

**HYBRID GOVERNANCE OF COMMERCIAL STATE CORPORATIONS IN KENYA:
A BALANCING ACT BETWEEN ENTERPRISE AND GOVERNMENT**

**A THESIS SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR
THE DEGREE OF MASTER OF LAWS (LLM), UNIVERSITY OF NAIROBI, KENYA**

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Declaration

I, **MANDUKU STANLEY KERANDI** declare that this Thesis is my own original work and that it has not been submitted for examination for the award of a degree at any other university.

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This Thesis has been submitted for examination with my approval as University Supervisor.

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Dedication

To My wife Divine and daughters Tracey and Nissy

Acknowledgement

This paper would not have been possible without the able supervision of Mr. Richard Kariuki. His knowledge and interest in the subject helped shape this thesis to what it is.

Secondly, I wish to thank my wife, Divine, for her sacrifice and support during the course of my studies.

Thirdly, I am grateful to my colleagues at the Kenya Pipeline Company Limited for their support and useful suggestions and criticism

Be that as it may, I take sole responsibility for any shortcomings in this thesis.

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4. Ethics and Anti-Corruption Act no. 22 of 2012
5. National Cohesion and Integration Act, Act No. 12 of 2008
6. Public Audit Act, Cap 412A Laws of Kenya.
7. Public Finance Management Act, Cap 182 Laws of Kenya
8. Public Officer Ethics Act, Cap 183 Laws of Kenya
9. Public Procurement and Disposal Act, Cap 412C Laws of Kenya
10. Salaries and Remunerations Act, Cap 5F Laws of Kenya.
11. State Corporations Act, Cap 446 Laws of Kenya
12. The Constitution of Kenya 2010
13. The Public Procurement and Disposal Regulations, 2006.

List of Cases

1. Employment and Labour Relations Court of Kenya at Nairobi, Petition no.30 of 2014, the Kenya Union of Commercial Food and Allied Workers vs. Salaries and Remuneration Commission, the Hon Attorney General *Exparte* National Social Security Fund.

CHAPTER ONE: HYBRID GOVERNANCE OF COMMERCIAL STATE CORPORATIONS IN KENYA: A BALANCING ACT BETWEEN ENTERPRISE AND GOVERNMENT

1.0 Background

A commercial state corporation, otherwise known as a: state-owned company, state-owned entity, state enterprise, publicly owned corporation, government business enterprise, government-owned corporation, commercial government agency, public sector undertaking, or Parastatal is a legal entity that undertakes specified activities and objectives on behalf of an owner government. For the purposes of this study “commercial state corporations” will be used.

Governments engage in business across the globe in order to provide a subsidized commercialized option to their citizens and continue to deliver critical services in important economic sectors such as utilities, finance, and natural resources. Even in competitive industries, enterprises in large-scale manufacturing and services remain in state hands in many countries.¹ Despite the trend toward privatization over the past 20 years, commercial state corporations are still significant economic players. Globally, State corporations account for 20 percent of investment, 5 percent of employment, and up to 40 percent of output in some countries.² They continue to deliver critical services in important economic sectors such as utilities, finance, and natural resources. Even in competitive industries, enterprises in large-scale manufacturing and services remain in state hands in many countries.³ Upon independence Kenya adopted the philosophy of African Socialism which can be described as an African political and economic

¹ World Bank and Development Research Center of the State Council. 2013. *China 2030: Building a Modern, Harmonious, and Creative Society*. Washington, DC: World Bank and Development Research Center.

² Abubakar, Ir. Mustafa. 2010. “Ministry of State-Owned Enterprises, Indonesia: Towards World Class Corporations.” *Medan Merdeka Selatan No.13*, 29 September 2010, Jakarta, Indonesia.

³ World Bank and Development Research Center of the State Council. 2013. *China 2030: Building a Modern, Harmonious, and Creative Society*. Washington, DC: World Bank and Development Research Center.

system.⁴ The aims of the philosophy was to ensure equal opportunities for all citizens; provide democracy; ensure that resources are used for the benefit of the Kenyan people; to encourage various forms of ownership of property and to promote freedom of conscience and human dignity.⁵ Under African Socialism, the power to control resource use resides with the State.⁶ The blue print further provided that the Government needed a fair share of control of national assets for the good of the people. In order to control effectively, many types and degrees of control were necessary ranging from control of a few variables such as prices or quantities, to absolute control represented by State ownership and operations.⁷ This can be said to be the philosophical foundation of the formation of commercial state corporations in Kenya. Unlike in the past, such business entities have come under scrutiny and immense pressure to improve their performance. There is ardent need for them to enhance their competitiveness and that of the economy as a whole. Commercial state corporations, compared with private sector companies, face distinct compliance challenges that directly affect their performance. A useful lens through which to view these differences is the classic distinction between the interests of a firm's owner (its principal) and its managers (the agents). In any principal-agent relationship, the principal confronts two distinct tasks; to set the goals that the agent is to pursue and to manage the moral hazard problems associated with delegation of responsibility to an agent whose private incentives are likely to differ from those of the principal. For private companies, the goal-setting challenge is relatively straightforward; the primary goal of owners is to achieve the best financial performance. Consequently, much of the focus of private sector corporate governance is to align the incentives of managers with those of the enterprise's owners and stakeholders.

⁴ Sessional Paper No. 10 of 1965 on African Socialism and its Application to Economic Development.

⁵ *ibid*

⁶ Clause 31 of the Sessional Paper No. 10 of 1965 on African Socialism and its Application to Planning.

⁷ *Ibid* at Clause 32.

The same cannot be said of commercial state corporations. These entities face many challenges of aligning the incentives of managers and owners.⁸ The Boards and management are not free to take the initiative to balance the foregoing interests. For instance, the remuneration and bonuses of staff of commercial state corporations is now controlled and dictated upon by the Salaries and Remuneration Commission (SRC), a Constitutional Commission.⁹ SRC's policy on managing the wage bill for the country does not take into cognizance the fact that commercial state corporation managers need to be remunerated differently as an incentive to perform.

For the commercial state corporations, the many governance practices contained in the various statutes are mandatory under the law. Failure to comply with these provisions attracts sanctions most of which are criminal in nature. The same cannot be said of the private sector. Private sector compliance areas are contained in nonbinding corporate governance codes, where the company is simply required to explain the reasons for the lack of compliance with the recommendations in the code ("comply or explain"). Such compliances for commercial state corporations are cumbersome and expensive to service delivery.

Apart from weak shareholder and stakeholder protection, many commercial state corporations have minority shareholders. Like other controlling shareholders in any business, the State may ignore minority rights, including carrying out transactions that are geared towards achieving what is contained in the ruling party's manifesto at the expense of outside shareholders and sound business practices.

⁸ Robinett, David. 2006. "Held by the Visible Hand: The Challenge of SOE Corporate Governance for Emerging Markets." Working Paper 37711, World Bank, Washington, DC.

⁹ Article 230 of the Constitution of Kenya, 2010

Besides the Government, commercial state corporations also often have a number of stakeholders, who include employees, consumers, and state-owned creditors. Balancing their competing interests can be a challenge for managers of these entities. Moreover, unlike private sector, commercial state corporations have other powerful stakeholders such as civil society (lobbyists), local communities, and the public at large whose interests are diverse. The donor community, otherwise known as development partners, imposes on Governments various conditions to be implemented by all state agencies including commercial state corporations. Some of these conditions are not favourable to business enterprises.¹⁰

1.1 Background of the study

Commercial state corporations in Kenya continue to underperform, with high economic and financial losses creating opportunity costs for the wider economy. We posit that the main reason why these corporations underperform is because of the requirement to comply with a myriad of governance instruments and Statutes at a considerable expense. These requirements not only limit the exercise of discretion by business managers but also create risk averseness among them. The fear of contravening these laws is as a result of the ensuing criminal sanctions. Further, there is a very fluid definition of offences like corruption, abuse of offices and other related offences. Some of the actions that are prohibited by the governance statutes are perfectly in order in a commercial arrangement. This scenario creates a situation where the commercial state corporation managers are unable to have a clear demarcation between what is allowed and what is prohibited. For instance, talent search through the practice of head hunting can be deemed to

¹⁰ Akitoby, Bernardin, Richard Hemming, and Gerd Schwartz. 2007. Public Investment and Public Private Partnerships. Economic Issues 40. Washington, DC: International Monetary Fund.

be an act of abuse of office if done by a commercial state corporation while for private business entities it is perfectly in order.

Past efforts at reform have made it clear that the poor performance of commercial state corporations, where it occurs, is caused less by exogenous or sector-specific problems than by fundamental problems in their governance such as underlying rules, processes, and institutions that govern the relationship between managers of commercial state corporations and their government owners. Commercial state corporations in Kenya are expected to undergo vigorous statute compliance stages and comply with directives from government as the owner and this creates inefficiencies in terms of their operational autonomy.

Moreover, the State frequently exercises its ownership responsibilities through multiple actors such as line ministries, the Ministry of Finance, and a number of other government bodies. As a result, conflicts between the state's ownership functions and its policymaking and regulatory functions do arise. Such conflicts leave the company vulnerable to being used to achieve short-term political goals to the detriment of its efficiency. In carrying out its ownership functions, the State often sets inconsistent goals, fails to monitor company performance closely, and cannot supply sufficient capital. The ever lingering threat of prosecution for non-compliance with political directives that are not cost effective and sound for businesses, make managers in commercial state corporations in Kenya inefficient.

In the absence of clear legal frameworks or the proper implementation of laws and regulations, the State also often assumes functions that should be carried out by the Board, such as appointing and dismissing the Chief Executive Officer and approving budgets and investment plans. This

provides scope for political interference and inconsistencies in direction and approach and opens opportunities for corruption.¹¹

In fact, a Kenyan commercial state corporation today is subjected to a myriad of governance instruments. These include the Government economic blue print, Vision 2030, the Constitution, various governance statutes, government policies and Executive Orders. The entities are also expected to adhere to government circulars, guidelines, Board charters, codes of conduct and the best tenets of corporate governance. A clearly defined legal and regulatory framework for commercial state corporations is essential for communicating key expectations to shareholders, Boards, management, and all other stakeholders, including the general public.

The underlying aim of such a framework is to make the broad policy directions of the State and the “rules of the game” for everyone involved in enterprise clear. Epitomized by predictable, open and enlightened policy-making, corporate governance in commercial state corporations become a bureaucracy. This bureaucracy seeks to enhance public good, the rule of law, hybrid transparent processes which conflicts with entrepreneurship that only focuses on positive economic dimension.¹²

Many commercial state corporations, for a long time now are plagued with a divergence of political interests between ownership (by the government on behalf of the citizens of the country) and control (by the directors and managers that run the company). These governance challenges can include complicated and at times contradictory mandates. The absence of clearly identifiable owners, politicized boards and management, lack of autonomy in day-to-day operational

¹¹ UNCTAD (United Nations Conference on Trade and Development). 2007. World Investment Report 2007: Transnational Corporations, Extractive Industries and Development. Geneva: UNCTAD.

¹² Barasa, F. O. (2013). Ethnicity: Reflecting on the Challenges and Opportunities in Kenya. In: International Journal of Professional Practice, 4(1&2), 26-38.

decision making complicates the situation.¹³ Moreover, laws on public procurement for commercial state corporations need an urgent overhaul. These laws are lengthy and cumbersome and a cause of inefficient application of financial resources.

The Public Procurement and Disposal Act¹⁴ was enacted to arguably maximise economy and efficiency; to promote competition and ensure that competitors are treated fairly; to promote integrity and fairness; to increase transparency and accountability in procurement procedures; to increase public confidence in those procedures and to facilitate the promotion of local industry and economic development.¹⁵ The Act was also meant to guard against corruption and misuse of public funds. The parameters for implementation of such rules in commercial state entities are unclear and pose a constraint on the ability of these corporations to operate and invest in a timely manner to outdo the competition from private enterprises. Complex, time consuming procedures that are not commercially oriented can have a significant negative impact, especially when these entities are purchasing commodities from world markets where speed and flexibility are paramount.

When institutions are weak and monitoring is lax, procurement procedures in government agencies provides scope for corruption. Thus, a careful assessment of the procurement regulations and practices of commercial state corporations should be carried out since any inefficiency will directly affect their governance arrangements and their ability to procure in an efficient, timely, and transparent manner. The weaknesses can then be addressed by either enacting separate procurement laws for commercial state corporations or through improvements in the existing procurement law. In formulating such laws, cognizance should be taken of the fact

¹³ Cooksey, B, A. Mullei & G. Mwabu. (2000). Forms and Causes of Corruption. In: Mullei, A (ed). The Link between Corruption and Poverty: Lessons from Kenya Case Studies. Nairobi: African Center for Economic Growth.

¹⁴ Act No.3 of 2005

¹⁵ Section 2 of the Public Procurement and Disposal Act 2005

that the State may also favour commercial state corporations in procurement contracts, creating a different kind of market distortion in countries where public procurement accounts for a significant fraction of economic activity. Notwithstanding the care exercised by many public authorities in designing competitive tenders in the effort of preventing public officers from benefiting from the process, distortions frequently arise in both design and implementation. This results in long processes that have no cost benefit, occasionally paralyzing the operations of the state corporation.

Some countries, such as the United Kingdom, have specifically addressed competitive neutrality in procurement contracts through a set of principles of competition put together after consultation with stakeholders. Recently, efforts have been made to analyze the merits of the procurement process including cost benefit analysis with a view to identify the characteristics that a competitively neutral procurement policy should have.

Other than the public procurement law, commercial state corporations are subject to a host of other governance statutes. These include their respective constitutive statutes, such as the Companies Act¹⁶ or their individual statutes for those that are Statutory in nature like the Kenya Airports Authority Act. Other governance statutes include the State Corporations Act,¹⁷ the Public Officers Ethics Act,¹⁸ the Anti-Corruption and Economic Crimes Act,¹⁹ the Leadership and Integrity Act,²⁰ the Public Finance Management Act,²¹ and Public Audit Act,²² among others.

¹⁶ Cap.486 of the Laws of Kenya

¹⁷ Cap.446 of the Laws of Kenya

¹⁸ Act No.4 of 2003

¹⁹ Act No.3 of 2003

²⁰ Act No.19 of 2012

²¹ Act No.18 of 2012

The Constitution of Kenya, 2010 has set up a number of independent Commissions which provide an additional accounting mechanism for commercial state corporations. Such Commissions include the National Gender and Equality Commission, the Commission on Administrative Justice (Ombudsman), the Salaries and Remuneration Commission, the Ethics and Anti-Corruption Commission, the Office of the Auditor-General, the Office of the Attorney General and the National Cohesion and Integration Commission. The role of these Commissions is arguably to protect the sovereignty of the people and to secure the observance by all the state corporations of the national values and principles set out in Article 10 and 232 of the Constitution including accountability and transparency. These Commissions, although important for a harmonized service delivery to the public, introduce additional bottlenecks in the management of commercial state corporations as commercial entities. The various compliances required by these offices and Commissions are costly to comply with and create inefficiencies for businesses. The same have increased procedural bureaucratic systems which are time consuming and expensive. We shall seek to argue that these Commissions and independent offices have contributed to the stagnation of operations in commercial state corporations.

1.2 Statement of Problem

The success and goodwill of any renowned corporation anywhere in the world, is rooted in its corporate governance practices. Similarly, the high level of public accountability expected and which applies to state-owned corporations makes its corporate governance very important as it has to be managed on behalf of the ultimate owner; the shareholder and citizen depending on the nature of the corporation. The need for proper governance of the state corporation for the ultimate benefit of diluted interest has quintessensed creation of myriad laws and regulatory

²² Cap.412A f the Laws of kenya

frameworks. However, these numerous laws have made it cumbersome for the state corporations to compete with the private enterprises which are only guided the Company Act and Tax laws. This is true in Kenya as state corporations are bogged-down by low performance owing to ineffective governance legal regimes. Thus, the study seeks to establish the extent to which these numerous laws have affected the performance of state-owned corporations with a view of recommending reforms to these myriad laws.

1.3 Aims and Objectives

1.3.1 Main Objective

This study aims at establishing the legal framework for hybrid governance of commercial state corporations in Kenya by offering a balance between enterprise and government.

1.3.2 Specific Objectives

1. To establish the effect of lack of clear, overlap of and conflicting roles of state owned commercial corporations in Kenya on their performance;
2. To determine how multiple legal and regulatory frameworks create significant ownership and oversight challenges for state corporations in Kenya;
3. To interrogate the various legal and institutional frameworks that affect the management of commercial state corporations; and,
4. To make a case for legal reform in the management of commercial state corporations.

1.4 Research Questions

The study aims to present the impact of legislative responsiveness for effective corporate governance of commercial state corporations. The following five related questions will be addressed:

1. How does lack of clear, overlap of and conflicting roles of state owned commercial corporations in Kenya affect their performance;
2. What are the ownership and oversight challenges created by multiple legal and regulatory frameworks governing state owned commercial corporations in Kenya?
3. What are the various legal and institutional frameworks that affect the management of commercial state corporations;
4. What legal reforms should be undertaken by the Government in Kenya in the management of commercial state corporations?

1.5 Hypothesis

It is the hypothesis of this study that the legal and institutional framework that commercial state corporations in Kenya are subjected to negatively affect their performance as business entities.

1.6 Justification of the Study

The Kenyan government has to take a proactive role to ensure that opportunities for public investment are well identified and explored. However, the highly politicized Boards and Management of commercial state corporations often lack a board of directors with the independent autonomy to perform the classic corporate governance roles, to guide strategy, oversee management, and ensure a robust internal control system. Such boards' decisions and management action have to be implemented under the purview of a myriad of governance

statutes and policies which are not only costly but also time consuming. Indeed commercial state corporation boards often represent different stakeholders, all of whom may have agendas that conflict with the interest of the company as an enterprise and invariably interfere with commercial decision making.

Moreover, commercial state corporation boards may act purely as a “rubber stamp” for government decision making, exercising no oversight over managers (who in practice report directly to the government). Board members are often government employees without experience in managing companies and the independent directors are appointed for political reasons rather than on the basis of technical and financial expertise. Truly independent directors are usually underrepresented on the board, and, where they do serve on boards, their independence is often called into question. Board-level committee structures are nascent, and board expertise in important areas such as audit and risk management remains weak in many commercial state corporations.

1.7 Significance of the Study

The study is significant in the sense that it is being undertaken when the country is engrossed in a debate about the level of transparency and accountability in the country’s commercial state corporations. A growing body of knowledge and the many practical reform experiences have unfolded in recent years, both in OECD countries and in emerging states. These show that while many technocratic solutions are available, implementation is not an easy task. Corporate governance reforms in commercial state corporations can be legally and politically challenging.

Entrenched groups may oppose reforms or find ways to resist them. The wide range of political and institutional circumstances in different countries, as well as differences between sectors and

types of commercial state corporations, means that there can be no one-size-fits-all approach to reform.

This research is aimed at contributing not only to the knowledge about a hybrid corporate governance structure but also recommending a legislative framework which is more practical for governing commercial state corporations in the current constitutional order.

1.8 Theoretical and Conceptual Framework

The study will examine the agency theory, among others. Though the theory has existed for long, the succinct postulations were developed in the late 1960s and early 1970s as a theoretical approach to the risk sharing problems among individuals and groups and their attitude or approach towards risks; that is, parties in contractual relationships have conflicting and different goals and visions. Among the contributors to the theory are Michael Jensen, Harold Demsetz and Armen Alchian.²³ Developed from contract theory, agency theory posits that corporations and firms are a nexus of contract between resource holders and such relationship is effected when the holders of resources who are the principals (shareholders or public) entrust individuals (agents) to perform functions or service on their behalf and fully hand-over decision-making function to them.²⁴

However, this relationship is not necessarily harmonious. Also known as the principal-agent model, the theory hypothesizes that under conditions of information asymmetry and uncertainty (incomplete information), agency problems are inevitable: moral hazards and adverse

²³ Jensen, Michael C., & William H. Meckling., 'Theory of the Firm, Managerial Behavior, Agency Costs, and Ownership Structure' (1976) *Journal of Financial Economics* 3, 305.

²⁴ Fama, Eugene, and Michael Jensen, 'Agency Problems and Residual Claims' (1983) *Journal of Law and Economics* 26, 327

selection.²⁵ While the former is a state where the principal cannot ascertain if the agent has exhausted or put forth his best effort, the latter is a situation in which the principal cannot determine if the agent has truthfully represented his ability to accomplish the work which he is remunerated to do.²⁶ Eisenhardt described this as a problem where “the desires or goals of the principal and agent conflict. [Thus,] it’s difficult or expensive for the principal to verify what the agent is actually doing... [or that] the agent has behaved appropriately”.²⁷

The theory, thus, seeks to determine the most efficient contractual terms which will minimize the principal-agent problem given the assumption that: people are “self-interest, bounded rationality, risk aversion by nature”; organizations are characterized with goal conflict between and among members; and, information is a “commodity that can be purchased”.²⁸ The agency theory holds that under the likelihood of adverse selection or moral hazards, fixed remuneration does not motivate the agent but variable remuneration based on residual claimancy on the corporations’ performance by way of bonuses or profits would.

The study will also appraise the stakeholder theory which deviates from the postulations of agency theory. Its underpinnings are derived from the importance of a corporation paying special attention to the various stakeholder groups in addition to the traditional attention given to investors.²⁹ That is, organizations serve broader community interests besides the maximization of shareholders’ wealth.³⁰ The theory opines that corporations’ actions affect various stakeholders

²⁵ Eisenhardt, Kathleen M., ‘Agency Theory: An Assessment and Review’ (1989) *Academy of management Review*, 14(1), 57

²⁶ Eisenhardt, K. M., ‘Control: Organizational and economic approaches’ (1985) *Management Science*, 31(2), 134.

²⁷ Supra note 49 P58

²⁸ Supra note 49 P58

²⁹ Gibson, K., ‘The moral basis of stakeholder theory’, (2000) *Journal of Business Ethics*, 26 245

³⁰ Mulili, Benjamin Mwanzia ‘Corporate Governance Practices in Developing Countries: The Case for Kenya’ (2011) *International Journal of Business Administration*, 2(1), 14.

and their success can be gauged from their ability to add value to all these stakeholders.³¹ These various groups of stakeholders such as customers, the business environment, suppliers, employees, the local community and shareholders are all deemed to have a stake in the business of a corporation. Thus, a corporation does not only have moral right, but legal obligation to serve these stakeholders well as they are all instrumental to its success.³² This gives light to the concept of corporate social responsibility.

When these stakeholders are satisfied, they are motivated to return to the corporation for more. As a result, corporations should consider claims of stakeholders in their decisions and conduct their business responsibly mindful of the various stakeholders.³³ Proponents of the stakeholder theory, thus, argue for representation of all stakeholder groups on boards for effective governance, reduction of conflicts and increase in efficiency.³⁴

John and Senbet argue that certain actions of management might have conflicting effects on various classes of stakeholders.³⁵ This implies that managers have a multiplicity of objective functions to optimize. Corporations should therefore adopt a proactive rather than reactive approach when integrating its decisions with stakeholders' interests.³⁶ Currall and Epstein

³¹ Dunphy, D., Griffiths, A., & Benn, S., *Organizational Change for corporate sustainability* (London: Routledge, 2003).

³² Ulrich, P., *Integrative Economic Ethics: Foundations of a Civilized Market Economy*, (Cambridge: Cambridge University Press, 2008).

³³ Manville, B. & Ober, J., 'Beyond empowerment: building a company of citizens', (2003) *Harvard Business Review*, 81(1), 48.

³⁴ Rothman, J., & Friedman, V.J., Identity, conflict, and organizational learning, in M.Dierkes, A.B. Antal, J.Child & I. Nonaka (Eds.), '*Handbook of Organizational Learning and Knowledge*', (New York: Oxford University Press, 2001), p 582-97,

³⁵ John K., and Senbet L., 'Corporate Governance and Board Effectiveness', (1998) *Journal of Banking and Finance*, 22, p 387

³⁶ Kaptein, M. & Van Tulder, R., 'Toward effective stakeholder dialogue', (2003) *Business and Society Review*, 108(2), 203

attribute collapse of corporations such as Enron and WorldCom to failure to align their interest with stakeholders'.³⁷

In the stewardship theory, the emphasis is on the executives as stewards and how they can be motivated to act in the best interest of the shareholders as the principals.³⁸ That is, their behavior is aligned to shareholders' objectives. It has gained prominence among scholars since the agency theory does not factor in psychological and sociological interplay in the agent-principal relationship. Stewardship theory is rooted in organizational theory and explains the psychological and sociological mechanisms to explain how agents can be motivated.³⁹ The theory asserts that generally, the executives seek to be good stewards of corporations' assets, not bend to conflict of interest between them and the principals or make surreptitious profits at shareholders' expense.

The theory develops mutual respect, cooperation and trust in the agent-principal relationship which then leads to improved performance.⁴⁰ That is, the shareholders trust the board's discretion in performing their duties and hopes that the directors act in the best interest of the corporation. Stewardship theory posits that the constant motivation for managers (which is financial and most importantly non-financial) is the need to achieve, intrinsic satisfaction from fruitfully performing challenging tasks, exercise of responsibility, authority and power, and in effect gain recognition from peers.⁴¹ Since motivation is intrinsic, the difference in performance level can be attributed to whether the corporate structural situation supports effective action

³⁷ Currall, S.C. & Epstein, M.J., 'The fragility of organizational trust: lessons from the rise and fall of Enron', (2003) *Organizational Dynamics*, 32(2), 193.

³⁸ Donaldson and Davis, 1991

³⁹ Barney 1990

⁴⁰ Tian and Lau, 2001

⁴¹ Davis, Schoorman, Mayer and Tan, 2000

(formulate and implement plans) by the executive.⁴² Structures are “facilitative of this goal to the extent that they provide clear, consistent role expectations and authorize and empower senior management”.⁴³ As such, governance laws are premised on stewardship theory.

The resource dependency theory explains corporations in terms of their interdependence with the environment.⁴⁴ It posits that corporations, just as any other organization, are interdependent with other organizations and their environment for survival. Corporations need resources (material, technological, financial and human), since they are neither self-dependent nor self-directed.⁴⁵ The level of interdependence is based on “availability of resources, control over the allocation of resources and the extent to which those who control those resources develop a monopolistic behavior”.⁴⁶

1.9 Literature Review

The review of pertinent literature for this study presents both theoretical and empirical literature. While state owned corporations have come to play an important economic role, evidence from the 1970s and 1980s from a number of countries shows that, on average, state owned corporations have performed poorly relative to private firms, partly because multiple policy goals proved difficult to reconcile. State owned corporations often incurred substantial financial losses and became an unsustainable burden on the national budget and banking system. Government policies in support of state owned corporations slowed the development of the private sector, crowded out private firms from credit markets, and limited the potential for

⁴² Davis, James H., & Lex Donaldson, ‘Stewardship Theory or Agency Theory: CEO Governance and Shareholder Returns’ (1991) *Australian Journal of Management*, 16(1), 49.

⁴³ Davis, James H., & Lex Donaldson. (1991). P52

⁴⁴ Balta, Maria Elisavet ‘The Impact Of Business Environment And Boards Of Directors On Strategic Decision-Making: A Case Study Of Greek Listed Companies’ (PhD Thesis, Brunel University, Middlesex, 2008).

⁴⁵ *Ibid* pg. 26,

⁴⁶ *Ibid* pg. P28

expansion of the private sector. Since the 1980s, reforms have sought to improve performance by exposing state owned corporations to competition, imposing hard budget constraints, and introducing institutional and managerial changes. Many state owned corporations were commercialized and later corporatized into separate legal entities. In addition, governments developed performance contracts with state owned corporations to monitor performance and hold managers accountable for results.

In their book *Separation of Ownership and Control*, Fama and Jensen recognize the board as the most important control mechanism available because it forms the apex of a firm's internal governance structure.⁴⁷ Michael Jensen in his book, *Governance, Residual Claims and Organizational Forms*, identifies control forces aligns management decisions with those that are optimal from society's standpoint. These are: the legal, political, and regulatory system; the capital markets; the internal control system headed the directors; and, the product and factor markets.⁴⁸ He adds that legal, political and regulatory systems are far too blunt an instrument to effectively handle wasteful managerial behavior. Product and market factors are too slow in acting as control force since, even though the corporations that offer low quality products eventually fizzle out, it often checks in too late.⁴⁹ He further opines that internal control systems, headed by directors, provide early warning system and remedies the situation before difficulties reach a crisis stage. However, the effectiveness of internal control rests with the directors themselves.⁵⁰

⁴⁷ Fama, Eugene, and Michael Jensen, 'Agency Problems and Residual Claims' (1983) *Journal of Law and Economics* 26, 327

⁴⁸ Jensen, M, *A Theory of the Firm: Governance, Residual Claims, and Organizational Forms*, (2000)

⁴⁹ *Ibid*

⁵⁰ *Ibid*

Developing from Fama and Jensen postulations, Macey in studying Governance in Italy, suggested that moral hazards resulting from separation of ownership and control can be corrected through aligning shareholders' interest with executives' interests through compensation plans, stock options, bonus schemes.⁵¹ Macey further suggested that there should be board monitoring by stakeholders and legal protection of minority shareholders from managerial expropriation. In case of state corporations, citizens are considered as minority shareholders owing to the dilution of their stake in such corporations.⁵²

Tomasic and Fu undertook a study on governance in Australia's and China's government-owned companies.⁵³ They established that government-owned companies are often torn between pursuing contradictory goals.⁵⁴ Unlike private corporations whose directors perform their functions in the company's interests as a whole, Parastatals merely serve the interests of one stakeholder group, the politicians: president or ministers.

Miring'u and Muoria conducted a study on the governance in Kenya's state corporations and how it affects their performance.⁵⁵ They established that bureaucracy, wastage, mismanagement, and directors' incompetence and irresponsibility have culminated into state corporations' poor performance. Low of good governance and consequent poor performance led to the Government funding state corporations operations to a tune of 1% of GDP in 1991.

⁵¹Macey, J, Italian Corporate Governance: One American's Perspective, 1998 Columbia Business Law Review 121 (1998)

⁵² Ibid

⁵³ Tomasic & Fu, Government-Owned companies and corporate governance in Australia and China: Beyond Fragmented Governance (2005).

⁵⁴ Ibid

⁵⁵ Miring'u & Muoria, An analysis of the effect of Corporate Governance on Performance of Commercial State Corporations in Kenya, 2011

Tsamenyi, Enninful-Adu and Onumah studied governance in Ghana.⁵⁶ They argue that there is dearth of governance in developing countries. Reasons given for this include, inter alia: weak legal framework, political instability, economic uncertainty, and frequent government intervention. While these issues should make it more necessary for adoption of effective governance structures in developing countries, this is not often the case. The study finds low level of disclosure in Ghana.⁵⁷

Luis Alberto Andrés studied governance structure of state corporations in Latin America.⁵⁸ The study established the need for tailoring governance practices to a corporation's realities. The paper, thus, states:

“[corporations with] partial state ownership, particularly those with significant private sector participation, a governance design reflecting the incentives of private enterprises seems more appropriate. For companies with significant gaps in both performance and management, transparent accountability mechanisms should be considered... those with full state ownership, characterized by good sector performance and management need to strike a balance between private sector orientation and public accountability, i.e. profit maximization behavior and social responsibility appeasing behavior”.

Esther Njiru studied the state corporations in Kenya.⁵⁹ She established that the encumbrances in governance faced by state corporations in Kenya are: politicization, weak supervisory mechanism and prosecution of those in breach of good governance practices. She states that the role of state corporation advisory committee is just advisory instead of monitoring and performance evaluation.⁶⁰ Besides, management decisions are partisan being that the executives are government's appointees. Furthermore, since the CEO is appointed by the president and not

⁵⁶ Mathew Tsamenyi, Shahzad Uddin (2008), Introduction to corporate governance in less developed and emerging economies, in Mathew Tsamenyi, Shahzad Uddin (ed.) *Corporate Governance in Less Developed and Emerging Economies (Research in Accounting in Emerging Economies, Volume 8)* Emerald Group Publishing Limited, pp.1 - 11

⁵⁷ Ibid

⁵⁸ Luis Alberto Andres, Jose Luis Guasch, and Sabastian Lopez Azumendi, *Governance in State-Owned Enterprises Revisited: The Cases of Water and Electricity in Latin America and the Caribbean*, World Bank (2012)

⁵⁹ Njiru, E., *The Role of State Corporations in a Developmental State: The Kenyan Experience*, (October, 2008)

⁶⁰ ibid

the board of directors, the board finds it difficult to control and discipline the CEO. The executive take advantage of the lack of observability of their actions to engage in activities to enhance their personal goals.⁶¹

Mwaura posits that the government has contributed immensely to state corporations' poor performance through appointment of inefficient boards, failure to accord autonomy to such boards, and through overlapping and conflicting regulations.⁶² According to Mwaura, lack of the boards' autonomy negatively impacts on their performance.⁶³ Kamal conducted a study on governance in Indonesia's state corporations and the governance principles conform to the Anglo-American governance regime.⁶⁴ He established that governance guidelines in Indonesia lack relevance as they seek to address governance issues present in publicly traded companies with dispersed and fragmented shareholders instead of state corporations which have government as citizens' representative. Thus, the governance code failed to address critical issues; conflicting objectives and political interference.

Kamal further notes that lack of transparency is a problem for state corporations since they do not disclose important and pertinent information to citizens as the ultimate owners.⁶⁵ The information asymmetry, according to Kamal, is intentionally cultivated by the actual principal (politicians) for their individual pecuniary and political interests.⁶⁶ Citizens, therefore, lack social

⁶¹ Ibid

⁶² Mwaura, K, '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) *Fordham International Law Journal*, 31(1), 73

⁶³ Ibid

⁶⁴ Kamal, M, *Corporate Governance and State-owned Enterprises: A Study of Indonesia's Code of Corporate Governance*, *Journal of International Commercial Law and Technology* Vol. 5, Issue 4 (2010) 206

⁶⁵ Ibid

⁶⁶ Ibid

control of the state corporations. Lack of transparency has, thus, led to poor performance and bad governance of the state corporations.⁶⁷

In assessing the challenges facing South Africa's commercial state corporations, PWC concluded that the strategic role that state owned corporations play in providing services to the citizens makes it imperative for them to be led by suitably qualified and experienced directors and CEOs. However, the government's role in these appointments negatively impact on the execution of their mandate owing to political influence. The government usurps the powers of the board with regards to appointment and dismissal of the CEO, and approval of financial and capital expenditure. Thus, a confluence of these factors confuses the board of directors as to its powers and their execution. Additionally, the setting of performance indicators by the state owned corporation's line ministry is often vague, unclear and uncoordinated. Furthermore, cushioning of the state owned corporations from insolvency makes the management and the board slump into complacency.

According to Zhao, the citizens, the true owners of state corporations, entrust the government with their administrative duties.⁶⁸ Thus, these corporations should ensure they maximize shareholders' (citizens) benefits.⁶⁹ The government and the corporations are never in a principal-agent relationship but an agent-agent one. In reality, the government supervises these corporations and the shareholders (citizens) have no right and never receive fair return. Moreover, owing to the agent-agent relationship, the government rarely exercises oversight responsibilities as an owner leading to their poor performance and bad governance practices.

⁶⁷ Ibid

⁶⁸ Zhao, J, Accounting for the Corporate Cash Increase, State University of New York (SUNY), Stony Brook, Department of Economics, (2014)

⁶⁹ Ibid

Owing to ‘free-rider problem’ whereby state corporations have numerous owner (all citizens), no individual citizen is motivated to monitor the corporations as the benefits would accrue to all owners while cost are borne by the monitor. This warrants a study on what causes the disjoint between governance and constitutional provisions in most countries and Kenya in particular; if application of good governance can only be realized from effective constitutional provisions, what often causes this disjoint and why have countries like Kenya not realized proper governance of its state corporations?

1.10 Research Methodology

The study uses qualitative research methods which provide an opportunity to interact with subjects and express the underlying values which may not otherwise be obvious to an outsider.”

Nick Black has argued that qualitative methods seek deeper truth and aim to study things in their natural setting, attempting to make sense of, or interpret phenomena in terms of the meanings people bring to them.⁷⁰ They also seek to use holistic perspectives which preserve the complexities of human behavior.⁷¹ The use of qualitative methods that give voice to minorities has been suggested to be appropriate, as opposed to survey techniques which tend to be too abstract.

To effectively explore the research questions, a triangulated research strategy is adopted. This strategy is preferred due to the relative ‘newness’ of research into this area in Kenya. The study adopts techniques which have often been used to access hard-to-reach populations. Strauss and Corbin⁷² have remarked that the nature of the research objectives dictates the research methods.

⁷⁰ Nick Black, *Qualitative Research in Health Care*, 3rd Edition, New Delhi, BMJ Books, 2006

⁷¹ Ibid.

⁷² Strauss and Corbin 2001 research methods

The primary method of presentation for this thesis in respect of documentary data is the evaluation, critique and synthesis of previously published information. The presentation method will include a number of elements. Some descriptive or interpretive work will be necessary throughout the thesis, but the primary form will be analytical and critical. Inherent within this approach is also the need to compare various intellectual positions.

Additionally, information obtained from secondary sources, (notably literature drawn from textbooks, peer journals, Commissions of Inquiry reports and/or documents generated by government agencies involved in interventions) is also be used to supplement, corroborate and provide theoretical perspectives for discussing and drawing conclusions along the objectives of the study. The paper also analyses and makes use of relevant case law. Other sources of data, such as web sources, are used in conducting this study.

1.11 Thesis Organization

This thesis will develop along the following lines:

Chapter One: Introduction

This introductory chapter lays the basis for the entire study by giving the background to the problem as well as identifying the problem of the study. It has given the scope, justification, significance as well as the theoretical framework for the study. It has given the hypotheses, the objectives and the research questions that have guided the study. It has also discussed the methodology used and its advantages. It finally outlined the structure of the study.

Chapter Two: Attaining the Balance: A Review of the Gains Made Pursuant to Parastatal Reforms in Kenya

The Chapter will entail critical analysis of the gains made pursuant to Parastatal Reforms in Kenya in the Constitution and appointment of Boards of Directors; Governance, Ethics and Leadership; Shareholder and Stakeholder relationships; Performance Management; and Statutory compliance issues.

Chapter Three: Government versus Enterprise: An appraisal of the Constitutional, Legislative and Regulatory Framework for Management of Commercial State Corporations.

This Chapter will discuss the general overview of Parastatal reforms in Kenya. It will examine the Constitutional framework through which commercial state corporations operate. It will also analyse the various Statutes and Regulations relevant to the management of commercial state corporations among the many compliance areas.

Chapter Four: The *Mwongozo* Code and the Proposed Government Owned Entities Bill, 2014: A New Frontier in the Management of Commercial State Corporations

This Chapter will entail an in-depth analysis of the Executive Order No.7 and the *Mwongozo* Code of Governance of State Corporations as a key output of the findings of the Presidential Taskforce on Parastatal Reforms in so far as it relates to commercial state corporations.

Chapter Five: Conclusion and Recommendations

This chapter will contain a summary of the findings of the study as well as the key recommendations proposed towards achieving effective management of commercial state corporations in Kenya as business concerns.

CHAPTER TWO: ATTAINING THE BALANCE: A REVIEW OF THE GAINS MADE PURSUANT TO PARASTATAL REFORMS IN KENYA

2.0 Introduction

Kenya can be termed as a “developmental state,” a term which is used by political economy scholars to refer to a state which utilizes state-led macro-economic planning.⁷³ This phenomenon was originally used to describe East Asian states in the late 20th Century, including Japan, South Korea and Singapore.⁷⁴ What is common across these countries is that they did not rely solely on free market principles to grow their economies like the United States of America did.⁷⁵ In a nutshell, developmental states are led by the ideology that for economic development and growth, states should promote social development too. By establishing state corporations to perform economic development functions, Kenya took on a developmental function right after independence.

At the time Kenya got her independence in 1963, there was need to establish state corporations in order to meet certain goals. One of the main aims of establishing commercial state corporations was to accelerate the rate of economic development in the country. The other reason, closely related to economic development, was to address economic imbalances in certain regions of Kenya. Apart from facilitating the economic goal, the government saw the need to accelerate social development and to increase citizen participation in the development of the economy. All these desires were expressed in Sessional Paper No.10 of 1965 on African Socialism.

⁷³Njiru, E., “The Role of State Corporations in a Developmental State: The Kenyan Experience,” (October, 2008), p.5

⁷⁴Ibid.

⁷⁵Ibid.

State corporations are created to spearhead economic development in countries all over the world. They perform both commercial and social functions. In Kenya, it is no different. When performing their commercial function, state-owned corporations are able to contribute to the development and acceleration of economic growth.

The reform process in the manner in which commercial state corporations are owned, governed and controlled has always been hinged on economic development. If these enterprises perform well, the result is that the country's economy in general, will benefit. Poor performance of commercial state corporations will have adverse effects on the economy. Finding the best balance in order to enhance the commercial function of these corporations is what the government of Kenya has been grappling with since independence.

At independence, in 1963, state corporations were empowered to become tools for the indigenization and acceleration of Kenya's economic development.⁷⁶ This intention was encapsulated in Sessional paper no.10 of 1965.⁷⁷ Since the adoption of the Sessional Paper no. 10 of 1965 there have been several reforms in the governance, management and control of commercial state corporations. This Chapter examines the reform process and how commercial state corporations have evolved through time.

2.1 Reform process: 1979-1982

The performance of state corporations, in general, has been an issue of concern and has triggered debate over time. In 1979, for instance, a review of how public enterprises were

⁷⁶Ibid.

⁷⁷Sessional Paper no. 10 of 1965, on African Socialism and its Application to Planning in Kenya.

Also available at:[http://siteresources.worldbank.org/INTAFRICA/Resources/257994-1335471959878/Sessional-Paper-No-10-\(1965\).pdf](http://siteresources.worldbank.org/INTAFRICA/Resources/257994-1335471959878/Sessional-Paper-No-10-(1965).pdf) (Accessed on 10th October, 2015)

performing was carried out and a report concluded on the same.⁷⁸ In 1982, the Report of the Working Group on Government Expenditure was completed.⁷⁹ These two reports assessed the state of commercial state corporations and how they were doing in terms of economic development. The conclusions made in the two reports pointed to the lack of efficiency in systems within these corporations, hence making them underperform. There was also evidence of corruption, malpractice, financial waste and financial mismanagement within these enterprises.

According to the 1979 Report,⁸⁰ it appeared that the government had been reduced to a rescuer and an indispensable partner in government investments that had private business persons as promoters. The Report also found that the establishment of too many state corporations posed the danger of politicizing their commercial function in relation to production and distribution.

According to the 1982 Report,⁸¹ the Working Group concluded that while state corporations absorb a huge portion of the national budget, they still underperform and record low productivity. One of the reasons given for the low productivity registered by these corporations was that they have multiple objectives to fulfill hence causing inefficiency and unprofitability. According to the Report of the Working Group, the budget set aside for running these corporations would best be suited for national development if they were left to perform within the private realm. The trend has been that when these joint ventures completely fail, the government, as the majority shareholder, incurs a heavier burden. The tragedy is that failure on

⁷⁸The Report on the Review of Statutory Boards, 1979.

⁷⁹Kenya National Assembly Official Record (Hansard) Mar 15 - Jul 12, 1983

Also available at:

https://books.google.co.ke/books?id=dnYTT8I_RP8C&pg=PA759&lpg=PA759&dq=report+of+working+party+on+Government+Expenditure&source=bl&ots=wbe9_ZN8QE&sig=nCTaQdl1KTnOuv18-CWWCl45v9k&hl=en&sa=X&redir_esc=y#v=onepage&q=report%20of%20working%20party%20on%20Government%20Expenditure&f=false

⁸⁰The Report on the Review of Statutory Boards, 1979

⁸¹ P. Ndegwa et al, Working Party on Government Expenditures, Government Press (1982)

the government's side translates into losses which affects the economy, and, in the long-term, creates a fiscal problem.

Recommendations given in the two reports seemed to lean towards making the government take a back seat in the control of commercial state corporations. The Working Group also suggested that the government should reduce on existing administrative hurdles and bureaucracy to curb corruption and encourage engagement with the private sector.

After the 1979 and 1982 reviews of the public enterprise performance in Kenya, certain measures were introduced in order to ensure that state corporations performed better. The first, and most important of these measures, was the enactment of the State Corporations Act.⁸² The Act was enacted in 1986 in order to introduce some level of streamlining and mainstreaming in the control and management of commercial state corporations.

2.2 1992: Policy paper on Public Enterprise Reforms

During and after the 1970s, it became apparent that the government had taken on too much responsibility and had surpassed the kind of participation it had intended to have in the management of commercial state corporations.⁸³ The period was characterised by increased debt on the part of the national government as the sector continued to deteriorate and register losses. It was also apparent that while intense and active participation of the government in the affairs of state corporations was suitable to kick-start them at independence, changing times required reduced interference to enable commercial state corporations to effectively carry out their commercial function.

⁸²Cap 446, Laws of Kenya.

⁸³Muindi, S, 'Public Enterprises in Reform and Privatisation in Kenya,' (1982), pg.1.

Available at:<http://unpan1.un.org/intradoc/groups/public/documents/AAPAM/UNPAN028231.pdf>(Accessed on October 8, 2015).

The Policy Paper on Public Enterprise Reforms was significant in that it introduced the move to privatize commercial state corporations to improve on their profitability.⁸⁴ The idea of privatization was not new, as it was first suggested by the Working Party on Public Expenditure back in 1979. The Report of the Working Party had clear findings on how the government was losing money off the national budget yet there were serious deficiencies in the performance of commercial state corporations at the time. The Report had even proposed that a series of reforms be put in place to reduce the role of commercial state corporations, and instead, promoting active private sector engagement.

2.3 2003-2007: Economic Recovery Strategy for Wealth and Employment Creation (ERS)

The ERS was hinged on three important pillars, one, growth and macroeconomic stability, two, equity and poverty reduction, and lastly, improvement of governance.⁸⁵ The reason behind choosing these three pillars was to bring Kenya's economy out of recession and to start the journey towards an economy that was equitable and underpinned by maximum efficiency in the delivery of public services.

Within the implementation period of the ERS, Kenya experienced significant growth and development in her economy. The four and a half years were characterized by a GDP growth from 0.6% to 6.1% in 2006.⁸⁶ In the first quarter of the next year (2007), the GDP rose to 6.3%.⁸⁷ The implementation of the ERS saw the economy of the country get back on track since its stagnation in 2002.

⁸⁴ OVP/MOF, Policy Paper on Public Enterprise Reform and Privatization, (July 1992)

⁸⁵ The Kenya Vision 2030, (2007), pg 1.

⁸⁶ The Kenya Vision 2030, (Popular Version), pg.1.

⁸⁷ Ibid.

Within the implementation period of the ERS, the second pillar, equity and poverty reduction, was also implemented. Since 2003, numerous fiscal interventions and institutional reforms were implemented in order to ensure that economic growth and development was a component shared by all Kenyans in different regions.⁸⁸ This was in order that development initiatives be carried out on a regional level to promote equity and poverty reduction.

Evidence of these efforts to reduce inequalities and eradicate poverty can be seen in the form of initiatives to improve efficiency in the public sector. One of the ways in which this was done was through the removal of barriers to trade, especially administrative ones.⁸⁹ Of importance to, and in relation to, commercial state corporations was the efforts taken to privatize and restructure public entities. The aim of privatization was towards making Kenya competitive on the commercial front.⁹⁰

Efforts to make the economic environment in Kenya one conducive for thriving business was also seen in the changes in corporate governance. Since 2003, several reforms in the corporate governance sector were implemented, firstly, to get rid of corruption, and secondly, to enhance participation by the private sector in economic growth and poverty reduction. Of great significance in implementing this third pillar were the governance reforms in the areas of crime investigation, prevention and prosecution.⁹¹ This period was characterized by the enactment of several Acts of Parliament to fight corruption, to enhance public ethics and to manage public finance. There were also legislations in place to control and govern public procurement and to provide oversight and transparency in the management of public finances.

⁸⁸Vision 2030, (2007), pg.3.

⁸⁹Ibid., pg. 4.

⁹⁰ Ibid.

⁹¹ Ibid.

2.4 Performance Contracts as a Tool for Management Accountability

One of the important reforms which the government introduced following the ERS, was performance contracting. The reform was piloted in 1991 through Kenya Railways Corporation and the National Cereals and Produce Board.⁹² In 2004, performance contracting was introduced in the public service sector, after observing that the government spent so many resources on the public sector yet it was characterized by inefficiency and wastefulness.⁹³ One of the causes of such inefficiencies was linked to lack of clarity in performance contracts. In the same year, a subsidiary legislation specific to state corporations was introduced.⁹⁴ It is this Legal Notice that set out the functions of the Board of Directors, the Parent Ministry, Inspector General of State Corporations, and the Performance Contracting Department in the process of implementing performance contracting.⁹⁵

This particular reform process was of significance because it created an air of clarity within the management of commercial state corporations. The issuance of the Legal Notice No. 93 of August 2004, was instrumental because it also recognised that state corporations used to operate under numerous pieces of legislations and institutional structures, and that these Acts of Parliament needed harmonization. Performance contracts could enable the effective monitoring of state corporations, especially the Chief Executive Officers who are in charge of managing such institutions. By introducing performance contracts, commercial state corporations are also open to ministerial rationalization.

During the period after the re-introduction of performance contracting in the management of state-corporations, the sector registered enhanced generation of revenue. In the first nine months,

⁹² The Reform was introduced in 1991 by the Parastatal Reform Strategy Paper which was approved in the same year.

⁹³ An administrative circular was issued to that effect.

⁹⁴ Legal Notice No.93 of August 2004

⁹⁵ Ibid.

for example, the 16 pilot state corporations registered 382% increase in revenue.⁹⁶ The period saw commercial state corporations make profits which they never made before. Additionally, they were able to pay dividends to their major shareholder, the National Treasury.⁹⁷ The period was also characterized by improved asset management. Evidence of this was the ease by which commercial state corporations were able to identify their assets, and get title deeds for the land they owned. The government was also able to improve its service delivery to Kenyans, a goal which was expected to be fulfilled by the introduction of performance contracting. Towards this end, commercial state corporations developed Customer Service Charters for the customers they had identified as a benchmark for service delivery. During the period under review, customer satisfaction was placed at 63% which was a big improvement on the part of the government.⁹⁸

Apart from improving the citizens' confidence in the government in terms of service delivery, the reform process managed to provide clarity in how state corporations, and especially, commercial ones, managed their affairs and finances. For instances, state corporations were obliged to come up with a mission and vision statement to guide them in achieving their duties under the law. Through their Strategic Plans, these corporations were also able to clearly state their objectives which act as work plans for performance in their respective setups. To some extent, the reform managed to achieve some level of reduced controls and enhancement of autonomy in their management.. Above all, their targets were made to be aligned with the national budget, hence improving how they utilize their resources.

While this reform could be seen as a measure to keep commercial state corporations in check and accountable for the national resources they absorbed, the sector was subjected to numerous

⁹⁶Mohamed, A..et al, "Report of the Presidential Taskforce on Parastatal Reforms," (October, 2013), pg.130.

⁹⁷ Ibid

⁹⁸ ibid

regulations and bureaucratic process. Even though it was recognised that the sector needed to have harmonized legal and institutional frameworks, it, in fact, opened and exposed it to more regulations, checks and balances. While these interferences, for instance, by the parent ministry could be argued to be necessary for accountability and transparency purposes, they, to a large extent hinder the ease of conducting business by commercial state corporations which need to comply with such regulations.

2.5 Significant Legislation Enacted During the Period

The reforms between 2003 and 2007 led to several changes in the legal regime, this was especially in relation to how commercial state corporations were to be run. Among the important governance statutes that were enacted was the Public Officer Ethics Act, 2003. This Statute was enacted primarily to provide a Code of Conduct and Ethics that would advance the ethics of public officers.⁹⁹ The enactment of the Act introduced the requirement that all public officers were to make declaration of their assets as well as liabilities on an annual basis. Furthermore, the verification of the declarations would be done by the defunct Kenya Anti-Corruption Commission which would then submit a report to the appointing body. It was this Act that also introduced the Codes of Conduct and Ethics for all public officers, including those who managed the affairs of commercial state corporations.

The Anti-Corruption and Economic Crimes Act, 2003, was also another important piece of legislation that came as a result of the reform process. This Act was significant because it established an Anti-Corruption institution, the Kenya Anti-corruption Commission for the purposes of investigating corruption, economic crimes and other serious frauds committed by public officers.

⁹⁹Preamble to the Act.

The era was also marked by the introduction of laws to guide and safeguard responsible financial management by commercial state corporations. One key legislation in this area was the Public Audit Act¹⁰⁰ which provided guidelines and requirements for auditing of records of commercial state corporations. In 2004, the Public Finance Management Act was enacted, and in 2005, the Public Procurement and Disposal Act. The enactment of the Public Procurement and Disposal Act was closely followed by the Public Procurement and Disposal Regulations. The Act and its Regulations were important in that they created a system through which state corporations would procure goods and services. The aim of keeping the procurement and disposal system open was for transparency and accountability purposes. However, the sector was left marred with too many compliance mechanisms and requirements to adhere to, instead of focusing on their commercial function of increasing productivity and profitability.

2.6 Kenya Vision 2030 Economic Blueprint

After the introduction performance contracting in 2004, management of commercial state corporations improved but the sector continued to face challenges in its implementation. There was still lack of clarity on the role of these corporations in the overall economic development of the country. The situation was compounded by the inadequate and poor performance management framework linking these enterprises to the development goals of the nation. There was a difficulty in linking individual performance to that of the particular institution.

In 2008, Kenya launched its Vision 2030, a development blueprint which was launched by H.E President Mwai Kibaki to cover the period between 2008 to 2030. The aim of the Vision is to transform the country into “a middle-income country providing a high quality of life to all its

¹⁰⁰Cap 412A, Laws of Kenya.

citizens by the year 2030.”¹⁰¹ To meet the aims in the Vision, there are three important pillars which were recommended by the National Economic Council- economic, political and social.¹⁰² Vision 2030 was expected to complement the implementation of the eight Millennium Development Goals by 2015.¹⁰³ The eight goals are crucial for social and economic development, and one of the areas of emphasis was poverty reduction.

Commercial state corporations play and will continue to play an important part in the economic development of Kenya.¹⁰⁴ In the country’s Vision 2030, the manner in which business is conducted requires a different mindset. In the spirit of the Vision 2030, they are expected to play several key roles in ensuring that they fully contribute to the development process. These enterprises are expected to accelerate and promote the rate of economic growth and its development by 2030,¹⁰⁵ and support various efforts which are geared towards building capacity, both technical and institutional, in order to facilitate development.¹⁰⁶

Another important role which these enterprises are expected to play is the creation of employment and business opportunities, especially for the youth, women and the disadvantaged groups in the society. This, according to the letter of the Vision, will lead to a more cohesive and stable society.¹⁰⁷ In order to actively participate and promote economic growth and development,

¹⁰¹The Kenya Vision 2030, (2007).

¹⁰² The National Economic Council recommended the three pillars in 2006, and they were subsequently adopted by Cabinet.

¹⁰³ The Millennium Development Goals are eight internationally recognized goals whose deadline was 2015. The eight goals are for social and economic development.

¹⁰⁴ Mohamed, A. et al, “Report of the Presidential Taskforce on Parastatal Reforms,” (October, 2013), pg. xv.

¹⁰⁵ Ibid.

¹⁰⁶ Ibid.

¹⁰⁷ Ibid.

commercial state corporations are also expected to improve service delivery to the public, and in doing so, meet the citizens' basic needs.¹⁰⁸

Vision 2030 is seen by many, as the blue print that would see to it that Kenya achieves its economic goals by 2030. If the statistics are anything to go by, it can be deduced that the country is headed in the right direction. Since the period between 2008 and 2009, for instance, the output of commercial state corporations to the country's GDP has been increasing. From 2008/2009 to 2010/2011, it increased from 1.64% to 9.54%. What is interesting is that the contribution was based on internally generated income.

While the increasing contribution towards the country's GDP is a gain, state corporations have also experienced several failures. It is important to also note that losses made by state corporations, in general, seem to be reducing with time. For instance, in the period between 2011 and 2012, eleven state corporations incurred losses compared to twelve in the period between 2010 and 2011, and sixteen in the period between 2009 and 2010.

2.7 National Cohesion and Integration Act, of 2008

A significant piece of legislation which was enacted in this period of the reform process was the National Cohesion and Integration Act No. 12 of 2008. The purpose of enacting the Act was to encourage national cohesion and integration especially after the post-election violence experienced after the 2007 Presidential general elections. It aimed to do this by outlawing discrimination on ethnic and racial grounds. The effect of the enactment of the Act was that commercial state corporations would not discriminate on any Kenyan based on their ethnicity, in areas such as appointment/employment of staff and service delivery. Compliance with the

¹⁰⁸ Ibid.

National Cohesion and Integration Act as read with Article 10 of the Constitution of Kenya are key performance indicators under the performance contracting framework for commercial state corporations.

Apart from outlawing discrimination, the Act is also known for establishing Kenya's first National Cohesion and Integration Commission. The Act not only provides for the powers of the Commission but also its functions. Among the primary functions of the Commission is to investigate complaints of ethnic and racial discrimination, and making recommendations to the Attorney General or any other relevant authority such as the Human Rights Commission.¹⁰⁹

2.8 Constitution of Kenya, 2010: A New Era for Good Governance

The launch of Vision 2030 in 2008 was followed closely by the enactment of the new Constitution. The promulgation of the Constitution of Kenya 2010 was of great significance to the governance, management and control of the country's resources including commercial state corporations. Of significance are the several modifications and safeguards which the Constitution introduced in order to improve governance and management of public finances. The Constitution also places heavy emphasis on the social development aspect and the political role of state corporations. In fact, some have opined that the Constitution of Kenya 2010, which is said to be one of the most progressive in the world, is heavily hinged on national values and leadership as its two crucial pillars.

Firstly, and most importantly, the Constitution lays a lot of emphasis on human rights principles. A whole Chapter, the Bill of Rights, has been set aside to deal with human rights and fundamental freedoms of the people of Kenya. These human rights principles have found their

¹⁰⁹ Section 25 (2) (h)

way in the structure and functioning of state corporations, and especially, commercial ones. For instance, the principles of equality and nondiscrimination have been promoted. The idea behind the inclusion of these principles in the running of the affairs of commercial state corporations is to promote inclusivity and to provide equal opportunities for people from all parts of Kenya. The idea behind such initiatives is to promote economic development in all parts of the country.

Secondly, the Constitution provides for principles of good governance. Corporate governance as provided by the Constitution finds its basis under Article 232, which provides for values and principles by which state corporations shall be governed. The values and principles envisioned by the Kenyan Constitution include high standards of ethics; efficient, effective and economic use of the country's resources; impartial and equitable provision of public services; and the involvement of the citizens in the policy-making processes. Principles of good corporate governance as borrowed from the Constitution include accountability for administrative acts.¹¹⁰ These values and principles are also inclusive of transparency and providing the public with accurate information.

Thirdly, the Constitution of Kenya 2010, emphasized on fair representation of Kenyans and their diverse communities. For a commercial state corporation, this means, affording adequate and equal opportunities for women, persons with disabilities, youth, and other vulnerable groups in relation to employment, training and appointments.¹¹¹ In order to ensure that equal opportunities are given to all, they shall be guided by principles of fair competition and merit as the basis of appointing and promotion of staff. For commercial state corporations, this may not be workable.

¹¹⁰ Article 232, Constitution of Kenya, 2010.

¹¹¹ Ibid.

Apart from providing guiding principles and values to improve corporate governance and promote inclusivity of all Kenyans, in the socio-economic development of their country, the Constitution also established a framework of institutions and legislation to ensure that the constitutional ideals are carried out by commercial state corporations. The Constitution has introduced a number of independent commissions with the sole purpose of providing oversight and accountability mechanisms for state officers, public institutions, state corporations, and commercial state corporations. The commissions include the National Gender and Equality Commission, the Commission on Administrative Justice (Ombudsman), the Salaries and Remuneration Commission, the Ethics and Anti-Corruption Commission, the Office of the Auditor-General, the Office of the Attorney General and the National Cohesion and Integration Commission. It was envisioned that these commissions and independent offices would see to it that public bodies which include commercial state corporations would comply with the national values and principles provided under the Constitution.¹¹²

While the Constitution provides for the establishment of commissions, it also led to the enactment of new laws and regulations to complement it. Commercial state corporations were all expected to align their systems and governance structures to the emerging laws, or end up on the wrong side of the law.

While the Constitution has so far succeeded in achieving some level of inclusivity and participation of various vulnerable groups in public processes which affect them, it can be deduced that the commercial function of commercial state corporations has suffered. The main challenge which these constitutional ideals and obligations create for a commercial state corporation is finding a balance between performing its commercial function as a business entity

¹¹²Ibid., Article 10 and 232.

and discharging its political and governance function. Where these two important functions collide, it can create hindrances in a dispensation that seems to place more emphasis on the political function rather than the commercial role. Additionally, compliance with the requirements of all these statutes, Commissions, and other numerous regulatory frameworks, is costly on the part of these corporations. A lot of time, money and effort are consumed in meeting compliance and reporting requirements to all these Statutory and Constitutional institutions.

2.9 Significant Legislation Enacted During the Era

After the promulgation of the Constitution 2010, commercial state corporations were subjected to more laws and regulations in the conduct of their affairs. In 2012, the Leadership and Integrity Act and the Public Finance Management Act were enacted.¹¹³ The Leadership and Integrity Act was an act of parliament to establish procedures and mechanisms for the effective administration of Chapter 6 of the Constitution 2010.¹¹⁴

The Public Finance Management Act, No.18 of 2012, on the other hand, contributed to the reform process by compounding the role of the National Treasury in the management of commercial state corporations. The Treasury's role was enhanced and it now has powers including that of assessing the financial management systems of commercial state corporations. In fact, the Treasury has the power to enter their premises and inspect its records.¹¹⁵ As the majority shareholder in commercial state corporations, the National Treasury provides for their financing. It is also in charge of authorizing the opening of their bank accounts, setting accounting norms and standards to be used by the enterprises and above all, to offer concurrence in most of the decisions made by the board. In overall, the Treasury is in charge of monitoring

¹¹³ Cap 182, Laws of Kenya, (Revised 2014).

¹¹⁴ Ibid., Preamble to the Act.

¹¹⁵ Section 13, Public Finance Management Act, No.18 of 2012.

the management of the finances of public enterprises and investments by the national government and its entities.¹¹⁶

While having the Treasury as a monitor of public finance is aimed at benefiting the public good, interferences by the institution could do more than achieve transparency and accountability. The danger of such interferences is that commercial state corporations lack autonomy in the manner in which they discharge their commercial function.

Apart from the two Acts, the Ethics and Anti-Corruption Act was also enacted to give effect to the Constitutional requirements and obligations of commercial state corporations and the public officers running them. The Act is known for establishing the Ethics and Anti-Corruption Commission pursuant to Article 79 of the Constitution.¹¹⁷

Another significant legislation is the Salaries and Remunerations Act,¹¹⁸ which set up the Salaries and remuneration Commission. One of the main functions of the Commission is to set and review the salaries and benefits of public officers who include staff of commercial state corporations. In discharging its functions, the Commission shall be guided by principles of fairness and transparency, and shall recognize the need to recognize performance and productivity.

2.10 The Report of the Presidential Taskforce on Parastatal Reforms (October, 2013)

The Presidential Taskforce on Parastatal Reforms (PTPRs) was charged with the task of reviewing policies governing the management and control of Parastatals in Kenya. The aim of convening the Taskforce was to determine how best commercial state corporations can

¹¹⁶Ibid., Section 12(2).

¹¹⁷ Act No.22 of 2011, Laws of Kenya.

¹¹⁸Cap 5F, Laws of Kenya.

contribute to the national development goals of the country and how they can be able to transform the country into a country of opportunities for all its citizens.

Some of the key questions which the Taskforce had to grapple with included that of the actual definition of a state corporation in Kenya. This definition has always been problematic especially since commercial state corporations have always been lumped together with other state corporations that do not perform a commercial function. The other question deals with the ownership of state corporations, policy and oversight functions and whether they are supportive of the national development goals of the country.

The Taskforce was also convened for the purposes of reviewing the existing legal and regulatory framework for the control and management of these corporations and how the challenges they face could be dealt with so as to transform and improve their performance for the benefit of the economy of Kenya. Another key priority of the Taskforce was to set out procedures on how government could make decisions on establishing and dissolving state-owned entities. Also of key importance to the Taskforce was finding ways on how to align the sector and its frameworks to conform to the ideals and imperatives provided for in Kenya's 2010 Constitution.

In order to execute its mandate, the Taskforce reviewed previous and existing legislation governing the management and control of all state corporations. The Taskforce also drew recommendations based on some of the jurisdictions in the world which have experienced success in managing state corporations, including South Africa, Malaysia, Singapore and China. Such benchmarking reviews are important in finding out how these countries have managed to have a thriving public service sector which complements national development strategies and contributes to the overall economy of the nation.

2.10.1 Useful Findings of the Taskforce

The Taskforce found out that one of the problems faced by commercial state corporations stemmed from the unclear definition of government-owned entities. This leads to lack of appreciation of what the various state corporations functions are and the roles which they perform. The Taskforce looked into the definition and defined government-owned entities under four headings, namely: state corporations, state agencies, county corporations and county agencies. The Taskforce suggested that to remove ambiguity in the current definitions, state corporations should be “an entity howsoever incorporated that is solely or majority owned by the government or its agent for commercial purposes.”¹¹⁹ Commercial state corporations are included under state corporations, and a commercial function to mean, a “function the dynamics of which are governed by a competitive profit-driven market,”¹²⁰ or “a function that can be performed commercially but serves a strategic socio-economic function.”¹²¹

Furthermore, the Taskforce recommended that these types of corporations be incorporated under the Companies Act.¹²² State corporations, according to the Taskforce, should be differentiated from state agencies which carry out specific government functions assigned to them.

The Taskforce also recommended that, in line with providing clarity on definitions, clarity should also be provided in the institutional setup of government entities. This much-needed clarity will cure the issue of conflicting policy direction brought about by numerous reporting centres and procedures. There should also be a distinction between entities offering commercial services and those which do not. This will enable commercial state corporations focus on their commercial functions and not get entangled with non-commercial functions. Providing clear and

¹¹⁹Mohamed, A. et al, “Report of the Presidential Taskforce on Parastatal Reforms,” (October, 2013), pg.139.

¹²⁰ Ibid.

¹²¹ Ibid.

¹²² Cap 486, Laws of Kenya.

separate regulatory and legal frameworks for the four categories of government entities would reduce the confusion which they all experience currently.

2.11 Government-Owned Entities Bill, 2014 and the *Mwongozo* Code of Governance of State Corporations.

The report of the Taskforce recommended the enactment of the Government Owned Entities Bill of 2014. With the enactment of the Government Owned Entities Bill, there would be one overarching piece of legislation to govern all national government-owned entities, county corporations and agencies. The Bill, if enacted, would offer several exceptions for some state-owned entities, among them commercial state corporations. Instead, commercial ones would be governed under the Companies Act. The end result would be that there would be reduced compliance requirements for them while still providing transparency and accountability mechanisms to promote effective corporate governance.

The Report of the Taskforce was also the precursor to the Code of Governance for State Corporations (*Mwongozo* Code). The Code was prepared with the joint effort of the State Corporations Advisory Committee and the Public Service Commission. The Code was launched by the H.E President Uhuru Kenyatta this year (2015) and if implemented, would be the much needed solution to the governance issues experienced by state corporations, especially commercial ones.

2.12 Conclusion

This Chapter has looked into the reform processes in the management and control of state-owned entities. While the reform process made several gains, it also failed to bring commercial state corporations out of the poor management and losses they still experience. With every phase of reform, the government enacted laws and introduced numerous regulations and compliance

requirements for commercial state corporations and their officers. As it is now, the sector is characterized by numerous laws, regulations and institutions, all of which have obligations to be met by one enterprise.

The next Chapter will discuss the current regulatory and legislative framework for the management and control of commercial state corporations. The analysis will discuss the gains and failures of the current system in improving the efficiency of commercial state corporations.

CHAPTER THREE: GOVERNMENT VERSUS ENTERPRISE: AN APPRAISAL OF THE CONSTITUTIONAL, LEGISLATIVE AND REGULATORY FRAMEWORK FOR THE MANAGEMENT OF COMMERCIAL STATE CORPORATIONS

3.0 Introduction

The legal status of commercial state corporations varies from being a part of the government to being limited liability companies with the state as a regular shareholder. The defining characteristics of these corporations are that they have a distinct legal form and they are established to operate in commercial affairs. While they may also have public policy objectives, commercial state corporations should be differentiated from other forms of government agencies or state entities established to pursue purely non-financial objectives.¹²³ Commercial state corporations were established in Kenya with the initial objective of fostering development of the private sector and improving the provision of public services.¹²⁴ The poor performance of state-owned corporations over the years necessitated the modification of the regulatory framework for the management of such corporations. The end result was that the sector became swamped by many pieces of legislation and institutions.

While some hold the opinion that the existing regulatory framework for state-owned corporations in Kenya is necessary to ensure their smooth-running, and to reduce the corruption rate in these corporations, this paper advances a contra argument. The many laws and institutions which regulate commercial state corporations are detrimental to their performance as commercial entities. This study considers the two-faceted role of these corporations: to make profits as a business and to offer services to the public. In other words, state corporations perform both

¹²³Profiles of Existing Government Corporations, pp. 1–16

¹²⁴Mwaura, K, '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) Fordham International Law Journal, 31(1), 73

commercial and social functions.¹²⁵ This study notes that attaining a balance between these two roles poses a big challenge and can tilt the scales to one side. In a bid to ensure good governance, transparency, accountability and other principles of good governance, state corporations may end up losing out in terms of achieving their business potential.

This Chapter of the study looks at the existing legal, regulatory and institutional framework for the management of commercial state-owned corporations, with specific attention to relevant Acts of Parliament, the subsidiary legislations made thereunder, the various government guidelines through circulars and executive orders. Part of this discussion is dedicated to scrutinizing the institutional framework in place for the management of these corporations. This discussion will also delve into the inadequacies of these frameworks and how they act as stumbling blocks for commercial state corporations to conduct business.

3.1 The Concept of Commercial State Corporations

In Kenya, state corporations are formed to meet social and commercial goals.¹²⁶ Such corporations exist for a number of reasons, for instance, as tools to correct market failure, to provide basic services such as health and education, to increase development in marginalized areas, and to achieve political objectives.¹²⁷ Commercial state corporations can be fully owned or partially owned by government. Examples of such entities in Kenya include, Kenya Power and Lighting Company, Kenya Pipeline Company Limited and the Kenya Ports Authority, Kenya Electricity Generating Company (Kengen), National Oil Corporation of Kenya, Geothermal Development Company Limited, Kenya Electricity Transmission Company Limited among others.

¹²⁵ Njiru, E, 'The Role of State Corporations in a Developmental State: the Kenyan Experience,' (October, 2008)

¹²⁶ Ibid.

¹²⁷ Ibid.

The legislative underpinning of the establishment of commercial state corporations in Kenya is provided for under the State Corporations Act.¹²⁸ The interpretation section of the Act defines a state corporation, and it does not include building societies, banks, cooperative societies or the Central Bank of Kenya.¹²⁹ Any other body corporate established under the a company incorporated under the Companies Act (Cap 486, Laws of Kenya) which is not wholly owned or controlled by the Government or by another state corporation is also excluded from this definition. A state corporation, by the definition of the Act, is a body corporate which is established by the order of the president, and the functions to be performed by the specific corporation are found in that order.¹³⁰

The Act also makes provisions for the control and regulation of state corporations and does not distinguish the various types of State Corporations i.e. commercial, regulatory and/or research. However, in the Kenyan context, it is not only the State Corporations Act which regulates the management and control of commercial state corporations, but also other numerous Acts and Regulations.

3.2 Characteristics of Commercial State Corporations

The main characteristic of state corporations in Kenya is that they are all owned by the state. Going by the interpretative section of the State Corporations Act, a commercial state corporation is a commercial entity that is either owned or controlled by the state.¹³¹ A commercial state corporation is also a body corporate which is established by the order of the president.¹³² Accordingly, the functions of a specific commercial state corporation will be dictated by the

¹²⁸ Cap 446, Laws of Kenya

¹²⁹ Ibid., Section 2.

¹³⁰ Ibid., Section 3.

¹³¹ Section 2, State Corporations Act

¹³² Ibid., Section 3

constitutive instrument such as the memorandum and articles of association for the entities that are limited liability companies, the various statutes for the statutory state corporations the order which is specific to it for those that are created by way of an executive order.¹³³

Another important characteristic of these corporations is that the entities and their employees are subject to a specific legal framework that binds public entities and public servants. In Kenya, this legal framework cumulatively encompasses the legislative, regulatory and institutional frameworks for the control and governance of these enterprises. The upshot of this is that such a legal framework has the effect of subjecting these enterprises, their Boards, managers and employees to extra and more stringent quality controls by both government authorities and investors.

3.3 The Role of Commercial State Corporations: Commercial vs. Governance

3.3.1 Commercial Role

In order to understand the regulatory framework of state-owned corporations and the effect it has in relation to the performance of their functions, it is important to gain insight into the role of commercial state corporations as businesses. The main goal of an enterprise is to perform a commercial role. The most basic objectives of any business would be to create wealth by increasing its profitability by either increasing production or minimization of operating costs or both. Minimising costs and maximizing profits, is, in summary, the main aim of doing business.

Commercial state corporations could be successful if they served only a commercial function, but unfortunately, they are oftentimes used for non-commercial objectives such as social

¹³³ Ibid.

cohesion, universal access to basic services and resource redistribution purposes.¹³⁴ The effect of this is that they end up serving conflicting aims and objectives, which in turn, subject them to inefficiency in the performance of their functions.

3.3.2 Governance Role

Commercial state corporations also serve a governance role. They are deemed to be an extension of the Executive and as such their employees are public servants and they will be subjected to all the governance structures and statutes that relate to the public service. This dual role cannot be overlooked. They are, firstly, political, and secondly, mandated to serve a public interest function which involves being accountable to and responsible for the general public through the various public accountability checks. The mechanisms in place to ensure that state-owned companies perform their governance role effectively include safeguards to promote transparency in their day-to-day activities; accountability measures, for example in relation to financing and auditing, and safeguards to promote ethics, anti-corruption and leadership among others.

State-owned companies are expected to comply with constitutional provisions and human rights principles relating to ethnic inclusivity and gender balance in their working environment. The aim is to promote the well-being and the interests of the nation at large. This paper appreciates the dual role of commercial state corporations and the fact that these types of companies are national assets in any state. However, the study critiques the structure of commercial state corporations in Kenya and the contradictions posed by the conflicting roles. The paper attempts to show how the governance role seems to be overtaking their commercial role, which, in essence, should be prioritized.

¹³⁴Corporate Governance, State-owned Enterprises and Privatisation, (1998, OECD Publishing).

3.4 Commercial State Corporations vs. a Non-State-Owned Company: A Companies Act Perspective

Companies in Kenya, until just recently, have operated under a common legal framework, the Companies Act, Cap 486, Laws of Kenya.¹³⁵ The Companies Act is primarily based on the United Kingdom's Companies Act of 1948. The Kenyan Companies Act outlined the types of companies that may exist in Kenya and provides for guidelines on the incorporation, regulation and winding up of companies.

Companies in the private sector bear similarities to state-owned companies, but they also have differences especially as regards their governance and management structures. One similarity is that both types of companies are distinct legal entities, which means that they are legal persons in their own right with perpetual succession. This also means that they can sue and be sued. The difference between the two, in this regard, is that state-owned companies perform their commercial function on behalf of their owner, the government. Being answerable to the government does not only entail answering to government authorities but also being accountable to the public in general through the various public accountability mechanisms. Regular companies, on the other hand, answer to a smaller group consisting of shareholders and other stakeholders, including its customers, employees. On the overall, the Board of Directors, which run the activities of the company, must ensure that they put the interests of the company before theirs. This includes, avoiding conflicts of interest and acting in the best interest of the company at all times. The formation of regular and state-owned companies also offers a point of departure in how the companies operate. While the formation of regular companies in Kenya is guided by the Companies Act, that of commercial state corporations is provided for by the State

¹³⁵ Kenya has a new Companies Act, presently

Corporations Act. The latter are formed by an order made by the President, while private sector companies are formed by individuals with a common interest to perform a commercial function.

Additionally, these two types of companies differ in aspects relating to the manner in which they conduct business. While they both perform a commercial function, they are not subjected to the same procedures of conducting business. For instance, while regular companies get into contracts at will, and when the need arises, commercial state corporations have to go through an elaborate process to perform even the most basic of business functions. This can be seen in aspects such as purchasing goods and acquiring services. While a regular company would simply go out and pay money to buy specific goods, a state-owned company would have to go through a tendering process, and advertise for bidders to bid before picking the lowest bidder to deliver the goods or services. Such processes are also characteristic of the employment phase, salary allocation, reduction and increment among other activities which the commercial state corporation may want to engage in. In introducing such kind of processes, the basic concept of contract and contractual principles and concepts such as offer and acceptance, are undermined. The danger of such process also extends to matters of independence in conducting business, and the ultimate consequence is that state-owned companies end up losing business opportunities and incurring losses which could be easily avoided by sticking to the normal conduct of business.

The regulatory frameworks for the two types of companies are also distinct. While regular companies have the Companies Act and their Articles of Association to guide their activities, their counter-parts have extra regulations for their control and governance. This framework ranges from legal to institutional safeguards that affect the running and performance of commercial state corporations.

In a nutshell, non-state owned or controlled companies are not subjected to the various constitutional, legislative, regulatory and institutional frameworks that commercial state corporations are subjected to and yet, they are expected to be as effective, efficient and profitable as the non-state owned businesses. It is this framework that this Chapter discusses in this part of the study

3.5 The Constitutional Framework Governing Commercial State Corporations in Kenya

The Constitution of Kenya 2010 is the country's supreme law and has been described as progressive. Commentators have identified the provisions on national values and leadership as its two important pillars. This is logical because poor governance was at the very heart of the quest for a new constitutional dispensation. It lays a lot of emphasis on human rights principles and the upholding of the principles and standards of good political governance.

Management of state corporations in Kenya can be traced back to the Constitution. Article 232, for instance, provides for the values and principles which should guide commercial state corporations. These values and principles include high standards of professional ethics; efficient, effective and economic use of resources; responsive, prompt, effective, impartial and equitable provision of services; involvement of the people in policy-making processes; and accountability for administrative acts.¹³⁶ The values and principles also include transparency and timely provision of accurate information to the public.

Other values and principles include fair representation of Kenya's diverse communities and affording adequate and equal opportunities for appointment, training and advancement to men

¹³⁶Article 232, Constitution of Kenya, 2010.

and women, persons with disabilities and members of all ethnic groups.¹³⁷ Towards this end, commercial state corporations shall be guided by fair competition and merit as their basis for promotions and appointments. Article 232 also gives parliament the power to enact legislation to give effect to the article.¹³⁸

The Constitution of Kenya, 2010, apart from providing guiding principles and values for commercial state corporations, also establishes a number of independent commissions and offices. These commissions provide additional accounting mechanisms for commercial state corporations. These commissions include the National Gender and Equality Commission, the Commission on Administrative Justice (Ombudsman), the Salaries and Remuneration Commission, the Ethics and Anti-Corruption Commission, the Office of the Auditor-General, the Office of the Attorney General and the National Cohesion and Integration Commission.

The rationale behind establishing these commissions is to protect the sovereignty of the people. The other rationale is that these commissions will help to secure the observance by all the commercial state corporations of the national values and principles set out in Articles 10 and 232 of the Constitution. However, these Commissions, although important for a harmonized service delivery to the public, introduce additional bottlenecks in the management of these corporations as commercial entities. The various compliances required by these offices and Commissions are costly to comply with and create inefficiencies for businesses. The same have increased procedural bureaucratic systems which are time consuming and expensive. We shall seek to argue that these Commissions and independent offices have greatly undermined the effective operations in commercial state corporations.

¹³⁷ Ibid.

¹³⁸ Ibid.

The implementation of the Constitutional principles in public service is backed up and complemented by other laws and regulations. These laws also bind commercial state corporations and they require that they align their service delivery and overall activities to the set principles and standards.

3.6 Legislative Framework for the Management of Commercial State Corporations in Kenya.

The Statute that is at the core of the management and control of commercial state corporations is the State Corporations Act, which is complemented by other pieces of legislation and institutions. The State Corporations Act provides for the establishment of commercial state corporations and contains provisions for their control and regulation.¹³⁹ All commercial state corporations established in this manner have perpetual succession, the capability to sue and be sued, and subject to the Act, to hold and alienate immovable or movable property.¹⁴⁰ Responsibility for commercial state corporations is vested on cabinet secretaries, and it is the President who assigns such responsibility.¹⁴¹

The Act also goes further to provide for the powers of commercial state corporations in the discharge of their functions. The Act provides that these corporations shall have the powers necessary or expedient for the performance of their functions.¹⁴² This may be taken to mean that such a corporation can exercise any powers which will see to it that it discharges its commercial functions in an expedient manner. However, this is not the case because the powers come with many conditions which stall the exercise of their functions. For instance, a commercial state

¹³⁹ Cap 446, Laws of Kenya.

¹⁴⁰ *Ibid.*, section 3(2).

¹⁴¹ *Ibid.*, section 4.

¹⁴² Section 5(1).

corporation has the power to engage and employ staff,¹⁴³ but the Act goes ahead to put a condition on that power. The engaging and employment of staff is to be undertaken only on terms and conditions specified and approved by the minister (Cabinet Secretary) in consultation with the Committee.¹⁴⁴ Additionally, they have the power to establish pension, gratuity, provident or other funds, but with the approval of the Minister (Cabinet Secretary), who also needs to consult with the National Treasury and the Committee.¹⁴⁵

The State Corporations Act also contains provisions for the control of finances of commercial state corporations.¹⁴⁶ Each of these corporations is required to prepare and submit estimates of its annual revenue and expenditure to the Cabinet Secretary and the Treasury.¹⁴⁷ Additionally, they must accompany the estimates with a proposal for funding all projects which the corporation is to undertake, or the implementation of which will continue during the financial year to which those estimates relate.¹⁴⁸ The Act expressly provides that no annual estimates and proposals for funding projects shall be implemented until the Minister approves and the Treasury concurs.¹⁴⁹ Other requirements for commercial state corporations include keeping books of accounts, audits and records and to make provisions for the renewal of depreciating assets.¹⁵⁰

According to Section 4 of the State Corporations Act,¹⁵¹ the President assigns responsibility for commercial state corporations to the Vice-President and several ministers (cabinet secretaries). It is interesting to note that whereas Section 5 of the Act provides that these corporations shall have all the powers necessary or expedient for the performance of their functions, there are limitations

¹⁴³Ibid., section 5(4).

¹⁴⁴ Ibid.

¹⁴⁵ Ibid Section 5(5).

¹⁴⁶Ibid., Part IV.

¹⁴⁷Ibid., Section 11(1).

¹⁴⁸ Ibid.

¹⁴⁹ Ibid., Section 11(2)

¹⁵⁰Ibid., Section 15 and 16, respectively.

¹⁵¹ Cap 446, Laws of Kenya.

to these powers. For instance, they can borrow money in Kenya, or elsewhere. However, this is subject to the consent of the Cabinet Secretary responsible for the specific corporation.¹⁵² In an instance where the Cabinet Secretary does not give their consent on borrowing, the corporation may not be able to access funds and discharge its commercial functions. To complicate matters, the National Treasury may impose some limitations and conditions on borrowing by commercial state corporations.¹⁵³

3.7 Finance, Procurement and Auditing as Part of the Regulatory Framework

3.7.1 Procurement

Business leaders across all sectors place top priority on reducing costs and are aware of potential cost savings in relation to the supply chain.¹⁵⁴ For a business entity, the procurement process is very crucial to the running of the business because it offers an opportunity for enterprises to get low-cost contracts for supplies and services. Procedures such as tendering are important for commercial state corporations to meet their business demands in form of supplies.

In Kenya these procedures are governed by the Public Procurement and Disposal Act,¹⁵⁵ an Act of Parliament which is geared towards establishing procedures for the efficient procurement of unserviceable, obsolete or surplus stores, assets and equipment for public enterprises.¹⁵⁶ The Act also establishes procedures to govern the disposal of these stores, assets and equipment, and other related matters.¹⁵⁷

¹⁵²Ibid., Section 5.

¹⁵³ Ibid.

¹⁵⁴ The power of Procurement: A GLOBAL Survey of Procurement Functions, KPMG (2012)

Also available at : <https://www.kpmg.com/US/en/IssuesAndInsights/ArticlesPublications/Documents/the-power-of-procurement-a-global-survey-of-procurement-functions.pdf> (Accessed on 24th September 2015)

¹⁵⁵ Cap 412C, Laws of Kenya

¹⁵⁶ Ibid., Preamble to the Act

¹⁵⁷ Ibid.

The Public Procurement and Disposal Act was enacted with the objective of maximising economy and efficiency, and to promote competition while ensuring that competitors are treated fairly.¹⁵⁸ The Act also has the objective of promoting the integrity and fairness of the procurement and disposal procedures carried out by state entities.¹⁵⁹ In doing so, it is hoped that the public can have confidence in such procedures because of their increased transparency and accountability measures. Finally, the Act aims at facilitating the promotion of local industry and economic development.¹⁶⁰

What the Act has as its objectives, is commendable. However, it runs the risk of interfering with the smooth-running of businesses carried out by commercial state corporations. Firstly, it may be argued that the procurement process set up by the Act would do harm instead of improving or maximising on the efficiency of these corporations. It should not be forgotten that the main concern of a business is to make profits and minimise their losses as much as possible. This can be done effectively if there were no barriers to free conduct of business. To support this argument, some of the procedures set out for commercial state corporations to follow while doing business shall be looked at.

To begin with, the Act provides a tendering process which every procuring entity may use.¹⁶¹ Regulation 40 of the Regulations provides that the minimum time for the preparation of tenders for the purposes of section 55(1) of the Act shall be 21 days.¹⁶² The evaluation of the tender, on the other hand, shall be within 30 days after the opening of the tender.¹⁶³ This tendering process is arguably, long and unnecessary. Furthermore, according to the Act, the commercial state

¹⁵⁸Ibid., Article 2

¹⁵⁹ Ibid.

¹⁶⁰ Ibid.

¹⁶¹Ibid., Part V of the Act, and Article 29 of the Constitution of Kenya 2010.

¹⁶²**The Public procurement and Disposal Regulations, 2006.**

¹⁶³Ibid., Regulation 46.

corporation shall pick from the lowest bid it gets from the tendering process. There is no guarantee that after the tendering process, the lowest bidder will necessarily have the desirable price. Chances are that the enterprise would have achieved a much lower price were it allowed to go beyond the tendering process. While procedures such as tendering are intended to act as checks on the conduct and practice of public entity officials, they may end up paralyzing the functioning of these entities as they may compromise on quality, price and overall effectiveness of the procurement process.

3.7.2 Financing & Finance Management

For a commercial state corporation to conduct its commercial functions effectively, it needs to manage its finances. In Kenya, these corporations get their financing from the government. The National Treasury is their major shareholder and the implication of this is that the funds are derived from the national budget, which not only finances these corporations but also other sectors of the economy.

This Act provides for the effective management of public finances by both the National and County Governments. It also has provisions on the oversight responsibility of Parliament as well as the County Assemblies, and that of other government entities. The Act is important in the business of commercial state corporations because it establishes the National Treasury. The Treasury is at a crucial position because it is the major shareholder in the business of commercial state corporations. It is the Treasury that monitors the financial performance of these corporations.

Apart from establishing the Treasury, the Public Finance Management Act also provides for the functions and powers of the Cabinet Secretary in relation to approving the budgets and proposals

for commercial state corporations. The Act also provides for the debt process and budgeting system for national government entities.

3.7.3 The Role of the National Treasury in Finance Management

In Kenya, the Treasury is a key institution in the management and control of commercial state corporations and their finances. It has been charged with, among other functions, to monitor their financial performance.¹⁶⁴ Section 13 of the Public Finance Management Act provides for the powers of the Treasury to include the accessing of financial management systems of state-owned entities, and where necessary, to access their premises and to inspect their financial records.¹⁶⁵ The powers of the Treasury extend to those of requiring state-owned entities to comply with specified applicable norms or standards regarding accounting practices and budget classification systems.¹⁶⁶ The Treasury is also in charge of banking arrangements for state-owned entities.¹⁶⁷ Towards this end, the National Treasury authorises the opening, operating and closing of bank accounts of all government entities.¹⁶⁸

The National Treasury is relevant to the discussion of how commercial state corporations are managed, especially in terms of finances. Pursuant to Article 225 of the Constitution of Kenya 2010, the Public Finance Management Act establishes the National Treasury.¹⁶⁹ Section 12 of the Act outlines the functions of the Treasury to include the formulation, implementation and monitoring of macro-economic policies involving expenditure and revenue.¹⁷⁰ The Treasury is also charged with ensuring that uniform accounting standards are applied by the national

¹⁶⁴Section 11, Public Finance Management Act, No.18 of 2012, Laws of Kenya.

¹⁶⁵Ibid., Section 13.

¹⁶⁶ Ibid.

¹⁶⁷Ibid., Section 28(1).

¹⁶⁸Ibid., Section 28(2).

¹⁶⁹Ibid., Section 11.

¹⁷⁰Ibid., Section 12.

government and its entities. In order to ensure this, the Treasury consults with the Accounting Standards Board.¹⁷¹

The National Treasury also performs the function of monitoring the management of the finances of public enterprises and investments by the national government and its entities.¹⁷² Apart from that, it has the function of monitoring their financial performance.¹⁷³

In order to discharge its functions, the National Treasury has several powers.¹⁷⁴ Firstly, it can access any system of public financial management and control of government entities, as well as their premises.¹⁷⁵ The Treasury may also require that a government entity use certain specified norms and standards of accounting, and to provide it with any information necessary for carrying out the Treasury's responsibilities under the Act and the Constitution.¹⁷⁶ Other responsibilities of the National Treasury include the management of the Consolidated Fund and the Contingencies Fund, and to make banking arrangements for national government entities.

The National Treasury, just like the other institutions in the regulatory framework for the management of commercial state corporations can be seen both as performing a positive function and as a stumbling block when it comes to conducting business. To begin with, the Treasury is the majority shareholder in these corporations. This essentially means that the Treasury provides the most percentage in terms of capital for them to run their businesses.

As already discussed, under the State Corporations Act, commercial state corporations shall cause to be prepared and shall, not later than the end of February in every year, submit to the

¹⁷¹Ibid., Section 12(1).

¹⁷²Ibid., Section 12(2).

¹⁷³ Ibid.

¹⁷⁴Ibid., Section 13.

¹⁷⁵ Ibid.

¹⁷⁶ Ibid.

Minister and to the Treasury for approval, estimates of their revenue and expenditure for the following financial year accompanied by proposals for funding all projects to be undertaken by the corporation, or the implementation of which will continue during the financial year to which those estimates relate. Furthermore, no annual estimates and proposals for funding projects shall be implemented until they have been approved by the Minister with the concurrence of the Treasury.¹⁷⁷

While private-owned companies have the freedom to manage their funds, commercial state corporations are subjected to budget-approval processes that require the concurrence of the National Treasury for the release and use of funds. Such budget approval processes are lengthy and involve various stages of approval. Additionally, there is no guarantee that the budget proposed by the management and approved by the parent ministry shall obtain the National Treasury's concurrence, or if the concurrence is given, the same may have many conditions attached to it making it difficult, if not impossible for the entity to apply the resources for their intended purpose/use.

In the commercial world, certain business demands, especially urgent ones, need a quick reaction. This is usually in terms of emergency spending. Owing to such processes in the management and control of finances of commercial state corporations, it becomes difficult for these entities to respond to business demands and this makes them ineffective. For them the procedure for obtaining a supplementary budgets so as enable it obtain emergency funds to enable them react to urgent business demands is cumbersome and lengthy. They must get approval of funds from the supplementary budget. The proposal for such an approval ultimately

¹⁷⁷ Section 11, States Corporations Act, Cap 446, Laws of Kenya.

involves the National Assembly approving the budget. This may take a lot of time hence denying the corporation the chance to address the emergency demand.

3.7.4 Auditing

Auditing is a process that evaluates an enterprise's internal systems and controls to assess their effectiveness. This is an important process that ensures a business maintains and achieves its objectives by promoting transparency and accountability. The process provides a reliable financial reporting system that limits occurrences of fraud and misappropriation of company funds and assets.

In Kenya, it is a requirement that the accounts of every commercial state corporation should be audited and reported on an annual basis. Public auditing of these corporations must be done in accordance with the Public Audit Act, 2003.¹⁷⁸ The Act established the Kenya National Audit Commission and the office of the Controller and Auditor General.¹⁷⁹

Of relevance to these corporations is Part III of the Act on Audits. Section 12 provides that each and every commercial state corporation shall prepare and submit for audit, accounts to the Controller and Auditor General. The role of the Controller and Auditor General is to examine the accounts submitted for auditing and prepare a report to the Cabinet Secretary responsible for finance.¹⁸⁰ This is in line with Article 229 (4 and 6) of the Constitution, which require that the Auditor General report and confirm whether or not public money has been applied lawfully and

¹⁷⁸ Cap 412A, Laws of Kenya

¹⁷⁹ Ibid., Preamble to the Act

¹⁸⁰ Ibid., Section 14 and 15, respectively.

in an effective way. The entity whose accounts are under audit pays for the costs of examination and audit.¹⁸¹

While carrying out audits is an important practice that enhances the effectiveness of companies in relation to the appropriation and usage of funds, the auditing requirements for Kenyan commercial state corporations could have an undesired effect. Firstly, the auditing process is hinged on politics and not business. The audit done by the Controller and Auditor General is to ensure that public funds are utilized appropriately. The danger of this kind of audit is that these corporations cannot use funds freely and in an independent manner. Any use of funds that would appear unlawful, even when necessary for the advancement of a business function, would appear as misappropriation of funds. The effect of this is that state-owned entities will fear getting into certain business transactions that would otherwise have benefits in terms of profitability and productivity.

Another challenge brought about by the auditing mechanism provided for under the Public Audits Act is that it could prove time-wasting. Instead of commercial state corporations saving time for the conduct of day-to-day business activities, they have to make audit reports to reflect their annual records to various institutions including parliamentary committees. Non state owned businesses, on the other hand, do not have to comply with such lengthy auditing processes.

¹⁸¹Ibid., Section 19.

3.8 Governance, Ethics, Anti-Corruption Safeguards

As already discussed, commercial state corporations in Kenya not only serve a commercial role, but also a governance role. In order to ensure that the latter role is discharged effectively, there is a regulatory framework in place to ensure that certain principles are upheld.

One way in which the government does this is by enacting laws and creating institutions that ensure good governance, leadership, ethics, and anti-corruption. An important piece of legislation in relation to corporate governance in Kenya is the Public Officer Ethics Act which was enacted in 2003.¹⁸² The Act was enacted primarily to provide a Code of Conduct and Ethics that would advance the ethics of public officers.¹⁸³ In line with Section 3 of the Act, the responsible Commission for commercial state corporations is the Public Service Commission.¹⁸⁴ While each responsible Commission is charged with the task of preparing a Code of Conduct and Ethics for the officers under them, the Act, in Part III provides for a general code of conduct and ethics for all public officers. The Code provides for measures that promote the rule of law, prohibitions from improper enrichment and avoidance of conflict of interest among others. The Code also provides that public officers shall exercise impartiality and shall not practice favouritism, nepotism or sexual harassment. The Code also provides for regularly filing of declarations of assets and liabilities of public officers¹⁸⁵.

Contravening the Code of Ethics attracts disciplinary action which is preceded by investigations by the responsible Commission. The Public Officer Ethics Regulations of 2003 are relevant to state-owned corporations. It complements the Public Service Commission Code of Conduct and Ethics. Under the Code of Conduct and Ethics, Section 22 stipulates that a public officer shall

¹⁸² Cap 183, Laws of Kenya

¹⁸³ *Ibid.*, Preamble to the Act.

¹⁸⁴ *Ibid.* Section 3(3).

¹⁸⁵ Section 27 of the Public Officers Ethics Act.

practice and promote the principle that public officers should be selected on the basis of integrity, competence and suitability.¹⁸⁶

Another Act is the Anti-Corruption and Economic Crimes Act, which provides for the prevention, investigation and punishment of corruption, economic crime and other related offences.¹⁸⁷ The Act, in Part V, provides for offences which when committed by public officers, attract a penalty. The offences include bribery, improper benefits to trustees for appointments, bid rigging, deceit, conflicts of interest and abuse of office.

The Leadership and Integrity Act,¹⁸⁸ which was enacted so as to give effect to Chapter Six of the Constitution of Kenya 2010, also comes with additional requirements for public officers managing commercial state corporations. The Act also features a general Leadership and Integrity Code for all state officers, and which mirrors the Public Officer Ethics Act.¹⁸⁹ The Leadership and Integrity Code provides for the observance of the rule of law, and the exercise of authority for the best interests of the people of Kenya. Apart from that, there are requirements for such officers to be professional and avoid conflicts of interest.

State corporations being legal entities that are created by the government in order to partake in commercial activities on the government's behalf, serve two main purposes, a business function and a public trustee function, a position that obligates the corporation to exercise its authority for the benefit of the people of Kenya. To balance these two functions is problematic because as an enterprise, the main function would be to do business and make profits.

¹⁸⁶ Ibid., Section 22, Code of Conduct

¹⁸⁷ Cap 65, Laws of Kenya

¹⁸⁸ Cap 182, Laws of Kenya.

¹⁸⁹ Public Officer Ethics Act, No.4 of 2003.

While these Acts of Parliament set out offences to safeguard the interests of both the state and the public, there is the danger of making commercial state corporations suffer losses instead of making profits. For instance, the procedure for appointments may be good for accountability and transparency of the process, but there is the danger that talent may be lost. This means that, even if you find a person who can be an asset to the business of the enterprise, you cannot immediately appoint him. There has to be advertisement, a tendering process and adherence to the requirement that the appointment shall comply with the gender requirement, ethnic inclusion and competence.

3.9 Employment and Remuneration

A company of any kind cannot function without employees, and employees require compensation in form of payment of salaries and wages for the services they render to their employer. As argued in this paper, employees of commercial state corporations in Kenya are public officers. This, in essence, is simply an extension of the government and it poses the danger of making commercial state corporations more political than commercial entities.

One of the roles of the Cabinet Secretary relates to the employment of staff by commercial state corporations. This involves consenting to employment or setting conditions for employment of staff by these corporations.¹⁹⁰ While this may be beneficial in terms of accountability and transparency of processes carried out by these corporations from a political angle, there is the danger of making such employment processes lengthy and time-wasting. The State Corporations Act also requires that the Cabinet Secretary must consult with the Committee before approving

¹⁹⁰Ibid., Section 5(3).

the employment of staff.¹⁹¹ All these responsibilities are placed upon the Cabinet Secretary who may not be a business manager or a human resources expert.

While the regulation of employment of staff in these corporations is governed by the State Corporations Act, the Public Procurement and Disposal Act and the Constitutional requirements, the remuneration of employees of these enterprises is governed by the Salaries and Remunerations Commission. The Commission is established under the Salaries and Remunerations Act,¹⁹² and is an independent body whose independence is guaranteed by the Constitution of Kenya 2010.¹⁹³

In addition to the Commission's functions under the Constitution, the Act provides for other functions which the Commission shall discharge.¹⁹⁴ The functions include, the inquiry into and advising on the salaries and remuneration to be paid out of public funds, keeping under review all matters relating to the salaries and remuneration of public officers, and advising the national and county governments on the harmonization, equity and fairness of remuneration for the attraction and retention of requisite skills in the public sector.¹⁹⁵ Apart from conducting comparative surveys on the labour markets and trends in remuneration to determine the monetary worth of the jobs of public offices, the Commission also determines the cycle of salaries and remuneration review upon which Parliament may allocate adequate funds for implementation.¹⁹⁶ Lastly, the Commission may make recommendations on matters relating to the salary and remuneration of a particular public officer, and on the review of pensions payable to holders of

¹⁹¹ Ibid.

¹⁹² Cap 5F, Laws of Kenya.

¹⁹³ Article 230 and 253, Constitution of Kenya 2010.

¹⁹⁴ Section 11, Cap 5F, Laws of Kenya.

¹⁹⁵ Ibid.

¹⁹⁶ Ibid.

public offices.¹⁹⁷ In order to discharge its functions, the Commission has been given several powers under the Act.¹⁹⁸ It can interview individuals, groups or members of institutions, conduct inquiries, and gather any information it considers relevant for the purposes of discharging its functions.¹⁹⁹

The Cabinet Secretary responsible for a commercial state corporation, just like the Commission, is also involved in matters related to remuneration of employees of that enterprise. It is the Cabinet Secretary who provides approval for the establishment of a pension scheme for the employees of the corporation, gratuity, superannuation, provident and other funds.²⁰⁰ This, just like employment processes for staff, involves the Treasury and the Committee, who must be consulted.

It can be argued that the Salaries and Remuneration Commission, as well as the Cabinet Secretary, are a hindrance to the performance of commercial functions by these corporations. In private-owned companies, employment and remuneration of staff is a function of the company. For commercial state corporations, this is a statutory function of another body. While it could be argued that this interference is necessary for the regulation of remuneration to regulate the public wage bill, curb corruption and improve accountability and transparency, this study argues that it is detrimental to the commercial undertaking of the company. For example, if a commercial state corporation would like to adjust the salary of an employee, the process requires that this proposal to adjust must go through its management, its parent ministry, the National Treasury and the Salaries and Remuneration Commission. The parameters of such review and the considerations accorded by the Salaries and Remuneration Commission, while considering such a proposal, is

¹⁹⁷ Ibid.

¹⁹⁸ Ibid., Section 13.

¹⁹⁹ Ibid.

²⁰⁰ Ibid., Section 5(4).

insensitive to the performance, and the needs of the business. The Salaries and Remuneration Commission overriding objective may be to harmonize salaries and remuneration with other players in a non-commercial environment and with the sole aim of reducing or containing the public wage bill. This is done in total disregard of the corporations' profitability, performance of the employees in the enterprise and the fact that it generates its own funds and it is not funded by the exchequer.

The inability for such corporations to increase the salaries of employees at will has more often than not led to loss of talent as employees may not feel motivated or they may leave the corporation in search of increased salaries offered by their competitors, who, ordinarily will be regular and private-owned companies who are in competition with them.

3.10 The Myriad Compliance Mechanisms: Beneficial or Detrimental?

Commercial state corporations are subjected to numerous compliance systems. For every lack of compliance with the legislation in place for the regulation and control of these enterprises, there is a penalty on the part of the public officer responsible. At this juncture, this study examines some of the compliance requirements in place for commercial state corporations to follow, and the repercussions they attract for non-compliance. The study does this by discussing the role of several institutions which help in enforcing the various legal requirements.

3.10.1 The Role of the Ethics and Anti-Corruption Commission.

Upon the ratification of the new Constitution in August 2010, the Ethics and Anti-Corruption Commission (EACC) replaced the Kenya Anti-Corruption Commission (KACC) as the anti-corruption body in Kenya. The defunct KACC was established by the Anti-Corruption and Economic Crimes Act and was mandated to enforce the said Act. The Ethics and Anti-

Corruption Act establishes the Ethics and Anti-Corruption Commission pursuant to Article 79 of the Constitution.²⁰¹ This Act was enacted to provide for the functions and powers of the Commission.²⁰² Apart from the functions of the Commission which are outlined in Article 252 of the Constitution, the Act outlines additional functions. The Commission is tasked with working with state and public offices in the development and promotion of standards and best practices in integrity and anti-corruption.²⁰³ It also receives complaints related to the breach of the code of ethics by public officers.²⁰⁴

The Commission is also responsible for the enforcement of the provisions of the Anti-Corruption and Economic Crimes Act. The EACC also has an investigative role, which involves the investigation of any violations of the code of ethics and acts of corruption and related acts under the Act. After investigation, the Commission recommends to the Director of Public Prosecutions, the prosecution for those acts.²⁰⁵ Above all, the Commission recommends appropriate action to be taken against state officers who have engaged in unethical conduct.²⁰⁶

In discharging its functions, the Commission shall be guided by the principles in Article 10 of the Constitution as well as the principles of impartiality and gender equity, accommodating the diversity of the Kenyan people, and the rules of natural justice.²⁰⁷ In order to discharge its functions under the Act and the Constitution, the Commission has several powers. One such

²⁰¹ Act No.22 of 2011, Laws of Kenya.

²⁰² Ibid., Preamble to the Act.

²⁰³ Ibid., Section 11.

²⁰⁴ Ibid.

²⁰⁵ Ibid.

²⁰⁶ Ibid.

²⁰⁷ Ibid., Section 12.

power is to conduct investigations on its own initiative or on a complaint made by any person.²⁰⁸

The contravention of the provisions of the Act results in the commission of an offence.²⁰⁹

3.10.2 The Role of the Kenya National Human Rights and Equality Commission

The Commission was established under Article 59(1) of the Constitution of Kenya 2010. The functions of the Commission include the promotion and respect for human rights and the development of a human rights culture in Kenya.²¹⁰ The Commission is not yet operationalised; therefore, the Kenya National Commission on Human Rights still acts in the interim. The Commission's mandate complements that of the Ethics and Anti-Corruption Commission and the main idea behind its establishment is to promote human rights principles such as gender equality, the observance of human rights in private and public institutions and to monitor, investigate and report on human rights violations.

For a commercial state corporation, contravening the gender equality rule or the rule on ethnic inclusion in employment is an offence. A person who feels like their right has been violated by such a corporation can complain to the Commission.

3.10.3 The Role of the Commission on Administrative Justice (Ombudsman)

The Commission on Administrative Justice (CAJ), also known as the Office of the Ombudsman is an independent constitutional office established by the Commission on Administrative Justice Act 2011 pursuant to Article 59 (4) of the Constitution of Kenya.²¹¹ The purpose of the Act was

²⁰⁸Ibid., Section 13(2)(c).

²⁰⁹Ibid., Section 11(2).

²¹⁰Article 59, Constitution of Kenya 2010.

²¹¹No.23 of 2011, Laws of Kenya.

to restructure the Kenya National Human Rights and Equality Commission and to establish the Commission on Administrative Justice.²¹²

Section 8 of the Act outlines the functions of the Commission to include that of investigating any conduct in state affairs, or any act or omission in public administration by any State organ, State or public officer in National and County Governments that is alleged or suspected to be prejudicial or improper or is likely to result in any impropriety or prejudice.²¹³ The Commission is also mandated to address all forms of maladministration, promote good governance and efficient public service delivery by enforcing the right to fair administrative action.²¹⁴ It also investigates abuse of power, manifest injustice and unlawful, oppressive, unfair or unresponsive official conduct.²¹⁵ As per Section 29, the Commission has the jurisdiction to investigate commercial state corporations within the meaning of the State Corporations Act.²¹⁶

3.10.4 The Role of the National Cohesion and Integration Commission

The National Cohesion and Integration Commission was established under the National Cohesion and Integration Act which was enacted to encourage national cohesion and integration by outlawing discrimination on ethnic grounds.²¹⁷ The Act was also established to provide for the establishment of the National Integration Commission, its functions and powers.²¹⁸

This Commission and the Act are relevant to commercial state corporations in relation to employment matters. In line with the Constitution 2010, the Act provides that all public establishments shall seek to represent the diversity of the people of Kenya in the employment of

²¹²Ibid., Preamble to the Act.

²¹³Ibid., Section 8.

²¹⁴ Ibid.

²¹⁵ Ibid.

²¹⁶ Cap 446, Laws of Kenya.

²¹⁷Preamble to the Act, No.12 of 2008.

²¹⁸ Ibid.

their staff.²¹⁹ As per the reading of Section 7(2), they shall adhere to the rule that they should not employ more than one third of their staff from the same ethnic community. Where the Commission receives complaints that a commercial state corporation has engaged in racial and ethnic discrimination, the Commission will investigate the complaints and make recommendations to the Attorney General, the Human Rights Commission and other remedial measures to be taken if such complaints are indeed valid.²²⁰ To exercise its functions, the Commission has several powers, including the power to summon witnesses.²²¹ Contravening the Act also attracts criminal liability.²²²

The provisions of this Act may be beneficial for the upholding of the principles of good governance, inclusion of all ethnic groups and non-discrimination. However, for a commercial state corporation, this may be a stumbling block to some transactions. For instance, the requirement that the employment of staff should go by the rule of not more than one third being from one ethnic group may lead to loss of talent. It is also restrained from head-hunting for talented persons that could be assets to the company. Instead, the corporation has to consider the ethnic balance even where the competency level of those shortlisted may be wanting. The problem is worsened by the long processes of recruiting employees, since the process has to involve advertisement and a shortlisting stage then interview before employment can be done.

3.10.5 Additional Compliance Requirements

The institutions and regulations discussed in this Chapter are too many and they lead to a complex web of offences, adherence requirements and control mechanisms for commercial state corporations. Apart from adhering to all these laws and institutional requirements, they also have

²¹⁹Ibid., Section 7.

²²⁰Section 25(h).

²²¹Ibid., Section 27.

²²²Ibid., Section 65.

to pay attention to the Penal Code which provides for criminal liability of body corporate and companies.²²³

Additionally, public officers running these corporations are subjected to procedures such as filing returns, declaring their wealth and avoiding conflicts of interest. While such compliance and monitoring requirements are necessary for the effective and transparent running of the business affairs of these corporations, too many compliances and monitoring have the effect of watering down on discretion and independence of managers of such entities to perform their commercial role.

3.11 Mwongozo Code

In a bid to increase the efficiency and performance of all state corporations in Kenya, a Code of Governance for State Corporations, otherwise known as Mwongozo was developed. Mwongozo was launched in March, 2015 and subsequently, the President issued Executive Order No. 7 for its implementation.

Mwongozo code draws from several sources, among them the Constitution of Kenya 2010 and the OECD Guidelines. Developed by the Implementation Committee, the Institute of Certified Public Secretaries of Kenya (ICPSK) and in consultation with World Bank, the Code addresses matters ranging from transparency, good corporate citizenship and risk management. The Code is envisioned to bring about sustainability and excellence as hallmarks of government-owned entities in Kenya.

While it is argued that Mwongozo would be the much-needed remedy for poor performance of commercial state corporations, this study argues that what it has really done is to pick from the

²²³Section 23, Cap 63, Laws of Kenya.

existing corporate governance framework without addressing the issue of multiple compliances. The concern of having the sector immersed in numerous and unnecessary laws and institutions is still valid.

3.12 Conclusion

After discussing the regulatory framework for commercial state corporations in Kenya, it is evident that the sector needs serious reforms. If commercial state corporations are to perform their commercial function and achieve their full potential, the sector should be freed from all these regulations and institutional requirements and controls. This will increase the chances of these enterprises competing with their counterpart companies who have no such complex and extensive regulatory frameworks.

The next Chapter will do an in-depth analysis of the *Mwongozo* Code of Governance of State Corporations as a key output of the findings of the Presidential Taskforce on Parastatal Reforms in so far as it relates to commercial state corporations.

CHAPTER FOUR: THE *MWONGOZO CODE* AND THE PROPOSED GOVERNMENT-OWNED ENTITIES BILL, 2014: A NEW FRONTIER IN THE MANAGEMENT OF COMMERCIAL STATE CORPORATIONS

4.0 Introduction

The sustained poor performance of commercial state corporations in Kenya, and the collapse of several of such enterprises, has caught the attention of the public as well as that of the Government of Kenya. As a result, the President of the Republic of Kenya²²⁴ appointed the Taskforce on Parastatal Reforms on 23rd July 2013.²²⁵ The Taskforce was mandated with, among other things, addressing the sectoral challenges faced by these corporations. In this light, it was mandated with designing the most appropriate institutional arrangement for the sector taking into account administrative, governance, managerial and audit needs; the many categories, types and sizes of institutions in the sector; and the relevance, viability and duplication of mandates.²²⁶

The Taskforce submitted its report to the President in October 2013. In its report, it listed a number of the challenges facing state corporations in Kenya among them; inadequate policy and policy coordination leading to poor definition of mandates, conflicts in mandates, and fragmentation of mandates that facilitate the proliferation of poorly resourced state corporations,²²⁷ poor governance leading to resource loss and burdening of the public purse,²²⁸ weak and ineffective boards and an inadequate performance management framework that effectively links performance of these corporations to national development goals and fails to

²²⁴ His Excellency, President Uhuru Muigai Kenyatta, CGH, President and commander in chief of the Defence Forces of the Republic of Kenya.

²²⁵ Presidential Task Force on Parastatal Reforms, 'Available at <http://www.scac.go.ke/index.php/2015-02-16-09-34-58/presidential-taskforce>. Accessed 21 September 2015.

²²⁶ *ibid.*

²²⁷ The Policy Issues and Challenges, Report of the Presidential Taskforce on Parastatal Reforms' (2013) at XIV.

²²⁸ *ibid*

adequately link individual performance to institutional performance.²²⁹ The task force did not however identify the myriad compliance requirements for state corporations under the various legal, regulatory and institutional frameworks as a reason for the inefficiencies of these institutions.

Under the Chapter on Governance of State Corporations,²³⁰ the Taskforce observed that an effective governance framework must start with the powers, roles and responsibilities of the Board being clearly defined because without such definition, clear accountability for the achievement of objectives cannot be achieved.²³¹ The committee recommended that professionals of good standing drawn from different fields prepare a Code of Governance for State Corporations, which would then be subjected to Stakeholder consultation before adoption.²³²

This recommendation resulted in the preparation and issuing of the Code of Governance for State Corporations, also known as the Mwongozo Code (Hereinafter “**The Code**”) as a joint effort of the Public Service Commission and the State Corporations Advisory Committee. It introduces a new framework for the governance of these corporations, which framework is intended to put in a new era in the management and performance of these enterprises. This Chapter focuses on the Code and the reforms it has introduced. However, it also touches on the Government Owned Entities Bill of 2014.

In the foreword of the Code, the President, Uhuru Muigai Kenyatta, styles Mwongozo as a Code of Governance for State Corporations aligned to the Constitution that is expected to increase the

²²⁹ Ibid.

²³⁰ *ibid*, Chapter Six ‘ Governance of Government Owned Entities’

²³¹ *ibid*. at 57.

²³² *ibid*.

efficiency and accountability in the use and deployment of scarce public resources.²³³ He states that the Mwongozo Code is his call to public institutions to act effectively and efficiently in order to aid in the achievement of the Country's goals, especially in the face of increasing demands from a growing population and the subsequent demand for employment, especially from the young people.²³⁴

Other than being a reformative tool, the Mwongozo Code also plays the role of streamlining the running of State Corporations in Kenya to the Constitution of Kenya 2010 and the international standards that have been developed for the running of State Corporations. With regard to the former, it is grounded in Article 10 of the Constitution which entrenches national values and principles of governance and Article 73 which emphasizes public trust, honour and dignity of public offices. It is also based on Article 232 which emphasizes the need for personal integrity and values and principles of public service and which also provides for efficiency, effectiveness and economic use of resources.

With regard to the latter, the Corporate Governance framework embedded in the Code embodies the six principles of good governance developed by the Organization for Economic Cooperation and Development (hereinafter "OECD"), and which are now global benchmarks for corporate governance principles.²³⁵ These are ensuring the basis for an effective corporate governance framework; the rights of shareholders; disclosure and transparency and the responsibilities of the Board.²³⁶ The Code also takes into account the 2005 OECD Guidelines on Corporate

²³³Public Service Commission & Public Service Commission, *Mwongozo, The Code of Governance for State Corporations*, Presidential Foreword, at III, para.1

²³⁴ Ibid.

²³⁵ ibid.

²³⁶ibid.

Governance of State Corporations.²³⁷ These guidelines include requirements that commercial state corporations should observe high standards of transparency in accordance with OECD principles of corporate governance, the Boards of commercial state corporations should have the necessary authority, competencies and objectivity to carry out their function of strategic guidance and monitoring of management; and members of the Board are required to act with integrity and be held accountable for their actions.

4.1 The Government Owned Entities Bill, 2014

The Mwongozo Code is not the only effort that has been made in an attempt to reform commercial state corporations in Kenya. If anything, the Mwongozo Code is limited to reforming the governance framework of commercial state corporations. The Government Owned Entities Bill²³⁸ however has a wider reach, ranging from the establishment of State Corporations to their administration, merger and even dissolution. If the Bill is successfully enacted into law, it is expected to repeal the State Corporations Act that currently provides for the establishment and management of State Corporations.²³⁹ The long title of the Act describes the proposed law as an Act of Parliament to provide a unified and comprehensive framework for the establishment of government owned entities, to provide for their classification, management and governance and for connected purposes.

Like the Mwongozo Code, this Bill is also intended to align the law on state corporations with the Constitution of Kenya 2010. For instance, a perusal of the Bill reveals that it takes into account the constitutional provision for devolved government by allowing the formation of

²³⁷ *ibid.*

²³⁸ Government Owned Entities Bill, 2014 Working Draft Available from http://www.cickenya.org/index.php/legislation/item/400-the-government-owned-entities-bill-2014#.VgSB8eLkX_V Accessed 22 September 2015

²³⁹ *ibid.* section 65

county corporations.²⁴⁰ It also requires that the establishment and management of commercial state corporations take into account the national values and principles of governance set out by Article 10 of the Constitution; the principles of leadership and integrity set out in Chapter Six of the Constitution and the values and principles of public service set out under Article 232 of the Constitution.

It is notable that the Bill establishes and defines both state corporations and state agencies and their county equivalents.²⁴¹ While a commercial state corporation is incorporated under the Companies Act and is established for a commercial purpose, a state agency may be incorporated otherwise than under the Companies Act and is intended to achieve a specific strategic government objective.²⁴² Other new introductions include government-linked corporation which is an entity in which the national or county government or a government owned entity is a shareholder with fifty percent or less of the share capital.²⁴³ A government owned entity on the other hand means a State or county corporation or agency and includes a subsidiary.²⁴⁴ The shareholding of the national or county government in such entities is above 51 per cent.

In terms of administration, the Bill proposes a commendable streamlining in the ownership and oversight of state corporations in Kenya. It does so by proposing the creation of the Government Investment Corporation Limited, wholly owned by the National Treasury and incorporated under the Companies Act.²⁴⁵ The Company shall be the holding company for the national government

²⁴⁰Section 2 of the Government Enterprises Bill defines A county Corporation is defined as an entity howsoever incorporated, that is solely or partly owned by the county government for commercial purposes; while a state corporation is defined as means an entity incorporated under the Companies Act, that is solely or partly owned by the national government for commercial purposes.

²⁴¹ibid. Section 2

²⁴²ibid.

²⁴³ ibid

²⁴⁴ Ibid.

²⁴⁵ Section 12.

in State Corporations and shall in that regard exercise ownership, investment and oversight roles over State Corporations on behalf of the National Treasury.²⁴⁶

It is noteworthy that the provisions of the Bill and those of the Mwongozo Code are in agreement, only that those of the former are more detailed than those of the latter. In fact, Section 24 of the Bill requires that the Company and Oversight Office established under Section 19 to develop a Code of governance for government owned entities that promotes or facilitates high standards of professional ethics; efficient use of resources; effective service delivery; responsive, prompt, effective, impartial and equitable delivery of services and public participation in the process of policy making among others. The Mwongozo Code already answers to these requirements. It is no wonder then that the President undertook to issue the Mwongozo Code as regulations under Section 30 of the State Corporations Act.²⁴⁷ It is arguable that if the Bill becomes law, the Mwongozo Code would properly fit as regulations under that proposed Act.

4.2 The Mwongozo Code: Substantive Provisions

The Presidential Task Force on Parastatal Reforms clustered the problems ailing State Corporations under the following heads; absence of a clear framework for recruitment, selection, appointment and inductions of Boards of State Corporations; lack of uniformity in the application of appointment procedure; inadequate induction processes for board members; lack of proper skills mix and bloated Boards; shortcomings in the process of appointment of CEOs; lack of understanding of the role of Boards by Directors and fusing of the Roles of the Chief Executive and Board Secretary. All together, the provisions of the Code although dealing with varying aspects of governance have the remedying of these challenges as their common goal.

²⁴⁶ Section 12(1).

²⁴⁷ Presidential Foreword (n9).

It is also notable that the drafters of the Mwongozo Code agreed with the recommendations of the Presidential Task Force on Parastatal Reforms that effective governance framework must start with the powers, roles and responsibilities of the Board being clearly defined because without such definition, clear accountability for the achievement of objectives cannot be achieved. This is because a perusal of the Code reveals that its central focus is the Board. If Boards were to perform and act as expected, then the rest of the organization would follow and this would be reflected in improved performance. The following section provides an account of the substantive provisions in the Code.

4.3 Structure of the Mwongozo Code

The Code exhaustively covers eight thematic areas, all of which are central to the governance of State Corporations. Under each of these areas is developed the governance statement that should guide the operation of that area and governance principles that players in that sector should abide by. Further, each sector is divided into smaller governance parameters and the specific governance practices for that parameter set out. The Code is a comprehensive account of how a state corporation should be managed and it introduces a number of significant changes to the governance framework of State Corporations.

The thematic areas are considered below and numbered accordingly.

4.3.1 The Board of Directors

This is the first and most prominently covered thematic area. The guiding statement for this thematic area is that for an organization to achieve its strategic objectives, it should be led by an effective Board.²⁴⁸ The Board should be composed of competent, diverse and qualified members

²⁴⁸ Mwongozo, Chapter 1 at 1.

capable of exercising objective and independent judgment.²⁴⁹ The Board should have appropriate autonomy and authority to exercise its functions and should be accountable to shareholders and act responsibly towards stakeholders.²⁵⁰

The Governance Principles proposed for a Board of Directors include: that the composition and size of the Boards should provide a diversity of gender,²⁵¹ competencies and skills required for effective leadership of the organization, that the Board should provide strategic direction to the organization, exercise control and remain accountable to shareholders, ensure that Board members are inducted and that their skills and knowledge are continually developed to enhance effectiveness of the Board and lastly, that the performance of its committees and individual directors should be evaluated annually. The notable parameters under this area are as follows:

4.3.1.1 Appointment, Composition and Size.

The Governance practices here go to the specifics of how Board members should be appointed and how many they should be. It is arguable that this specificity of numbers is expected to deal with the problem of bloated Boards. The Code provides that Board appointments shall be made in accordance with Article 27 of the Constitution²⁵² and such appointment will be through a transparent and formal process governed by the overriding principle of merit.²⁵³ The Code categorically specifies that the Board Membership of all State Corporations shall be between seven and nine members.²⁵⁴ Persons chosen should not have served in the same organization as

²⁴⁹ Ibid.

²⁵⁰ Ibid.

²⁵¹ This is in line with constitutional provisions against discrimination and those that call for affirmative action.

²⁵²²⁵² Equality and Freedom from Discrimination.

²⁵³ If well implemented, this provision could remedy the problem of political appointments where such appointments are used to reward political allies.

²⁵⁴ Mwongozo at.11

an employee in the last five years.²⁵⁵ Board members shall sit on the Board in their individual capacity with no power to appoint alternates,²⁵⁶ thus ensuring independence of opinion and judgment on the part of members. In order to allow smooth transition, appointing authorities shall ensure that the tenures of board members are staggered to ensure a phased transition.²⁵⁷ The chairpersons of all state corporations shall be appointed by the President and shall possess the requisite qualifications, skills and experience.²⁵⁸

For purposes of clarity, the Code specifies that the Chief Executive Officer shall be a Board member with no voting rights.²⁵⁹ In an effort to infuse professionalism and competence in Board Management, it is provided that Board appointments shall take into consideration the mix of skills and competencies required for the achievement of the organization's long-term goals. Specifically, a Board must have at least one financial expert.²⁶⁰ Related to this is the requirement that the Board may recommend the removal of a member based on non-performance, non-attendance of meetings, unethical conduct or as set out in any constitutive documents or applicable law. To introduce transparency into boardrooms, the Code requires that at least one third of the Board members be independent upon appointment and maintain their independence during their term of service on the Board.²⁶¹

²⁵⁵ Ibid.

²⁵⁶ Ibid.

²⁵⁷ Ibid.

²⁵⁸ Ibid.

²⁵⁹ Ibid.

²⁶⁰ This is interpreted to mean that he or she has the necessary qualifications and expertise in financial management or accounting and is a bona fide member of a professional body regulating the Accountancy profession, and in compliance with the requirements thereof.

²⁶¹ A Board Member shall be considered independent if he or she: is not in service of the National Government or any of the County Governments or of any statutory body or anybody or institution owned or controlled by the National Government or any County Government and who is not connected, pecuniary or otherwise with the State Corporation, its associated companies, subsidiaries, or any holding Company, has not been employed by the State Corporation in an executive capacity within the last five years, is not associated to an advisor or consultant to the State Corporation or a member of the State Corporation's senior management or a significant customer or supplier

Besides limiting the sizes of Boards, the Code also introduces term limits for Board members.²⁶² The tenure of a Board member shall not exceed a cumulative term of six years or two terms of three years each provided that upon first implementation of this Code, the appointing authority may extend the term of not more than a third of the members of the Board in order to achieve continuity.²⁶³ The renewal of a Board Member's tenure for a second term should be subject to a favourable evaluation.²⁶⁴

A notable position is that taken in the Report of the Presidential Taskforce on Parastatal Reforms on the composition of Boards. It requires that Membership to the Boards of State Agencies by Government Ministries/Departments is to be restricted to two members, one each from the National Treasury and the parent Ministry. The two shall be either the Principal Secretary or their nominees who shall be substantively appointed as members of the Board by the Cabinet Secretary of the relevant parent Ministry of the State Agency. It is arguable that this is an attempt to ensure that the agency complies with the specific purpose for which it is formed. In this view, this step may be said to be no different from a case in which a private investor is a board member in his company. However, due to the power vested in government and the tendency of governments to want to have things their way, this may also be seen as one way in which the government wants to retain great control of state agencies. An ideal situation would be where the interests of government are well balanced with the achievement of purpose.

of the State Corporation, has no personal service contract(s) with the State Corporation or a member of the State Corporation's senior management; and is not a member of the immediate family of any person described above.

²⁶² Governance Parameter 1.5

²⁶³ *ibid*

²⁶⁴ Parameter 1.12 on Board Evaluation

In order to secure the full commitment of Board members, the Code prohibits multiple directorships.²⁶⁵ It elaborates that a Board member shall not hold such a position in more than two State Corporations at any one time to ensure effective participation in the Board. This is coupled with the express requirement that Board members shall dedicate adequate time and effort for meetings and shall meet as regularly as required and at least quarterly in order to effectively lead the organization. Further, a Chairperson of a state corporation shall not hold such a position in any other state corporation concurrently in order to allow them devote sufficient time to steering the Board.²⁶⁶

4.3.1.2 Functions and Operative Mechanisms for Boards

The Code provides that Boards shall exercise their role collectively. Among other functions, Boards shall; set and oversee the overall strategy and approve significant policies of the organization, ensure that the strategy is aligned with the purpose of the organization and the legitimate interests and expectations of its shareholders and other stakeholders, determine the Organization's mission, vision, purpose and core values, ensure that the strategy of the organization is aligned to the long term goals of the organization on sustainability, approve the organizational structure, approve the annual budget of the organization, monitor the organization's performance and ensure sustainability, enhance the corporate image of the organization and ensure availability of adequate resources for the achievement of the organization's objectives. The Board shall also be responsible for appointing and removing the Chief Executive Officer,²⁶⁷ defining and approving his or her authority levels, setting his or her

²⁶⁵ *ibid.* 1.6 on Multiple Directorships

²⁶⁶ *Ibid.*

²⁶⁷ The CEO shall be responsible for the day-to-day operations of the organization, provide leadership to senior management and staff, prepare the annual budgets and establish proper internal controls, be responsible for the execution and communication of the Board's strategies, decisions and policies, develop and recommend to the Board the annual business plans for the organization, ensure that the organization has an effective management

performance targets and has put in place a succession plan for the office of the CEO and other senior management offices.

Individual Board members are expected to exercise the highest degree of care, skill and diligence in discharging their duties, act in the best interest of the organization, avoid situations where their personal interests conflict with those of the organization, understand and accept the principle of collective responsibility, devote sufficient time to carry out their responsibilities, regularly update their knowledge and enhance their skills, promote transparency and accountability at Board level and also, promote and protect the image of the organization. They further owe the organization a duty to hold in confidence all information available to them by virtue of their position as Board Members.

The Chairperson is expected to provide overall leadership to the Board, play a key role in setting the agenda for Board meetings, lead the annual Board Evaluation process, monitor the performance of the Chief Executive Officer and lead in the evaluation of his or her performance, maintain close but independent working relationship with the Chief Executive Officer, ensure appropriate balance of power between the Chief Executive Officer and the Board, be available for consultations with Board Members, ensure that there is a formal succession plan for Board members, ensure new Board members are inducted in accordance with the agreed induction programme, encourage board members to develop their skills and competencies, act as an informal link between the Board and shareholders and provide quarterly updates on governance

structure including succession plans, ensure that all Board papers are accurately written, are relevant and are availed to the Board members in good time, serve as the link between the Board and the Management, be responsible for the achievement of the objectives of the organizations, put in place effective administrative corporate image of the organization structures, processes and systems, provide regular, thorough and prompt communication to the Board on key technical, and administrative matters.

matters and any issue thereof to the responsible Cabinet Secretary and State Corporations Advisory Committee

Boards are required to establish an Audit Committee and a maximum of three other Committees and appoint the chairpersons of such committees.²⁶⁸ They shall provide Terms of Reference for each committee so established which should set out the Committee's objectives, delegated authority, operations and reporting mechanism to the Board. For the sake of prudence, the Chairperson of the Board should not be a member of any committee, save for an ad-hoc committee, committee members should have the necessary skills and expertise to execute their responsibilities, where required skills are not available to the committee, the Board may, with the approval of the oversight body, co-opt non-Board members to the Committee. Committees shall make recommendations to the Board.

4.3.1.3 Operations of Boards

In an effort to improve efficiency and planning, the Code requires Board members to ensure that an annual Board work plan is developed.²⁶⁹ The Work plan shall focus on: a review of the management's implementation of strategies, policies and plans, risk assessment and management, budgeting and financial management, Quality assurance processes, Board evaluation, strategic planning and review, governance and compliance and the competence development for Board members. The Board shall also develop and adopt a Board Charter that

²⁶⁸Parameter 1.7 on Committees of the Board. The three other committees shall discharge the functions governance, Risk, Compliance, Finance, Technical Matters, Strategy and Human Resources. On top of the four committees expressly provided for, the Boards may set up such other ad hoc committees as the need may arise.

²⁶⁹Parameter 1.9 on Board Work Plan.

shall be periodically reviewed and that shall define the role, responsibilities and functions of the Board in the governance of the organization.²⁷⁰

The Board shall develop an induction programme for new Board members and in order to instill a culture of personal improvement, the Code requires that a competence needs assessment be carried out and an annual development programme per Board member be put in place.²⁷¹

The Board shall determine its performance criteria and undertake an annual evaluation of its performance. Such evaluation shall cover the Board as a whole, its committees, individual members, the Chairperson, the Chief Executive Officer and the Corporation Secretary.²⁷² The evaluation report should be shared with relevant stakeholders. The re-appointment for a subsequent term for any Board member or Chief Executive Officer shall be based on a favourable evaluation as spelt out in the evaluation tool. In a way, this form of evaluation is an accountability mechanism by which the conduct of the Board members shall be interrogated.

Other than evaluation, the Code also provides for a governance audit.²⁷³ The Board in consultations with the Oversight Office shall ensure that it subjects the organization to an annual governance audit by the Institute of Certified Public Secretaries of Kenya (ICPSK). Such audit shall, among other areas cover leadership and strategic management, transparency and disclosure, compliance with laws and regulations, communication with stakeholders, Board independence and governance, Board systems and procedures, consistent shareholder and stakeholders' value enhancement; and corporate social responsibility and investment. It is

²⁷⁰ Parameter 1.11 on Board Charter.

²⁷¹ Parameter 1.10 on Board Induction and Continuous Skills Development

²⁷² Parameter 1.12 on Board Evaluation

²⁷³ Parameter 1.13 on Board Audit

arguable that this will aid in the implementation of the Mwongozo code as well as ensure compliance with other laws and policies relevant to the governance of State Corporations.

It is noteworthy that the code requires that the remuneration of Board members be linked to performance.²⁷⁴ This will ensure that Board members apply themselves diligently to their tasks. This can also be used as a source of motivation when used to reward the Board members whose productivity is notable. Accountability of Board members is ensured by the provision that Board members should be held liable for their acts and omissions arising from their negligence, default, breach of duty or breach of trust.²⁷⁵

Finally and in a decisive effort to rid Boards of the problematic fusion of the CEOs and the Board chairman's functions, the Code clearly sets out that the role of the Board should clearly be separated from that of the management, the office of the chairperson and that of the CEO.²⁷⁶ On the one hand, Board positions should be held by different persons, and on the other, the office of the CEO and that of the Corporate Secretary should be held by different persons.²⁷⁷

4.3.2 Transparency and Disclosure

The Governance Statement under this thematic area is that transparency and Disclosure creates and sustains confidence of investors, stakeholders and the wider society and provides opportunities for continuous improvement of business structures and processes. The Board should ensure effective, accurate, timely and transparent disclosure of pertinent information on the State Corporation's operations and performance.²⁷⁸

²⁷⁴ Parameter 1.15 on Board Remuneration

²⁷⁵ Parameter 1.17 on liability

²⁷⁶ Parameter 1.22 on Separation of Roles

²⁷⁷ Ibid.

²⁷⁸ *Mwongozo*, Chapter 2: Transparency and Disclosure

With regard to disclosure, Boards shall disclose the key shareholders and the extent of their shareholding, the key stakeholders who may have an influence on organizational performance and sustainability, the nature of its engagement with key stakeholders and the outcome of those engagements in the annual report.²⁷⁹ As a general requirement, Boards shall disclose all relevant information to key stakeholders to enable them exercise their rights. Similarly, the Board shall disclose details such as the composition and size of the Board, names, qualifications and dates of appointment of Board Members, the Committees of the Board and the Management, and a summary of the Board evaluation results in the annual report.²⁸⁰ The Board shall also disclose to stakeholders the major sources of revenue and major items of expenditure.²⁸¹

To encourage financial probity, the Board is required to disclose the remuneration of directors, individually and collectively, and the salaries and remuneration of the Chief Executive Officer and the senior management in the organization's financial statements.²⁸² Beyond this, the Board should, in the annual report, present an assessment of the factors that affected the organization's financial condition and results of operation over the period under review, and the known trends which are reasonably likely to have a material effect on the financial condition and results of operations in the future.²⁸³ The Board should also confirm that it has complied with applicable financial reporting standards in preparing the financial statements; any deviation from financial policies and related party transactions.²⁸⁴

A measure that is expected to further enhance transparency is the requirement that the Board should disclose the code of ethics and conduct of the organization, the policy of the organization

²⁷⁹Parameter 2.3 on Key Stakeholder Groups

²⁸⁰ibid

²⁸¹ibid

²⁸²Parameter 2.5 on Board Performance and Remuneration Structure

²⁸³ibid.

²⁸⁴Parameter 2.8 on Financial Reporting.

on conflict of interest, and the policy of the organization on whistle blowing on the website of the organization.²⁸⁵ To ascertain the effectiveness or otherwise of these policies, organizations are expected to disclose the extent to which the policies have been useful in dealing with unethical behaviour in the organization.

The Board shall also disclose the policy of the organization on procurement, the top ten contracts of the organization in terms of value and the number of legal challenges to procurement decisions including details of any that may have been successful.²⁸⁶ This should go a long way to prevent the corruption that is rife in procurement processes.

4.3.3 Accountability, Risk Management and Internal Control²⁸⁷

The Governance statement here is that the Board has the responsibility of ensuring that the organization has adequate systems and processes of accountability, risk management and internal controls. The Governance Principles include: the board shall ensure the timely preparation of accurate financial statements; the board shall ensure that effective processes and systems of risk management and internal controls are in place and that the procurement process is cost-effective and delivers value for money.

The Governance Parameters include those described below;

The First is Financial Reporting.²⁸⁸ Under this head, the Board should ensure that the books of accounts are prepared on a timely basis. It should also ensure that the external audit of the financial statements is completed and submitted within timelines stipulated in any law and

²⁸⁵ Parameter 2.6 on Code of Ethics and Conduct and Whistle- Blowing Policy

²⁸⁶ Parameter 2.10 on Procurement Processes

²⁸⁷ Mwongozo, Chapter 3: Accountability, Risk Management and Internal Control

²⁸⁸ Parameter 3.1 on Financial Reporting

government policies and ensure that an independent, competent and qualified external auditor conducts the annual audit of the organization.

The second parameter is Risk Management.²⁸⁹ Under this parameter, the Board should ensure the development of a policy on risk management which should take into account sustainability, ethics and compliance risks. It should also approve the risk management policy and the risk management framework, delegate to management the responsibility to implement the risk management plan and appoint a risk management committee. Once it has done that, it will be obligated to ensure compliance with the risk management framework by conducting a quarterly review of its implementation.

The third parameter is that styled Internal Controls.²⁹⁰ Under this, The Board should maintain an effective and efficient system of internal controls, receive from the internal audit function and from the external auditor a written assessment of the effectiveness of the system of internal controls on a quarterly basis and ensure that the internal audit function monitors for rectification, weaknesses noted by the external auditor.

The Fourth is Procurement Process²⁹¹ which is of special significance to the reform of state corporations. This calls on Boards to establish a procurement function in the organization and establish a procurement policy that promotes sustainability, high ethical standards and best practice. An organization's procurement policy should be aligned with the annual budget. It is the Board's responsibility to periodically review the implementation of the procurement plan, receive a quarterly report on the actual expenditure compared to the budget and demand

²⁸⁹ Parameter 3.2 on Risk Management

²⁹⁰ Parameter 3.3 on Internal Controls

²⁹¹ Parameter 3.5 on Procurement Processes

explanations from management on any variances and ensure that there exists a clearly documented audit trail of procurement activities.

Interestingly, neither the Report of the Presidential Task force nor the Mwongozo Code specifically requires the creation of tender committees. These committees would go a long way in expediting and ensuring transparency in the procurement process. However, commercial state corporations may compose a Tender Committee as an ad-hoc Committee in accordance with the Mwongozo Code.

The last head in this thematic area is Information Communication Technology.²⁹² Commercial state corporations are expected to integrate information technology in their operations. Boards are expected to establish an ICT function and align it to the objectives of the Organization. To sustain their technology installations, the Boards of State Corporations are also charged with ensuring that ICT related risks are identified and managed. This requirement recognizes that for State Corporations to reach optimum performance and compete favourably with private corporations, their tools of trade need to be functional and technologically up to date.

4.3.4 Ethical Leadership and Corporate Citizenship²⁹³

For a long time, it has been alleged that a great challenge faced by State Corporations is corruption. The collapse of a number of State Corporations has always revealed allegations of embezzlement against the senior management of that organization. The Mwongozo Code intends to change this state of affairs. In the outset, it states that the operations of the organization should be guided by ethical practices that seek to promote good corporate citizenship. The Governance

²⁹² Parameter 3.6 on Information Communication Technology

²⁹³ *Mwongozo* Chapter 4: Ethical Leadership and Corporate Citizenship

principle here is that an organization should commit to operate ethically and promote corporate social responsibility and investments.

The parameters under this thematic area are centred around the matter of ethics and integrity. The Board is called upon to provide ethical leadership in the management of the organization, to establish the core values of the organization and ensure that all members of the organization adhere to them.²⁹⁴ In the same breadth, the Board should see to it that a code of conduct and ethics is developed and ensure that all members of the organization subscribe to the code of conduct and ethics by promoting ethical conduct and sanctioning misconduct. Further, it shall review the code of conduct and ethics as necessary.²⁹⁵

As part of promoting ethical conduct, Boards shall ensure that a policy on the management of conflict of interest is in place.²⁹⁶ In this light, Board members shall declare any real or perceived conflict of interest with the organization upon appointment to the Board and declare to the Board any real or perceived conflict of interest that may subsequently arise. Subsequent to such disclosure, Board members shall not take part in or influence any discussions or decision-making regarding any subject or transaction in which they have a conflict of interest. This is a great step towards achieving fair play in corporate decision making.

With regard to developing good corporate citizenship, the Board shall ensure that a sustainable and appropriate budget is allocated for corporate social responsibility and investment and that the organization respects and promotes sustainable development.²⁹⁷

²⁹⁴ Parameter 4.1 on Ethics and Integrity

²⁹⁵ Parameter 4.2 on Code of Conduct and Ethics

²⁹⁶ Parameter 4.3 on Conflict of Interest

²⁹⁷ Parameter 4.5 on Corporate Social responsibility and investment

In an effort to encourage employees to report any kind of misconduct they sight, the Board is expected to ensure that there is a whistle blowing policy in the organization.²⁹⁸ That policy should be aimed at protecting and prohibiting victimization of those who disclose information in good faith. One way that the Code provides to ensure this happens is providing that an independent party is responsible for receiving and investigating reports received.

4.3.5 Shareholders Rights and Obligations

The Code requires organizations to recognize the rights of all shareholders and ensure their equitable treatment.²⁹⁹ The Board's obligations under this head are to ensure that there is an effective shareholder dispute resolution mechanism, to ensure that the shareholders receive adequate and timely information to enable them make appropriate decisions, to ensure that the financial statements are presented to shareholders in time, and to ensure that where approved, shareholders receive dividends.³⁰⁰ The Code also specifically provides for minority shareholders. The Board is required to facilitate the participation of minority shareholders in material corporate decisions, ensure that minority shareholder rights are safeguarded and encourage minority shareholders to form shareholder associations to champion their rights where appropriate.³⁰¹

The shareholders' obligations are to: monitor the performance of the Board, appoint the Board through a transparent and formal process, approve remuneration of the Board members, appoint the external auditor, attend and participate in the general meetings, approve the financial

²⁹⁸ Parameter 4.6 on Whistle-blowing

²⁹⁹ Mwongozo Chapter 5: Shareholders Rights and Obligations

³⁰⁰ Parameter 5.1 on Ownership Rights and Interests

³⁰¹ Parameter 5.3 on Minority Shareholders

statements, approve the distribution of profits, and provide an environment that allows the Board to exercise independent judgment and decision-making.³⁰²

4.3.6 Stake Holder Relationships

The Code requires that stakeholder relationships be managed in a proactive manner to ensure the realization of the legitimate interests and expectations of stakeholders and the achievement of corporate objectives. The governance principle here is that the effective management of stakeholder interest creates goodwill, promotes a positive image of the organization and enhances the achievement of corporate goals.³⁰³

The Board should carry out stakeholder mapping, ensure that a policy on the management of stakeholder relationships is developed and implemented, ensure periodic review of the policy for the management of stakeholder relationships, promote effective communication with stakeholders, ensure that stakeholder' interests, expectations and their power to influence the operations and direction of the organization are documented and ensure that the reputation of the organization and its linkage with stakeholders is a regular Board agenda item.³⁰⁴

Further, the Board should identify the rights of key stakeholders and ensure that their rights are respected, take account of the legitimate interests and expectations of its stakeholders in its decision-making and ensure that disputes with and among stakeholders are resolved effectively.³⁰⁵

The Code does take into consideration that commercial state corporations are government owned entities. Consequently, it provides that the Board should take proactive steps to manage its

³⁰²Parameter 5.2 on Shareholder Obligations.

³⁰³Parameter 6.1 on Stakeholder engagement.

³⁰⁴Ibid.

³⁰⁵Parameter 6.3 on Dispute Resolution

relationship with the national and county Governments, disclose in its annual report the nature of the organization's engagements with the national and county governments and other State Corporations and ensure that policies, practices and strategic plans of the organization are aligned with Government directives, National Policies and National Development Goals, including the Kenya Vision 2030.³⁰⁶

4.3.7 Sustainability and Performance Management³⁰⁷

Under this thematic area, organizations should embrace policies that meet the needs of the present without compromising their ability to sustain their future development needs and objectives. The Principle is that the goals and objectives of the organization should focus on the long term sustainability of the organization.

Boards are required to integrate sustainability into the organization's strategy and management practices. As part of doing so, they are required to adopt a holistic approach to economic, social and environmental issues in their core business strategy and take into account the impact of the organization's operations on the community and the environment.³⁰⁸ To ensure that the organization's policies and goals are sustainable, the Board should set performance targets that are Specific, Measurable, Attainable, Realistic and Time Bound (SMART). They should be reviewed regularly to ensure their improvement.

4.3.8 Compliance with Laws and Regulations³⁰⁹

Commercial state corporations are expected to conduct their business affairs in full compliance with the Constitution and all applicable laws, rules and regulations. The Board should establish

³⁰⁶Parameter 6.4 on Relationships with Governments.

³⁰⁷*Mwongozo* chapter 7: Sustainability and Performance Management

³⁰⁸Parameter 7.1 on Sustainability Goals and Strategy.

³⁰⁹ *Mwongozo* Chapter 8: Compliance with Laws and Regulations

internal procedures and monitoring systems to promote compliance with such applicable laws, regulations and standards and lay down a compliance strategy that is aligned to the operations of the organization. Besides, the Board should ensure that a legal compliance audit is carried out at least annually, with the objective of establishing the level of adherence to applicable law, rules, regulations and standards. Further, the Board should ensure that the recommendations in the Legal Compliance audit report are implemented and that a comprehensive and independent legal audit is carried out, at least once every two years. The Board shall file compliance reports on all statutory obligations in each quarter to the responsible Cabinet Secretary and SCAC.

4.4 Enforcement and Implementation of Mwongozo

It is provided that the Mwongozo code is to be implemented on a ‘comply or explain’ basis.³¹⁰

Boards shall include a statement of policy on good governance in the annual report. The statement should indicate aspects of the Mwongozo that have not been complied with and reasons thereof.

By providing for this, the framers of the Code appreciate that in the implementation of Mwongozo, commercial state corporations will be at different levels of compliance with corporate governance norms. This approach allows organizations time to adopt an implementation schedule that resonates with their circumstances and which agrees with their pace of implementation of other corporate governance norms.³¹¹ Even so, it places an accountability burden for the manner in which commercial state corporations choose to implement it.³¹² This requires that the disclosures for non-compliance will need to be detailed

³¹⁰ *ibid.*

³¹¹ *ibid.*

³¹² *ibid.*

and boards will be held to account for any explanations given.³¹³ In case of conflict between the Code and any sector specific code of governance, the higher standard shall prevail. The President issued Executive Order Number 7 for the enforcement of Mwongozo.³¹⁴

4.5 Challenges

The Mwongozo Code is an ambitious project. It is expected to turn around the governance of Kenyan commercial state corporations and hopefully, improve their performance. This is a daunting task given that unethical practices such as corruption and incompetence permeate not only the governance of State Corporations but also the general social fabric in Kenya. The implementation of this Code is going to require great commitment on the part of commercial state corporations. Already, there have been allegations that the Code is not being followed. These arose after the President appointed 302 commercial state corporation heads in April of this year. The appointments were viewed as a form of political reward system where loyal supporters and big political names were appointed.

Secondly, the ‘comply or explain’ mode of enforcement chosen for the implementation of Mwongozo though positive has the potential of slowing down its implementation. State Corporations have already proven that they need constant but not stifling supervision. Choosing this mode of implementation for a code that is expected to turn State Corporations around may become a loophole which leads to a failure of this ambitious project.

This work recommends that the level of ambition embodied in the Mwongozo Code be carried forward to its implementation. Only this will convert it from an intangible expression of hope to visible and tangible change in the management of commercial state corporations in Kenya.

³¹³ibid.

³¹⁴ibid.

CHAPTER FIVE: CONCLUSION AND RECOMMENDATIONS

5.0 Introduction

This study draws the conclusion that whereas there are many reasons that contribute to the poor performance of commercial state corporations, the main setback is that they are heavily regulated and this negatively impacts on their performance. The objective in commerce of maximising profits by increasing productivity and minimising expenses cannot be achieved in a scenario where there is a myriad of compliance and reporting requirements based on the parameters of a governmental system. This conclusion is also drawn after the study analyzed the current legislative and regulatory framework within which commercial state corporations operate.

The study began with a discussion of the importance of commercial state corporations in a “developmental state” like Kenya. In such a state, the government is at the center of the country’s development and it spearheads this through both social and economic development initiatives. The problem which the study sought to address was whether the numerous legislative and regulatory frameworks are to blame for the underperformance of commercial state corporations in Kenya. This, coupled with the absence of a clear legal framework and proper implementation of laws and regulations, has seen the deterioration of their commercial function. In tackling the problem, the study relied on the various laws and institutional framework in the management of these enterprises, analyzing the advantages and disadvantages of the various provisions.

The aim of the study was to show the impact of legislative responsiveness for effective corporate governance in commercial state corporations. In tackling the problem at hand, the study put one hypothesis to test: that the legal and institutional framework which commercial state corporations

in Kenya are subjected to negatively affects their performance as business entities. Based on this hypothesis, the study posed several questions: One, how does the lack of clear, overlap of and conflicting roles of commercial state corporations in Kenya affect their performance? Two, what are the ownership and oversight challenges created by multiple legal and regulatory frameworks governing commercial state corporations? Three, what are the various legal and institutional frameworks that affect their management? Lastly, what legal reforms should be undertaken by the Government of Kenya in their management?

In answering these fundamental questions, the study relied on the agency theory which was developed from the contract theory. The agency theory posits that corporations and firms are a nexus of contract between resource holders and such relationship is effected when the holders of resources who are the principals (shareholders or public) entrust individuals (agents) to perform functions or provide service on their behalf and fully hand-over the decision-making function to them.³¹⁵ The study also appraised the stakeholder theory which opines that corporations' actions affect various stakeholders and their success can be gauged from their ability to add value to all these stakeholders. The various groups of stakeholders who are deemed to have a stake in the business of the corporation include customers, the business environment, suppliers, employees, the local community and shareholders. Accordingly, the corporation not only has a moral right, but also a legal obligation to serve all the stakeholders who are instrumental to its success.

The study also reviewed and made reference to literature by various authors on topics related to the management of commercial state corporations and corporate governance. The research methodology adopted by the study included both primary and secondary sources of information.

³¹⁵Fama, Eugene, and Michael Jensen, 'Agency Problems and Residual Claims' (1983) *Journal of Law and Economics* 26, 327

The primary method of presentation for this thesis in respect of documentary data included the evaluation, critique and synthesis of previously published information. The study also made use of data collection methods which included in-depth interviews, focus group discussions as well as key informant interviews with selected members of various institutions that deal with governance issues in commercial state corporations. The study also used primary data obtained from case studies which were analyzed along themes derived from the specific objectives of the study to augment, cross-check, enrich and corroborate other data.

5.1 Conclusion

This study sought to look at the legal and regulatory framework in place for the management of commercial state corporations to gauge how effective or otherwise it is. The study found out that at independence, there was need to establish state corporations, especially commercial ones, so as to accelerate the rate of economic development in the country. The aim of establishing these corporations was also to enhance social cohesion and inclusion of Kenyans from all regions in the development process. In order to achieve these main objectives, there was need to set up structures to govern commercial state corporations.

The study, however, noted that after the establishment of commercial state corporations, and the required structures, government took the central position in the management and control of these enterprises. The burden on the state started being felt when these enterprises realized losses, a setback for the government since they got financing from the national budget. The government subsequently decided to introduce reforms in the sector so as to put them back on track, and most importantly, so that they could serve the two important aims they were established to achieve.

The hypothesis that was put to test was that the legal and institutional framework that commercial state corporations in Kenya are subjected to negatively affect their performance as business entities. This hypothesis was proved by showing the different reform eras which commercial state corporations have gone through. While the reform process commenced with the need to put up structures to run commercial state corporations effectively, as they progressed, they introduced additional frameworks. The end result was that these enterprises were left at the center of numerous laws and compliance mechanisms to adhere to instead of focusing on their commercial functions. The study illustrated this by looking at the different laws which these corporations have had to comply with since independence, and how they keep on adding onto each other with each reform process. The study also spent time to analyse the various laws that currently govern these corporations, as well as the institutions which they have to work hand in hand with. Failure to comply with these laws and compliances would lead to committing offences under the Penal Code or the specific laws which provide for certain offences. The study found that, while these institutional and legal frameworks could be necessary and advantageous for the smooth running of these corporations and their commercial affairs, they could also be the reason why they fail in their commercial function. Such compliances and laws end up taking most of the time that could be spent on increasing productivity and profitability.

In answering the question as to how the lack of a clear, overlap of, and conflicting roles of commercial state corporations in Kenya affect their performance, the study discussed the kind of confusion caused by the lack of a clear definition of what these enterprises are. The study concurs with the Report of the Presidential Taskforce on Parastatal Reforms,³¹⁶ that a clear definition should be adopted to distinguish between commercial state corporations and state

³¹⁶Mohamed, A. et al, "Report of the Presidential Taskforce on Parastatal Reforms," (October, 2013).

corporations performing non-commercial functions. Lack of a clear definition of the term “state corporation” has led to confusion in what roles should be performed by the former. The study opines that these corporations should solely carry out a commercial function and not get entangled in governance issues.

The existing compliance and reporting framework places unrealistic demands on the managers of these entities. The same also places high expectations to the stakeholders. The many controls are responsible for organizational ineffectiveness as they constrain the exercise of discretion, shaping priorities, and causes delays in the decision making processes. They also make managers of commercial state corporations risk averse for fear of accusation of abuse of office and attendant criminal investigations.

In answering the questions as to the various legal and institutional frameworks that affect the management of commercial state corporations, and that of the ownership and oversight challenges created by multiple legal and regulatory frameworks governing these enterprises, the study focused on some of the numerous laws which currently govern state corporations. It looked at the Public Audit Act, the Public Finance Management Act, the Anti-Corruption and Economic Crimes Act, the State Corporations Act, just to name a few. As if these Acts of Parliament are not enough, these enterprises also have to comply with and work under the supervision and oversight of institutions such as the National Treasury and their Parent Ministries. Above all, commercial state corporations also have to comply with Constitutional provisions, for instance, those that establish Commissions and offices, and adhere to principles outlined therein. These multiple frameworks, the study concludes, are detrimental to the normal conduct of business by these enterprises.

In this respect the study concludes that the proliferating regulations and oversight mechanisms designed to improve efficiency, prevent or root out corruption seriously undermine the commercial functions of commercial state corporations. The existing legal institutional and regulatory framework limits the decision making process. The rigorous compliance mechanisms have contributed to the contemporary crisis in their administration.

The many controls may provide excellent political cover for management and staff of these institutions, but it is doubtful whether they really make the organizations effective or reduce corruption. Further there is no empirical evidence that the benefits that arise out of the many controls actually outweigh the costs. In this study we posit that the many governance statutes and regulations are responsible for costly inefficiencies experienced by commercial state corporations. The controls make these businesses ineffective, unresponsive and less able to implement commercial operations effectively.

In answering the last questions as to what reforms should be undertaken by the Government of Kenya in the management of commercial state corporations, the study suggested several reforms that would make the sector more productive and profitable. The suggestions made by this study form the next part of this Chapter.

5.2 Recommendations

After reaching the conclusion above, this study would like to propose several recommendations for the management and control of commercial state corporations in Kenya. These recommendations are informed by the continued deterioration of the sector, and in light of the many reforms that have taken place to make it better but to no avail. This study is not blind to the

fact that for the sector to thrive there has to be a framework in place to govern these corporations.

5.2.1 Clear Definition of Commercial State Corporations

After discussing the challenges which are brought about by the lack of a clear definition of what a commercial state corporation is, this study recommends that there should be clarity in the definition of the various state-owned entities existing in Kenya. Commercial state corporations are state corporations which serve a commercial function, and as such, should be differentiated from state or government agencies which serve specific functions assigned to them by the government. The tradition has been that commercial state corporations have always been defined and categorized under the blanket name of “state-owned entities” when there are several entities performing distinct functions within that category.

A clear definition of commercial state corporations will provide clarity in terms of the distinct roles played by these enterprises. Not only will it demarcate these roles but a clear definition will also deal with the issue of mixing governance functions with commercial ones. Not until commercial state corporations are recognized as commercial bodies with a commercial function to discharge, will they be able to enjoy commercial status and increase their productivity and profitability.

5.2.2 Exemption from Certain Laws and Regulations

A clear definition of what a commercial state corporation actually means will not be enough to solve the issue of underperformance of the sector in Kenya. The study further recommends that the government should exempt commercial state corporations from some laws and regulations

that interfere with their day-to-day activities, and which could be a hindrance to the performance of their commercial function.

One of the laws which these corporations should be exempted from is the State Corporations Act.³¹⁷ This study posits that for these enterprises to fully perform their commercial function, they should be allowed to operate as commercial entities, independent of other unrelated functions. As it is now, the State Corporations Act governs all state corporations, be it commercial and non-commercial ones. Grouping commercial state corporations with state corporations without a commercial function oftentimes results in more confusion as to the role of each of these entities. Instead of having the State Corporations Act apply to commercial state corporations, they could be governed under the Companies Act like all the other companies. Exempting commercial state corporations from the State Corporations Act will also have the effect of exempting these enterprises from all compliance requirements which come with the Act. Above all, they will have equal and fair ground to compete with regular companies which do not have to deal with numerous laws and regulations to conduct business.

Another Act which commercial state corporations should be exempted from is the Public Procurement and Disposal Act.³¹⁸ One of the requirements under the Act is that they must adhere to a specific process when procuring goods and services. This process entails placing advertisements and evaluating tenders based on a set criterion before award. This process takes a minimum of sixty six days. In the event that the process is challenged at the Public Procurement Review Board, the same will take much longer. The process, needless to say, is time consuming,

³¹⁷ Cap 446, Laws of Kenya

³¹⁸ Cap 412C, Laws of Kenya

and ineffective. Further, there is a tendency of efficient suppliers shying away and not participating in the procurement because of the many bureaucratic bottlenecks.

Similarly, the process of hiring of staff does not allow for direct talent search. The procedure for recruitment too requires the placement of an advertisement, shortlisting candidates and interviewing them before choosing the best. Furthermore, while picking the final candidates for the job at hand, there should be consideration to ethnic inclusion and gender balance in the process. Such requirements are important in enhancing the social and governance role of commercial state corporations but they may lose out when such criteria is applied when running commercial functions. While regular companies do not need to adhere to such criteria, commercial state corporations have to, and it takes a lot of time to employ staff. This also has the implication that head-hunting would be an offence since it would mean that the process was not adhered to. Allowing direct talent search for commercial state corporations would be advantageous because it would enable them to get talent and people fit for the job through merit and not commit an offence while doing so. It would also save time otherwise spent advertising and shortlisting candidates especially where vacancies would be best filled immediately for the effective discharge of their commercial function.

Exempting commercial state corporations from other laws such as the Public Officer and the Anti-Corruption and Economic Crimes Act would help reduce compliance requirements. It would exempt public officers from facing liability for head-hunting, increasing salaries of employees at will, or even procuring goods and services at short notice. Such exemptions would be good for business since these enterprises may, from time to time, have to take business risks that do not enjoy the pleasure of time.

As an alternative to these exemptions, these corporations could make use of their internal mechanisms to improve on corporate governance and the eradication of corruption. This can be done using two main functions, namely, the internal audit function and utilizing the office of the corporation or company secretary as the case may be. In an era where the company secretary's role has evolved and ceased to be that of a mere scribe,³¹⁹ and assumed the role of a chief compliance officer this office could be of great importance in the reform process. Company secretaries are now equipped with knowledge and the appreciation of enterprises and the environment in which they operate in.

The company secretary has the responsibility of providing an oversight and compliance function for the company. The role of the company secretary covers various dimensions including statutory, operational, advisory, governance, administrative and procedural.³²⁰ The influence of a company secretary can be harnessed and applied in areas such as stakeholder engagement and corporate governance and ethics.³²¹ The company secretary can for instance apply his legal counsel and legal compliance role to investigate the corrupt dealings of the officers in their respective entities. He can, subsequently make a report and allow the mainstream criminal law procedure of charging and prosecuting the suspect to follow.

5.2.3 Autonomy

This study would also like to recommend that commercial state corporations should be able to enjoy some level of autonomy and independence like regular companies do. Commercial state corporations are run by a Board of Directors which, traditionally, has been politically constituted. The Board consists of a Chairman who is appointed by the President, a Chief Executive Officer,

³¹⁹ Lewis, C., *The Company Secretary: Custodian and Distributor of Information*, (October, 2010)

³²⁰ Ibid

³²¹ Ibid

the Principal Secretary of the National Treasury, the Principal Secretary of the Parent Ministry, and less than seven members appointed by the Cabinet Secretary, three of whom are required to be public officers.

This composition is *prima facie* political, as it has heavy representation from the government. This means that with a new government in place, the setup could change to favor the political ambitions of the incumbent party. Even while the Constitution provides for the inclusion of all in public processes, including Board membership in commercial state corporations, this is more theoretical than it is a reality. What is also theoretical is the power of the Board of such a corporation to make independent policy decisions.

Finding a balance between politics and commercial functions can be difficult especially since the former seems to take precedence over the latter. In order to enable commercial state corporations to reach their potential profit-wise, they should be allowed to enjoy some level of autonomy and independence. Such a Board composition means that before commercial decisions are made, concurrence should be given by the Board members, and most importantly the Treasury and the parent Ministry. Deciding on mundane business issues such as which kind of vehicle to purchase is hijacked by all the bureaucracy and compliance requirements. Making these decisions end up taking a lot of time due to a lot of bureaucracy which is characteristic of the government offices.

5.2.4 Reduce Compliance Mechanisms and Requirements

Another recommendation which this study puts forward is that commercial state corporations should be subjected to reduced compliance requirements. Exempting them from some laws and regulations would help in reducing some of these compliances. However, more could be done to

ensure that they exercise their commercial function without fearing they would break one law or another.

One compliance requirement which these corporations should be exempted from would be adhering to the salary reviews by the Salaries and Remuneration Commission. The work of the Commission is to set salaries and review remuneration for public officers in state-owned entities. However, it should be realized that commercial state corporations are in business and they make profit. Whenever they make good profit, they should be able to increase their employees' salaries as a sign of motivation without having the Commission to determine whether they can do so or not. Regular companies do not have such stringent measures as to remuneration and salaries can be increased to award good workmanship. This is one way of encouraging staff and keeping them motivated and more productive. This position was supported by the Attorney General³²². In an advisory opinion to the Secretary of State corporations Advisory Committee opined that:

“The definition of a public officer in Article 260 of the Constitution does not include an employee of a state corporation from the terms “public service” and “state organ”. A person who is an employee of a state corporation or a member of the board or council of a state corporation cannot be considered to be employed in the public service because the state corporation is not a state organ by virtue of not having been established under the constitution. The guidelines that have been issued by the Salaries and Remuneration Commission do not apply to state corporations.”³²³

The High Court in trying to draw a distinction between commercial state corporation and other state corporations has held that:

³²² See Hon Githu Muigai's Advisory opinion to the Secretary of State Corporations Advisory Committee dated 11th October 2012.

³²³ Ibid.

“State corporations may be classified into three major types, Namely; Commercial Corporations; Independent Regulatory Agencies and Research Institutions (Public Universities; Tertiary Education and Training Institutions)”³²⁴

From the NSSF Case,³²⁵ it also appears that the intention of government is that commercial state corporations should be self-sustaining, with minimal interference in the manner of financial intervention from the Treasury.³²⁶ The case involved a prayer for an injunction to prevent the Salaries and Remuneration Commission from interfering with NSSF’s members’ salaries as well as benefits through a circular issued by the Commission on 4th July, 2012.³²⁷

Another compliance which commercial state corporations should be exempted from is, having to obtain approval from their parent ministries before they make commercial decisions. The situation is made far worse when, after obtaining the approval from the Ministry, they have to get concurrence from the National Treasury. Having to follow such procedures when doing business can be detrimental to the profitability of commercial state corporations, mainly because some commercial decisions need to be taken as fast as possible to avoid potential losses. Additionally, having to comply with such requirements also opens them to the issue of bureaucracy. The time spent on following up on approvals and concurrences by relevant institutions could be put into good use by addressing business risks immediately they present themselves.

³²⁴Justice Mathew Nderi Nduma, . Employment and Labour Relations Court of Kenya at Nairobi, Petition no.30 of 2014, the Kenya Union of Commercial Food and Allied Workers vs. Salaries and Remuneration Commission, the Hon Attorney General *Exparte* National Social Security Fund at pg. 11

³²⁵ Ibid

³²⁶ Ibid, pg.12

³²⁷ Ibid.

5.2.5 Implement the *Mwongozo* Code of Governance of State Corporations and Enact the Government-Owned Entities Bill

This study discussed the reform process in Kenya with regard to commercial state corporations and reached the conclusion that they could be underperforming because of the multiple laws and regulations which they must comply with. What the sector needs, this study posits, is an overhaul in the current legal and regulatory framework. The laws governing these corporations should be streamlined and included in one or just a few pieces of legislation. The study recommends the enactment of the Government-Owned Entities Bill, 2014, as a step towards streamlining the existing framework. Enacting this Bill will see to it that commercial state corporations are distinguished from other government-owned entities and that they stand alone in their sole purpose of profit generation.

The study also suggests the implementation of *Mwongozo*, which it considers as an ambitious plan for action for commercial state corporations. If implemented, the *Mwongozo Code* would open a new era for the management and governance of commercial state corporations in Kenya, and hopefully, this will improve their productivity and profitability.

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