issues raised in the General Report of the Auditor-General on Audit outcomes; Issues of financial probity as highlighted in the audit report or disclosed in the management report or notes to the financial statements; Compliance with the PFMA, Treasury Regulations, the Audit Committee and the management report of the accounting officer; Interrogation and evaluation of instances of over-expenditure and instances of unauthorized expenditure; Interrogation of instances relating to irregular, fruitless and wasteful expenditure; The functioning of risk management systems; and Corporate governance of departments, public entities, and constitutional institutions.

5.4.3. Portfolio Committees

Given their involvement in the legislative, budget and in-year monitoring processes, Portfolio Committees exercise oversight of the service delivery performance of SOE's. Portfolio Committees fulfill the responsibility of reviewing non-financial information contained in the annual reports of SOE's. These Committees should exercise oversight as to whether entities have delivered on the service delivery commitments they made in their corporate plans. They must also consider the SOE's financial performance in order to develop a holistic understanding of the SOE's performance. To give effect to this role, these Committees focus on the following in considering the annual reports of SOE's: The technical quality of the annual reports produced by Departments and SOE's; The economic, efficiency and effectiveness of service delivery as measured by performance indicators presented in the annual reports; Evaluating management's explanation as to why the entity's service delivery performance did not attain the targets set in the corporate plans; Equity of service delivery; and Investigating the circumstances that led to financial underperformance and the impact this had on service delivery and the measures taken by management to rectify the situation. The National Assembly Portfolio Committees are

responsible for overseeing the relevant National Department for which they are responsible. SOE's report to an Executive Authority (Shareholder Ministry) and their annual reports are submitted to both the Public Accounts Committee and the relevant Executive Authority.

5.6. CONCLUSION

This chapter has made a comparative analysis of corporate governance practices in Kenya with practices by the OECD countries. This is because good corporate governance in the appointment process consists of four pillars namely: fairness, accountability, responsibility and transparency. These tenets are key to the appointment and running of SOE.[252] However, as earlier noted, a code of good corporate governance in place in another jurisdiction cannot be said to be applicable word for word in another jurisdiction. The King III Committee (South Africa) observed that enterprises are governed within the framework of the laws and regulations of the country in which they operate.[253]

Since countries differ in culture, regulation, law and generally the way business is done, there is no single generally applicable corporate governance model.[254] The principles are however, intended to assist OECD and non-OECD governments in their efforts to evaluate and improve the legal, institutional and regulatory framework for corporate governance in their countries and to provide guidance and suggestions for standards that no country can escape in the era of global investor and that is what Kenya is seeking to adopt.

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[252] The Common Wealth Association of corporate governance was established in 1998 with the objective of promoting the best international standards germane to a country on corporate governance through education, consultation and information throughout the Commonwealth as a means to achieve global standards of business efficiency, commercial probity and effective economic and social development. The CACG also aims to facilitate the development of institutional capacity that promotes good corporate governance by education, consultation and information in all Commonwealth countries. International guidelines developed by the OECD, the International Corporate Governance Network (ICGN) and the Commonwealth Association for Corporate Governance (CACG) encompass the four pillars of fairness, accountability, responsibility and transparency.

[253] King III Committee on Corporate Governance *King Report on Corporate Governance for South Africa* (2002) at 15 para 23.

[254] Ibid.

It is stated that the principles are not intended to substitute for government, semi-government or private sector initiatives to develop more detailed “best practice” in corporate governance.

The drawback though is, there exists a weak legal enforcement of rules and regulations in Kenya despite a well-laid down guideline in the appointment process.

A precarious balance exists between sensible regulations and unreasonable enforcement hence the need to provide for consequences of breach of such responsibility. Moreover, the effectiveness of corporate governance legislation and regulations depends on the competence, integrity and forcefulness of the courts and regulatory agencies.[255]

However, it is worthwhile to note that most of these proposals are not new to the Kenyan government. In the 1998 policy paper on Public Enterprise Reform and Privatization that was to implement the Public Enterprise Reform Programme, it was proposed that one of the roles of the Department of Government Investment and Public Enterprises (DGIPE) within the ministry of finance was to design and implement a transparent system for selection and appointment of competent and qualified persons to SOE boards. Moreover, as part of its permanent function, it was envisaged that the DGIPE will maintain a database of qualified candidates for SOE boards and senior management posts and source all board members’ appointments from the database in accordance with the principle of transparency.[256] These proposals were never implemented.

[255] Office of the Commissioner for Public Appointments, (UK) op cit note 247.
[256] Ibid.

CHAPTER SIX

CONCLUSION AND RECOMMENDATIONS

6.1. CONCLUSION

This study set out to answer three questions namely: First to what extent has the procedure of appointment and removal of boards of directors in state owned enterprises contributed to their poor performance? Second, what are the other factors that have contributed to poor corporate governance in SOEs? Third, what reforms are needed in the State Corporations Act, which governs the appointment and removal process of directors, in order to improve corporate governance?

The legal and regulatory framework governing appointment of SOE chief executives and board members has gaps and weaknesses that have a impacted negative on the performance of SOEs. Other than the SCA, there exists a multiplicity of laws regulating SOEs which creates conflicts and loopholes for appointing authorities to flout the rules and regulations on appointments of board members. However, it is envisaged that with the passing of the new Constitution, the relevant provisions relating to SOEs as discussed in chapter three will go a long way in bringing about significant reforms in the SOEs.

On the first question, it is evident that the weak legal and regulatory framework governing the appointment and composition of BOD in SOEs has contributed to the poor performance of SOE. This has been demonstrated through fieldwork study that showed that 95 percent of the respondents agreed that the process of appointment of BOD in Kenya is not transparent. This is in addition to the 68 percent of were of the view that such appointments to SOE are devoid of a competitive process. In addition 65 percent of the respondents observed that a majority of BOD

do not possess the requisite qualifications and expertise. The State Corporations Act empowers the President to appoint Chairmen of boards in SOEs,[257] remove board members, revoke appointments and appoint new board members[258] with the implication that the President's word is the law in the management of state corporations. This deprives state corporations of autonomy, thus watering down good corporate governance in SOEs. These discretionary powers includes, providing an agenda of what to be discussed during the board meetings. Under the Exchequer and Audit Act, the President had powers to exempt SOE from the provisions of the SCA.

There are no clear guidelines on academic and professional qualifications in the selection and appointment process of members to these boards. This creates an opportunity for Ministers to make board appointments based on political allegiance, ethnicity and nepotism. This leaves out ethnic diversity in board appointments considering that Kenya is composed of forty-two tribes. It also undermines the efficiency of the boards as the requisite expertise and experience is never taken into account while appointing persons to these boards. Furthermore, whereas the government is the major shareholder in SOEs, it has a legitimate right to influence appointment of SOE, however the scope and extent of the influence has been excessive, which calls for some limitations.[259]

The second question with regard to other factors that have contributed to poor performance and corporate governance, it has been demonstrated that extraneous factors such as political patronage, ethnicity and corruption have been in play in the appointment of board members. This is an off shoot of the President wielding too much discretionary powers which he uses to appoint

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[257] See Section 6 of the SCA.
[258] See Section 7 (2) of the SCA.
[259] Ouko op cit at 84.

his political cronies, members of his ethnic community. Appointments of this nature do not add much value to SOE, which explains why many SOE have been afflicted with corruption.

As discussed in the preceding chapters, SOEs have over the years been run and managed on very weak corporate governance structures. This has affected their ability to effectively meet the mandate for which they were so established. An ineffective BOD leads to the collapse of SOEs.[260] In Kenya, little is known about the criteria of appointment to state corporations' boards, as no information is provided to the public on the processes and procedure used in filling up positions on the boards.

The third question relates to the reforms envisaged to improve the performance and corporate governance of SOE. The project examined international best practices in corporate governance that are relevant to the composition and appointment of SOE heads and board members, in Kenya. These international best practices have lessons on how Kenya can integrate them into the governance of SOE.

The new Constitution heralds a new dawn that is envisaged to reshape the legal and regulatory framework governing appointment and removal of BOD and chief executives in SOE. 75 percent of the respondents are of the view that full implementation of Constitution will herald good corporate governance of SOE in Kenya. This is so because among other things, the President's excessive powers over creation of SOEs, appointment and removal of members of the BOD under the law will be removed. This includes the power to issue directives to boards and to

[260] The Collapse of Uchumi Supermarkets op cit note 150.

appoint chief executives. The Constitution requires that all appointments to SOE boards must be based on fair competition and merit.[261]

Ministers (Cabinet Secretaries) will now have to be accountable to the public in all appointments made, including giving Parliament the power to vet all Presidential appointments.[262] These two provisions constitute a radical departure from the current mode of appointments as outlined in chapter two. The irregular appointment of directors responsible for the collapse of SOEs, and later appointed to other directorships and the cabinet witnessed in the past will not recur.[263] This is a demonstration that, board composition and independence will form important pillars of corporate governance reforms. [264]

Kenyan citizens, are the real owners, on whose behalf the government manages SOEs. These representatives should be accountable through various control mechanisms in the same way managers in private companies are accountable to their shareholders. The purpose of the control mechanisms is to ensure the efficiency of the SOEs. These control mechanisms include the national legislature, the line Ministry responsible for the SOE, the Ministry of Finance, and control agencies which are all charged by law to see to it that SOEs do not run consistent losses and fail to accomplish their objectives. However, the control and accountability mechanism can become a 'bureaucratic bottleneck' unless there is political commitment on the part of the government to ensure efficiency.[265]

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[261] Article 232 (g), Constitution of Kenya 2010.
[262] Ibid. Article 132 (2).
[263] Ibid. Article 75.
[264] Vagliasindi op cit note 78 at 16.
[265] Mogaka op cit note 99 at 85.

In conclusion, the study lays down some recommendations that if implemented could mitigate the problems ailing SOEs and especially those arising from irregular appointments of heads of BOD to SOEs.

6.2 RECOMMENDATIONS

6.2.1. Legislation to consolidate and harmonize laws in the appointment process

Although the principal Statute governing appointments to the BOD of SOE is the Sate Corporations Act, 1987 (Cap. 446) there exists a plethora of other laws, Orders, regulation and Circulars that come into play. This in turn creates loopholes which have been exploited with ease by the appointing authorities. Owing to this problem, I would strongly recommend that there be enacted legislation to consolidate and harmonize all laws pertaining to SOE so as to seal the existing loopholes in the appointment process. There is a greater need for a more open process that displays a high degree of independence to ensure merit based appointments through the establishment of a well structured and transparent board nomination process. In addition, there is need to establish and codify clear guidelines on the establishment of state corporations and appointment of heads and boards of SOEs. This would facilitate the elimination of political considerations in making appointments to boards of SOEs, since such considerations occasionally override merit, suitability and experience in the selection of board members and Chief Executives.

6.2.2. Amendment of all laws that regulate SOE

There is a need to amend all the laws that currently regulate SOE, because they overlap with one another besides having conflicting provisions. Why this becomes necessary is that the existing

laws allow for the Executive to interfere in the management of Public Enterprises. Section 6 of the State Corporations Act gives the President unlimited powers to appoint anybody to be a chairman and or a director of a SOE. These powers have opened floodgates for further interference that come in other forms, under Section 2 (b) of the State Corporations Act; the President has the power to declare a Public Enterprises to cease being one for the purposes of the Act. This provision has been misused to exempt SOE from the provisions of the Exchequer and Audit Act, which in effect removes it from any audit process. The Exchequer and Audit Act has vested the audit of state corporations in an unconstitutional office of the Auditor General-Corporations which is a department of Treasury that lacks finances, staff, independence and the security of tenure necessary to perform its duties.

6.2.3. De-politicization of the appointment process

In order to improve not only the performance of SOE and there corporate governance, there is the need to depoliticize the appointment process of members of the BOD of SOE. The wastage of resources, misappropriation of funds and corruption is linked to the lack of accountability to the populace from those who hold political power.[266] This qualifies the saying that power corrupts but absolute power corrupts absolutely. The ills of corruption, misappropriation of funds and abuse of office by Public Enterprises heads grew in leaps and bounds in tandem with the concentration of power in the presidency.[267] The unfettered power in the Executive created an environment where corruption in SOE grew to monstrous proportions.

6.2.4. SOE to be peer reviewed by ICPSK on corporate governance principles in appointment and removal of BOD

[266] Centre for Corporate Governance Development, op cit note 4 at 25.
[267] Ibid.

There is need for SOEs to embrace the award scheme that the Institute of Certified Public Secretaries of Kenya (ICPSK) introduced in 2010. The purpose of the scheme is to give recognition to organizations that practice and apply good corporate governance practices. The scheme will mainly focus on the BOD as that is where decisions are made.[268] Among the qualification criteria is the level of independence of the board which showed that "most Companies lack board independence and governance is wanting at such institutions."[269]

6.2.5. Full implementation of the Constitution

Full implementation of the Constitution is envisaged to improve the performance of SOE and corporate governance. The new Constitution has provisions that touch on the appointment of state officers that if fully implemented would correct the maladies experienced in the appointment and removal of BOD. Chapter 6, of the Constitution will ensure that only persons of impeccable integrity will hold elective and appointive office. This is in addition to Article 232, which has attempted to codify corporate governance principles of integrity, transparency and accountability and diversity the appointment process. That notwithstanding, Article 27 (8) envisages gender mainstreaming of the BOD.

The linkage between poor politics and poor performance is not difficult to fathom. Thus cleaning up of the politics of the country is bound to improve the governance of SOE. This is because many of the ills affecting public enterprises has largely been blamed on the desire of politicians to not only retain political power, but use SOE as institutions to employ their political supporters and dispense patronage.

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[268] Jackson Okoth, 'Poor Governance Hurts State Corporations', *The Standard* (August 3, 2010) p. 13.
[269] Comments attributed to Joe Mwangi, the Chairman of Institute of Certified Public Secretaries of Kenya (ICPSK).

Appendix 1: Letter of Introduction

Elijah Ireri

P.O. Box 325-00100

Nairobi, KENYA.

10th July 2012

Dear Respondent,

RE: INTERVIEW FOR RESEARCH PURPOSES

I am a Master's student at the University of Nairobi, Parklands Campus doing my final year. Am carrying out a Research study in the area of appointment of board of directors in state owned enterprises in Kenya in partial fulfilment of requirements for **an award of LL.M Degree of the University of Nairobi.**

The aim of this survey is to provide insight into the manner in which appointments to boards of state corporations in Kenya are made and whether such appointments are in line with the law governing the same. The results of this survey will inform reform proposals for a stricter regulatory framework on the appointment of boards of directors in state corporations. This will eventually lead to a transparent and competitive appointment process to these positions with the consequence of revolutionizing the running of state corporations in Kenya.

I will appreciate if you assist in this discourse by completing a questionnaire, which covers certain aspects of this topic, to the best of your knowledge. Rest assured that any information provided will be handled with the highest tenable level of confidentiality.

You are free to discontinue participation at any time or decline to answer particular questions. I

am available for any clarifications on this project.

Yours sincerely,

Elijah Ireri

0717 870251

Appendix 2: Questionnaire

QUESTIONNAIRE

SURVEY QUESTIONNAIRE

WHETHER THE MODE OF APPOINTMENT OF BOARDS OF DIRECTORS TO STATE CORPORATIONS IN KENYA CONTRIBUTE TO THEIR POOR PERFORMANCE

I hereby invite and encourage you to participate in a survey on the appointment of boards of directors in state corporations in our country.

The aim of this survey is to provide insight into the manner in which appointments to boards of state corporations in Kenya are made and whether such appointments are in line with the law governing the same. The survey will seek to investigate whether diversity in terms of skills, experience and gender, is incorporated while making the appointments to boards of SOE. The results of this survey will inform reform proposals on a stricter regulatory framework on the appointment of CEOs and boards of directors in state corporations. This will eventually lead to a transparent and competitive appointment process to these positions with the consequence of revolutionizing the running of state corporations in Kenya. I guarantee that any data collected

will be treated in strict confidence and will not be directly referenced in an oral or written report.

GENERAL INFORMATION

What is your occupation?

- Corporate Governance Expert
- Skilled Professional
- Lawyer
- Human Resource Expert
- Member of a State Corporation Board

Please put a mark (a tick or a dot) on the option that in your opinion best suits an answer to the questions asked.

1. The process of the appointment of board of directors to state corporations in Kenya is publicized?

Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
◯	◯	◯	◯	◯

2. The appointment of members to state corporations' boards in Kenya is competitive

Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
◯	◯	◯	◯	◯

3. Consideration of diversity such as gender balance on boards of state corporations in Kenya could improve their performance

Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
◯	◯	◯	◯	◯

4. The board of directors in state owned corporations in Kenya possess the requisite qualifications and expertise to sit on that particular board

Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
◯	◯	◯	◯	◯

5. The training of new board members appointed to state corporations in Kenya is important as a means of improving their performance in the state corporations they serve

Strongly Disagree **Disagree** **Neutral** **Agree** **Strongly Agree**

6. Persons sitting on boards of state corporations in Kenya should sign performance contracts

Strongly Disagree **Disagree** **Neutral** **Agree** **Strongly Agree**

7. Whether diversity in appointment of board members will improve performance

Strongly Disagree **Disagree** **Neutral** **Agree** **Strongly Agree**

8. The new Constitution as promulgated in the year 2010 will have an effect on the performance of boards of directors of state corporations in Kenya

Strongly Disagree **Disagree** **Neutral** **Agree** **Strongly Agree**

9. Any other comments/explanations

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