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INCORPORATING PRINCIPLES OF CORPORATE GOVERNANCE IN THE MANAGEMENT OF STATE CORPORATIONS IN KENYA: A CRITIQUE OF THE 'MWONGOZO' CODE OF GOVERNANCE FOR STATE CORPORATIONS

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

DECLARATION

I, **JUDE R. OCHIENG**, hereby declare that this is my original work and has not been submitted for the award of a degree in any other University.

SIGNED: …………………………………… DATE: …………….

JUDE R. OCHIENG

This project has been submitted for examination with my approval as the University of Nairobi Supervisor.

SIGNED: …………………………………… DATE: …………….

DR. JACKSON BETT

DEDICATION

To my supporting team Mary, Jude, Baz, Gladys and the late Judith.

ACKNOWLEDGEMENT

I thank my Supervisor, Dr. Jackson Bett deeply for every effort he made to make this project a success. His guidance and encouragement has been invaluable to me. Thank you.

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Enormous thanks to my family, friends and colleagues for their wise counsel, prayers and support during this study.

ABSTRACT

Mwongozo, the Code of Governance for State Corporations is the policy document by the government of Kenya that seeks to incorporate the principles of corporate governance in the management and governance of State Corporations in Kenya. It is an integral part of the reform recommendations developed by the Presidential Task Force on Parastatal Reforms. It aims to entrench principles and values of public service and best practices in the management of state corporations. The code has been issued as Executive Order number 7. However, the litmus test for Mwongozo is whether it will endure the challenges that have bedeviled the management and governance of public entities world over. The Code when passed through the various legal tests falls short of the mandatory constitutional dictate of public participation, contradicts provisions of statute and does not address the central concerns that have bedeviled SCs since independence. The code does not also fit in the social and economic environment. As a public policy document, Mwongozo can only succeed if it is enacted as a binding legal norm, addresses the specific challenges of our economy and if other laws such as the *State Corporations Act Cap 466* are aligned to the provisions of the Constitution, specifically Article 10 and 232.

LIST OF ABBREVIATIONS

APPER - African Priority Programme for Economic Recovery

CEOs – Chief Executive Officers

CGD - Centre for Governance and Development

CMA - Capital Markets Authority

CSRP - Civil Service Reform Program

ERS - Economic Recovery Strategy

FPLC - Federation of Public Listed Companies

ICPSK - Institute of Certified Public Secretaries of Kenya

MAICSA - Malaysian Institute of Chartered Secretaries and Administrators

MDGs - Millennium Development Goals

MIA - Malaysian Institute of Accountants

MICPA - Malaysian Associations of Certified Public Accountants

MID - Malaysian Institute of Directors

OECD –Organization for Economic Cooperation and Development

PECC PARNET - Pacific Economic Cooperation Council Peer Assistance and Review Network

PIC- Parliamentary Investment Committee

PSC - Public Service Commission

SAPs - Structural Adjustment Programmes

SASAC - State Owned Assets Supervision and Administration Commission

SCAC - State Corporations Advisory Committee

SCs - State Corporations

SEC- Security Exchange Council

SOX- Sarbanes Oxley Act

UNDP – United Nations Development Programme

UN-PAAERD - United Nations Plan of Action for African Economic Recovery and Development

VAT – Value Added Tax

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1.1 Introduction

After his ascension to power, His Excellency the President of the Republic of Kenya, Uhuru Muigai Kenyatta appointed the Taskforce on Parastatal Reforms on 23rd July 2013.[1] This was in response to a grave concern as regards the governance, management and performance of State Corporations (SCs). This concern about the management of state corporations had been there for quite a while.[2] The government, prior to the current regime and even the immediate former regime had embarked on several reforms in a bid to structure and improve the performance of SCs and one of such effort was implementing the structural adjustment programmes (SAPs).[3] The need for such reforms had taken off in the early 1970s.[4]

Muindi S, observes that between the period 1970 to 1980, the government discovered that it had taken in more than it could chew, the SCs which had initially performed very well and served the populace with essential services were highly exposed to debt, had a static equity base, faced high operating losses, had inadequate returns and constantly required intervention from the public coffers.[5] All these were brought about because the Government had taken too long to divest these investments to the citizens, who had the business skills and know how to run these enterprises.

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[1] Executive Office of the President of the Republic of Kenya, *Report of the Presidential Taskforce on Parastatal Reforms'* (2013) viii.

[2] Centre for Governance and Development, 'A Decade of Parastatal Waste, A Study of the Audited Accounts of State Corporations over the Period from 1993 to 2000' <http://www.cgd.or.ke/documents/Parastatal%20Waste.pdf> accessed 14 July 2016 and *Ibid* p. xiv.

[3] See Muasya Isaac, 'The Impact of Structural Adjustment Programmes (SAPs) on the Education System in Kenya'[]1(3) International Journal of Arts and Commerce <http://www.ijac.org.uk/images/frontImages/files/Vol._1_No._3/7.pdf> accessed 15 July 2016 where the author identifies that one of the goals for the SAPs was privatization of public enterprises.

[4] Njiru Esther, 'The Role of State Corporations in a Developmental State: The Kenyan Experience' (30th AAPAM Annual Roundtable Conference, Accra, Ghana 6th - 10th October 2008) <http://unpan1.un.org/intradoc/groups/public/documents/aapam/unpan034145.pdf> accessed 7 November 2016.

[5] S Muindi, 'Public Enterprises in Reform and Privatization in Kenya' <http://unpan1.un.org/intradoc/groups/public/documents/AAPAM/UNPAN028231.pdf> accessed 14 July 2016.

The initial trajectory taken by the government was to privatize most of the SCs.[6] In particular, in the year 1982 the Government of Kenya released the findings of the working party on public expenditure which specifically recommended that the role of SCs be reduced and that those roles be taken up by the private sector. This was informed by studies which demonstrated that privatization yields better performance.[7] That changes of ownership structure especially those involving strategic foreign partners or outside monitors has an impact on performance.[8] These studies further show that restructuring and control by outside owners has resulted into significant positive improvement because of efficiency and reduction on overhead costs in the SCs.[9]

This recommendation was immediately worked on and the budgetary allocation to SCs was reduced from Kshs 1.12 billion in 1982 to Kshs 0.36 billion in 1984. Other piecemeal reforms, such as operations rationalization measures, regulatory reforms and restructuring, followed thereafter but they were not uniform to all SCs and were based on an entity to entity basis for example, the reform to be undertaken in a SC in the agricultural sector was different from the one in the banking or insurance sector because of their operational differences.[10] To achieve the reforms, optimum resources must be allocated towards those strategies and initiatives. Unfortunately, the efforts to reform the SCs and improve their efficiency were short-lived because the cutting of funds affected the operations of these SCs and this had an overall effect on the economy.[11]

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[6] See the status of privatization from <http://www.pc.go.ke/index.php?option=com_fsf&view=faq&catid=3&Itemid=535 > accessed 14 July 2016. There are currently ongoing plans to privative SCs in the banking, manufacturing, service and even regulatory sectors.

[7] Bonin, J.P. *et al*, 'Privatization Matters: Bank Performance in Transition Countries' (Conference on Bank Privatization World Bank, Washington, D.C. November 20 - 21, 2003) <http://siteresources.worldbank.org/INTFR/Resources/475459-1107978088492/BankPerformanceEfficiency.pdf> accessed 14 September 2017.

[8] *Ibid*.

[9] *Ibid*.

[10] S Muindi, 'Public Enterprises in Reform and Privatization in Kenya' <http://unpan1.un.org/intradoc/groups/public/documents/AAPAM/UNPAN028231.pdf> accessed 14 September 2017.

[11] *Ibid*.

The net effect being the escalation of bank lending rates, thus the private sector could not fit the gap created as had initially been anticipated. Generally, the economy was hurting and between the years 1989-1990 funding for SCs had to be enhanced to the initial levels. This informed the opinion that the SCs were with us to stay because some of the functions undertaken by the SC were of such national importance and required huge amounts of resources that they could not be left to the private sector.[12] To add, some SCs could not attract private buyers due to their huge liabilities. [13] Also, privatization could not succeed in the absence of an effective legal regime that protects investments and a competitive marketplace that guarantees returns.[14]

The SCs are part and parcel of the economy and rather than close them up, it was beneficial to streamline their operations, incorporate good governance and management and enhance their productivity in line with the national vision and development goals.

The first concern for the task force appointed by President Kenyatta was with regard to the number and roles of SCs, their efficacy in line with the national development goals and their dwindling performance that was proving burdensome to the public coffers hence making them uncompetitive if viewed alongside and in comparison with the private sector enterprises.[15]Among its terms of reference, the taskforce was to address the sectoral challenges in SCs, namely; designing the most appropriate institutional arrangement taking into account the sectors administrative, governance, managerial and audit needs; reviewing the many categories, types, sizes, revenue viability and duplication of mandates among SCs; incorporating principles espoused in the new Constitution, devolution and the mandate of the salaries and remuneration commission; develop a clear policy direction for the sector in line with the country's national goals; and finally undertaken an audit of

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[12] Wong, S. C. Y., 'Improving Corporate Governance in SOEs: An Integrated Approach (2004) 7(2) Corporate Governance International 6.

[13] *Ibid.*

[14] *Ibid.*

[15] Report of The Presidential Taskforce on Parastatal Reforms <http://www.scac.go.ke/index.php/component/k2/item/118-presidential-task-force> accessed 14 July 2016.

the human capital in the sector with the hope of recruiting qualified and capable people in boards and senior management of SCs.

The task force observed that among the challenges facing state corporations were; poor governance leading to massive losses which burden the coffers, weak and ineffective boards that fail to provide strategic direction, facilitation and their emasculation, weak human resource and institutional capacity to attract and retain skills sets needed to drive performance. Some of these SCs were observed to be heavy into debt.[16] In its recommendations, the taskforce observed that corporate governance must be infused and strengthened among SCs.[17] This would specifically entail the reduction of the number of the board of directors, include term limits for board members, Chief Executive Officers to be hired on 4 year terms renewable only once based on performance, recruiting skills and competencies among the board, management and staff of SCs, a uniform code of governance and leadership in SCs based on the Constitution of Kenya, 2010 and adoption of the King III Report on Corporate Governance as modified by the OECD guidelines.[18]

Mwongozo, the Code of Governance for State Corporations hereinafter 'Mwongozo' was thus developed[19] and is an integral part of the reform recommendations developed by the Presidential

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[16] The task force report for instance observes that available data shows that guaranteed debt in respect of Kenya Broadcasting Corporation (KBC) and the Tana and Athi River Development Authority (TARDA) has since crystallized and the Government of Kenya (GoK) guarantee called up. For KBC, the GoK has so far repaid Kshs. 9.29 billion leaving an outstanding amount of Ksh.5.997 billion. The loan in question was an Overseas Economic Cooperation Fund (OECF) [Japan] loan that was contracted in 1989 and guaranteed by GoK, in respect of the KBC Modernization Project. The OECF loan of Japanese Yen 15.441 billion (Kshs.8,287,588,398 at the exchange rate at the time) had a moratorium period of 10 years (1989 – 1999) and repayment period of 20 years (1999 – 2019). KBC has not paid GoK any portion of this loan, but has continued to accumulate the liability (principal and interest amounts) in its books. As at 30th June 2012, the OECF loan reflected on KBC books as "GoK/OECF Loan" had accumulated to Ksh.28.925 billion, comprising a current (i.e. overdue) portion ofKsh.26.915 billion and a non-current portion of Ksh.2.010 billion. The total amount outstanding as at 30th June 2013 had risen to Kshs. 32.345 billion. In respect of TARDA, the Government as at 30th June 2013 had repaid Kshs. 3.44 billion comprising Kshs. 2.34 billion in principal repayment and Ksh.1.1 billion in interest. Consequently, the amount refundable by TARDA to GoK as at 30th June 2013 was Kshs.3.44 billion plus penalties amounting to Kshs. 7.7 billion. TARDA owed GoK Kshs. 11.14billion in respect of this explicitly guaranteed debt as at 30th June 2013.

[17] Executive Office of the President of the Republic of Kenya, *Report of the Presidential Taskforce on Parastatal Reforms* (2013) xxi.

[18] *Ibid* p. xxi and xxii.

[19] Public Service Commission and State Corporation Advisory Committee, *Mwongozo:* The Code of Governance for State Corporations (2015) <http://www.scac.go.ke/> accessed 14 July 2016.

Task Force on Parastatal Reforms. Mwongozo was developed as a critical building block in entrenching principles and values of public service and best practices in corporate governance.

The code has been issued as Executive Order number 7.[20] Mwongozo generally seeks to incorporate principles of good corporate governance in the management of SCs and it addresses 8 broad themes which are; appointments and functions of boards; transparency and disclosure; accountability risk management and internal control; ethical leadership and corporate citizenship; shareholder rights and obligations; stakeholder relationships; sustainability and performance management; and compliance with laws and regulations. The litmus test for Mwongozo which is subject to this interrogation is whether the code will endure the challenges that have bedeviled management and governance of public entities world over.[21] Whether the code fits and is in consonance with the legal, social and economic environment, if it will achieve uniformity in application among all the SCs, if it is able to merge the competing goals and objectives among SCs, deal with the weak protection of shareholders, clear the market protection associated to SCs, deal with the politics of board appointments and deal with low levels of transparency and accountability. Equally and more important in this interrogation is whether its architecture was sufficiently participatory and well-grounded in the Kenyan legal system and market economy, because the code can only endure and be as strong as its foundation.

Since the publication of Mwongozo and its issuance as executive order number 7, there is no evidence[22] of any studies attempting to address its efficacy in ensuring good corporate governance and an inquiry as to if and how all the stakeholders and the general public were involved in its formulation as envisioned in the now entrenched provision on public participation as provided for in *Article 10 and 232 of the Constitution*. It is additionally argued that 'the difficulty of reform lies

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[20] See information from the State Corporations Advisory Committee Website from <http://www.scac.go.ke/index.php/2015-02-16-09-34-58/mwongozo> accessed 14 July 2016.

[21] 'World Bank Tool Kit' <https://openknowledge.worldbank.org/bitstream/handle/10986/20390/9781464802225.pdf?sequence=1> accessed 15 July 2016.

[22] In *Republic v. Public Procurement Administrative Review Board & Another ex-parte Selex Sistemi Integrati [2008] eKLR*. The writer "is faced with a novel, untested and complex situation to unravel and perhaps arising for the first time and without precedent."

not in the development of adequate standards but in their actual implementation.'[23] This gap informed the choice of this area of study which seeks to critique Mwongozo. Specifically, the study seeks to assess its adequacy and identify the gaps and areas that it needs improvement on.

The context upon which Mwongozo is to operate and flourish is important for consideration because, there is need to consider the prevailing business[24] and legal[25] environment in which SCs operate. Attempting to copy a system from elsewhere and purport to impose it upon the SCs, without giving a careful thought on the prevailing circumstances, would make the code susceptible to failure. It is thus vital to establish standards and norms that implement good corporate governance practices within each context.[26]As good corporate governance is a journey and not a destination.

1.2 Statement of the problem

From the year 1990 to date, international media reports have portrayed sad stories of spectacular scandals in big corporations such as Enron, Lehman Brothers, BCCI, Polly Peck, Adelphia, HIH Insurance, Woldcom, Barings Bank, Parmalat, Boeing.[27] On the other hand, the local media has lately highlighted the outrage regarding the management of some state corporation such as the National Youth Service, Kenya Airports Authority, Geothermal Development Company Limited, Kenya Medical Research Institute, Uchumi Supermarkets Company Limited, Mumias Sugar Company Limited, Kenya Airways Limited, National Bank of Kenya Limited and East African

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[23] J. Lu and J. Batten, *The Implementation of OECD Corporate Governance Principles in Post-Crisis Asia* (Greenleaf Publishing, 2001) 47, 51.

[24] These are the combination of internal and external factors that influence a firm's operations including socio-economic trends, supply and demand, management, employees, ownership structure, competition and technology among others.

[2]5 These are business regulations or rules derived from multiple sources and enforced by bodies with fragmented and overlapping jurisdictions.

[26] M. Caron, I. *et al*, 'The Influence of Corruption on Corporate Governance Standards: Shared Characteristics of Rapidly Developing Economies' (2012) 2 Emerging Markets Journal 20, 24.

[27] P.L.O Lumumba, 'A value proposition for Corporate Governance: Restoring genuine internal values and conscience within corporate organizations' [February/April 2015] *ICPSK Governance Journal, 24.*

Portland Cement Company Limited, .[28] There is a concern that the above mentioned entities and others not mentioned have faced considerable challenges owing to poor management, lack of clear policies in line with the national development goals as enshrined in the Constitution of Kenya, 2010 and the Vision 2030, lack of proper leadership and integrity, corruption and lethargy. This has made such corporations to burden the ex-chequer and/or eventually collapse.

Other than public listed companies, the Kenyan corporate governance environment has generally been littered with many examples of corporate bodies (private and public) collapsing or being placed under statutory management for varied reasons.[29] Some of the reasons that have been identified specifically for SCs are; politicization and poor corporate governance, weak supervisory mechanisms, structure of finance and financial management, corruption and looting of funds in SCs.[30] Various SCs and government controlled enterprises in Kenya have suffered the adverse effects of the above mentioned problems leading to their collapse or near collapse, recent examples include; Kenya Corporative Creameries (KCC), Kenya Meat Commission (KMC), Kenya Airways (KQ), Mumias Sugar Company, Postal Corporation of Kenya, Kenya Railways and Uchumi Supermarkets.[31] For instance, Uchumi Supermarket's initial collapse was attributed to high interest rates, adverse exchange rates and internal governance issues while KQ which was at the brink of collapse made an outstanding net loss of Kshs 26.2 billion in the 2015-2016 financial year, which the Senate Select Committee attributed to poor management decisions, operational inefficiencies and failure to counter competition. The common thread among all these corporations is 'poor governance and management decisions'. [32]

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[28] Kenya's Chase Bank placed under receivership by CBK <http://www.bbc.com/news/world-africa-35989394> accessed 14 July 2016.

[29] Ngugi Brian, 'No timeline for Chase Bank reopening: CBK' <http://www.nation.co.ke/business/corporates/Chase-bank-customers-stranded-after-shock-CBK-closure/1954162-3149656-1aiu3fz/index.htm> 14 July 2016.

[30] Esther Njiru, 'The role of State Corporations in a Development State: The Kenyan Experience.' Presented at the 30th AAPAM RoundTable Conference, Accra, Ghana on 6th to 10th October 2008 accessed on <http:// Unpan1.un.org/…/unpan034145.pdf>

[31] Waita M Gichaiya *et al*, 'Accessing Success of Turnaround Strategies for Distressed Companies: A Case Study of UCHUMI Supermarkets Ltd. Kenya' (2014) 3(9) International Journal of Management Sciences 657-662

[32] Mwaniki Munuhe, 'Audit names KQ managers, lender and suppliers in scheme to defraud airline' (Standard Digital, 29 May 2016) < https://www.standardmedia.co.ke/article/2000203371/audit-names-kq-managers-lender-and-suppliers-in-scheme-to-defraud-airline> accessed on 16 July 2017.

Some of the scandals from the public listed companies arose after 2002 when the CMA Guidelines came into force. This may point to an indication that the CMA Guidelines may not have been as effective as they ought to have been. The challenges faced by the CMA Guidelines seem to point to; its legitimacy, implementation, enforcement, good will among stakeholders and collaboration between public and private sector entities to stem out corruption and implement policies on good governance. Mwongozo thus has to be viewed in the same prism as other public policy documents that have attempted to infuse the principles of corporate governance and their success or otherwise. The success and failure of those policy documents are to assist in informing the steps to be taken for formulation and implementation of Mwongozo.

Notably, Mwongozo has been developed in the background of other initiatives from other jurisdictions.[33] This study will look into the architecture of the Mwongozo to establish whether it is inherently adequate to fully transform corporate governance of SCs, look at its provisions and their effects, give an appraisal, address the challenges in it and do a comparative study with other jurisdictions- Malaysia, South Africa, United Kingdom, United States of America and China- thereafter proposing recommendations For comparative purposes, Malaysia was chosen as a country in Southeast Asia which was poorer and had a weak economy compared to Kenya and other Sub-Saharan African countries in the 1960s and early 1970s and Kenya has a lot to learn from its policies in macroeconomic stabilization, increasing productivity and liberalizing the

[33] Jurisdictions such as The Netherlands, Australia, Brazil, Canada, China, Germany, Ghana, Tunisia and India among others have Codes of Corporate Governance. See <http://www.ecgi.org/codes/all_codes.php> accessed 14 September 2017.

economy.[34] The decline of economies in Africa has been among others, attributed to a deterioration of public institutions and social services.[35]

South Africa provides a good model of study because it has experienced similar challenges as Kenya with its SCs namely; weak accountability, excessive politicization and unclear objectives.[36] In 2012, the Government of South Africa ordered a comprehensive review of state owned enterprises. This review is still ongoing because in November 2016, the South African cabinet endorsed further guidelines which include the framework of appointments of boards and CEOs of SCs.[37] Just like Kenya, South Africa SCs reforms is still work in progress. The express incorporation of King III report[38] in Mwongozo also makes this comparative necessary.

The United Kingdom developed the Cadbury principles[39] which were the foremost principles in infusing corporate governance in corporations and this code has informed the establishment of the

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[34] Jan Kees van Donge et al 'TRACKING DEVELOPMENT in Southeast Asia and Sub-Saharan Africa' accessed from http://www.institutions-africa.org/trackingdevelopment_archived/resources/docs/TD%20in%20SA%20and%20SSA_The%20primacy%20of%20policy.pdf on 19/7/2017. The authors note there has been sustained and rapid development in the South Asian Countries as compared to their counterparts in Sub-Saharan yet the former were poorer than the later in the 1960s. The study sought to compare four countries from each divide including a comparison between Kenya and Malaysia noting:

> *The second pair, Kenya and Malaysia, consists of two countries that have opted consistently for the 'capitalist road' to development, relying to a great extent on private ownership of the means of production, and on foreign direct investment. Tanzania and Vietnam, by contrast, are both countries which for a long time relied on state ownership and direct government intervention, and which have subsequently liberalized their economies. The fourth pair is Uganda and Cambodia, two cases of post-conflict reconstruction.*

[35] *Ibid* p. 4.

[36] See the OECD South Africa Policy Brief on Corporate governance of State Owned Enterprises July 2015 accessed from https://www.oecd.org/corporate/south-africa-state-owned-enterprise-reform.pdf on 19/7/2017

[37] See the 2016/2017 Financial position of Public sector institutions published by the South African treasury <http://www.treasury.gov.za/documents/national%20budget/2017/review/Chapter%208.pdf> accessed on 19 July 2017.

[38] The Institute of Directors in Southern Africa (IoDSA) formally introduced the King Code of Governance Principles and the King Report on Governance (King III). The Code and the Report were unveiled in September 2009 and adopts the 'apply or explain' principle.

[39] The Cadbury Report, titled *Financial Aspects of Corporate Governance*, was a 1992 report issued in the UK by "The Committee on the Financial Aspects of Corporate Governance" chaired by Adrian Cadbury that sets out

codes in the USA, EU and the OECD. This code developed the concept of "comply and explain" which *Mwongozo* has similarly adopted.[40]

The USA applies the ''comply or else'' model which makes it compulsory to apply the principles of corporate governance or face sanctions. The model varies from the 'comply or explain' model adopted by Kenya. The comparison helps in understanding and knowing the pros and cons of each having in mind the social, political, economic and legal environment of the countries.

China on the other hand provides key lessons in management of SCs by the state because incidentally more than 60% of corporations are owned either wholly or partly by the state.[41] Kenya inventory of SCs comprised of 262 enterprises, which is not a small number.[42]

1.3 Objectives of the research

1.3.1 General objective

Unless serious considerations are given to the corporate governance architecture and design, news of corporate scandals will still continue to dominate our media space. This brings to fore the question as to the legal architecture and design of Mwongozo. Therefore, the main objective of this study is to critique Mwongozo with the intent of identifying salient issues that have to be addressed for the full implementation of the principles of corporate governance in SCs

1.3.2 Specific objectives

1. To interrogate the legitimacy of the process that led to the formulation of Mwongozo in the context of Article 10(1)(a) of the Constitution of Kenya, 2010.

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recommendations on the arrangement of company boards and accounting systems to mitigate corporate governance risks and failures.

[40] Public Service Commission and State Corporation Advisory Committee, *Mwongozo:* The Code of Governance for State Corporations (2015) 57.

[41] Andrew Szamosszegi and Cole Kyle, 'An Analysis of State-owned Enterprises and State Capitalism in China' (2011) 6.

[42] Executive Office of the President of the Republic of Kenya, *Report of the Presidential Taskforce on Parastatal Reforms: Current Inventory of State Corporations'* (2013).

2. To identify and analyse the weakness and gaps in Mwongozo. Such analysis will reveal problems likely to arise in its implementation.

3. To assess the extent which Mwongozo will succeed in the reform agenda of SCs.

4. To distinguish Mwongozo from other similar domestic, regional and international codes.

1.4 Research question

This study seeks to answer the following questions:

1. Does the architecture and design of Mwongozo adhere to the constitution, its principles and other Kenyan laws?

2. Does Mwongozo guide and sufficiently address the concept of corporate governance among SCs?

3. How does Mwongozo compare to other domestic, regional and international codes used in its development and what reforms are necessary for it to achieve the objectives of the national development and vision?

1.5 Research hypothesis

This study is premised on the hypothesis that the Mwongozo is inherently weak and inadequate and bereft of sufficient legal impetus for its failure to advance a model that takes cognizance of the local context in Kenya. The underlying presumption is that a guideline transplanted from one jurisdiction to another without a careful review to adopt it to the local circumstances of the new jurisdiction, that guideline is likely to fail.

1.6 Literature Review

David Ndii observes that the parastatal reforms initiated by HE President of the Republic of Kenya Uhuru Kenyatta are doomed to fail.[43] According to Ndii, a good public policy document is essentially an exercise in persuasion, and three questions that have to be addressed 'why', 'what' and 'how'. Reforms are painful and costly and the architects need to provide compelling reasons for it. After the compelling reason is made, the road map has to be in place that will convince and benefit all the stakeholders. Mwongozo being the public policy document on SCs has to be passed through the same threshold. According to Ndii, the posed questions are not answered by government actions including the promulgation of Mwongozo. Why the parastatals have to be reformed is addressed by the already identified challenges of SCs in Kenya and documented by the Presidential Taskforce of SCs, but what needs to be done and how it needs to be done seems not to be sufficiently addressed. If Mwongozo proposes the same interventions as the CMA Guidelines of 2002 or/and borrows from other codes without the necessary modifications, exceptions and adaptations then it may not be effective, if it is not sufficiently participatory then it fails the mandatory Constitutional test.

Mwanzia and Wong in addressing the concept of corporate governance in developing countries observes that many corporate organizations always seek ways of improving their activities, these institutions are both private and public.[44] They note that from the 1980s going forward there was a concern owing to the many corporate failures that had been caused by poor governance policies. This was a predominant driver for change of corporate governance codes. Mwanzia and Wong are of the view that the prevention of corporate failure is not the only reason that led to the adoption of corporate governance ideals, it was also a growing acknowledgment that improved corporate governance was crucial for the growth and development of the economy of a country. The concept thus developed in various environments and in various forms, for countries that adopted the civil

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[43] Ndii David, 'Why Uhuru's Parastatal Reform was Doomed to Fail' <http://www.nation.co.ke/oped/Opinion/Why-Uhurus-parastatal-reform-was-doomed-to-fail/440808-2710686-rnv9gqz/index.html> accessed 5 September 2016.

[44] Mwanzia Mulili Benjamin and Wong Peter, 'Corporate Governance Practices in Developing Countries: The case for Kenya' (2011) 2 (1) International Journal of Business Administration.

law legal system, this principle centered on stakeholders whereas in countries that apply the common-law system the corporate governance concept focused on shareholders.

Wong's ideas resonate with the state of SCs in Kenya. Most SCs were established in the colonial period. Sessional paper number 10 of 1965 sought to retool SCs as vehicles of indigenization but years later into the 1980s and 90s most of them were riddled with debt, fraud, theft and gross mismanagement that had led to a total collapse of some and others left critically dysfunctional. In June 2003, the government being consciously aware of the problem unveiled the economic recovery strategy for wealth and employment creation.[45] This piece-meal infusion was meant to introduce principles of corporate governance and was a recognition by the government that only corporate governance would revamp the SCs and make them have improved and sustained performance and service delivery. Some authors such as Njiru have argued that some of these changes partly contributed to GDP all-time low of 0.3% in 2001 to 5-6% growth by 2007.[46]

Wong in his study points out that 'State owned enterprises face unique governance challenges that make the path to reform even more difficult than in the private sector'.[47] He identified the core governance deficiencies of State Owned Enterprise as multiple and conflicting objectives, excessive political interference and lack of transparency.[48] Mulili and Wong analysed 'corporate governance in public universities in Kenya.'[49] They argue that, due to the variance of business

[45] A specific act by government included signing of performance contracts by State Corporations Chief Executive Officers and the board.

[46] Esther Njiru 'The role of State Corporations in a Development State: The Kenyan Experience.' Presented at the 30th AAPAM RoundTable Conference, Accra, Ghana on 6th to 10th October 2008 <http:// Unpan1.un.org/…/unpan034145.pdf> accessed on 14 July 2017

[47] Wong, S. C. Y, 'Improving Corporate Governance in SOEs: An Integrated Approach (2004) 7(2) Corporate Governance International 5.

[48] Kiarie Mwaura, 'The Failure of Corporate Governance in State Owned Enterprises and the Need for Restructured Governance in Fully and Partially Privatized Enterprises: The Case of Kenya' (2007)31(1) Fordham International Law Journal, the author indicates that initiatives adopted in order to make parastatals more efficient are inadequate and will not realize the intended objectives unless the chief executives of parastatals are hired on a competitive basis, given more autonomy and the government is committed not only to designing performance contracts that set realistic standards, but also enforcing them strictly.

[49]See also Mange Mbirithi Daniel, 'Management Challenges Facing Kenya's Public Universities and Implications for the Quality of Education' (Degree of Doctor of Philosophy, Kenyatta University 2013) <http://ir-

environment in different countries, it follows that the notions about the aspects that comprise good corporate governance would also vary.[50] Even so, key elements of good corporate governance practices can be gleaned from the OECD principles, Cadbury Report, Sarbanese-Oxley Act and Treadway Report.[51]

The authors observe that little attention has been given to research in corporate governance practices in Africa.[52] From their review, they ascertained that the available literature indicates that good corporate governance practices have been adopted by developing countries. They posit that 'corporate governance structures in developing countries are weak.' They explored the challenges encountered by developing countries in the process of adopting the corporate governance ideals. They suggest that the challenges 'include uncertain economies, weak legal controls, protection of investors and frequent government interventions.'[53] The authors concede that the adoption of the corporate governance philosophy does not necessarily prevent corporate failures and scandals. Nevertheless, they recommend that developing countries should develop their own corporate governance models that take into account their unique backgrounds.

The Economic Commission for Africa while addressing the Public Sector Management Reforms in Africa noted that the 1980s were identified as a lost decade for Africa.[54] There was a reduction in the prices of the primary products from Africa, high oil prices, growing external debt, rapid population growth, desertification, civil wars and other internal conflict.[55] This led to the initiation

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library.ku.ac.ke/bitstream/handle/123456789/7030/Mbirithi%20Daniel%20Mange.pdf?sequence=1> accessed 7 November 2016.

[50] *See* UNCTAD 'Selected issues in Corporate Governance: Regional and Country Experiences' <*http://unctad.org/en/docs/iteteb20033_en.pdf*>accessed 15 July 2016.

[51] See <http://www.ecgi.org/codes/all_codes.php> accessed 14 September 2017.

[52] Mwanzia Mulili Benjamin and Dr. Wong Peter, 'Corporate Governance Practices in Developing Countries: The Case for Kenya' (2011)2(1) International Journal of Business Administration.

[53] Most African states have just recently post 1990 embarked on legal (Constitutional reforms).

[54] See the Economic Commission for Africa, 'Public Sector Management Reforms in Africa: Lessons Learned' (December 2003) <http://www.uneca.org> accessed 31 July 2016.

[55] *Ibid* p. 4.

of the structural adjustment programs led by the Bretton Woods Institutions.[56] The aim for the SAPs was to reduce the role of the state in production and service delivery.[57] The emphasis being to maintain the macro-economic stability, lower the inflation rates, cut the deficit spending and reduce the scope and cost of government.[58] The SAPs however proved to have limitations and there was need to broaden the agenda for public sector reforms. The agenda includes good governance of the public sector. One of the avenues suggested is commercialization which is a technique of managing public enterprises to make them profitable. The problem being addressed under this head being that many public enterprises, performance problems arise from insufficient autonomy and authority.[59] The remedies offered by SAPs eventually failed to offer long term and tangible solutions because SCs especially in Africa are critical as they offer essential services and the initial privatization created gaps that could not be filled by the private sector. The state was also divested control of critical aspects of the economy but then for the State to run these enterprises it had to adopt effective modes and corporate principles. [60]

Julian W Francis[61]notes that for developing countries, the infusion of the corporate culture enables its enterprises secure reputation capital. The maintenance of sound corporate processes and structures at every level of the society becomes imperative for the continued well-being of a society.[62] Thus, among public enterprises there is need for a standard setter. In Bahamas for instance, the Central Bank released comprehensive guidelines on corporate governance. These guidelines were subjected to lengthy and wide consultations with the industry and reviews of

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[56] *Ibid.*

[57] *Ibid.*

[58] *Ibid.*

[59] *Ibid.*

[60] Ogbimi, F.E., 'Structural Adjustment is the Wrong Policy' <http://web.mit.edu/africantech/www/articles/PlanningAdjust.htm> accessed 14 September 2017

[61] An address by Julian W Francis, Governor of the Central Bank of the Bahamas, to the Bahamas Director's Forum on Corporate Governance, 'The Role of Regulator in Corporate Governance (24th February, 2004).

[62] *Ibid*.

international best practices.[63] The guidelines address director responsibility, licensing processes and corporate governance, disclosure requirements, accountability and consolidated supervision.[64]

Benjamin Mulili and Wong Peter note that "corporate governance is now an international topic due to the globalization of businesses."[65] Nevertheless, countries differ from each other in a wide variety of ways, such as politically, economically, culturally and technologically.[66] This partially explains why corporate governance approaches in developing countries differ from those of developed economies.[67]

The Centre for Governance and Development CGD in conjunction with USAID evaluated the performance of SCs in Kenya between the years 1993 to 2002 and published its report in the year 2005.[68] Out of 100 reports from the parastatals examined by the Auditor General only 8 reports were satisfactory.[69] From the 130 parastatals examined, only 23 were satisfactory in terms of financial performance.[70] Generally, the CGD observed that the narrative is one of 'loss, fraud and gross mismanagement.'[71] Between the periods aforementioned the CGD approximates that a total

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[63] *Ibid*.

[64] *Ibid.*

[65] Benjamin Mwanzia Mulili and Wong Peter, 'Corporate Governance Practices in Developing Countries: The Case for Kenya' (2011) 2(1), International Journal of Business Administration 16. *See also* Nu Nu Htay Sheila, Syed Ahmed Salman and Ahamed Kameel Mydin Meera, 'Let's Move to Universal Corporate Governance Theory' [2013] <http://www.idosi.org/mejsr/mejsr15(7)13/18.pdf.> accessed 19 July 2016.

[66] Benjamin Mwanzia Mulili and Wong Peter, 'Corporate Governance Practices in Developing Countries: The Case for Kenya' (2011) 2(1), International Journal of Business Administration 22.

[67] *Ibid*.

[68] Centre for Governance and Development, 'A Decade of Parastatal Waste: A study of the Audited Accounts of State Corporations over the Period 1993-2002' (2005) <www.cgd.or.ke> accessed 29 July 2016.

[69] *Ibid* p.11.

[70] *Ibid*.

[71] *Ibid*.

of KSHS 54 Billion may have been lost where 14 billion was irrecoverable and about 40 Billion had slim chances of ever being recovered.[72]

In the foreword to the Mwongozo Code, His Excellency the President of the Republic of Kenya, Uhuru Muigai Kenyatta indicates that at independence state corporations were established to implement government policies.[73] They took a greater role in the development of critical factors, however with time it became clear that there were challenges that hindered the operation of the SCs to expected levels due to weak governance structures and other factors, some of which the Mwongozo Code was keen to address.[74] Mwongozo is thus that paradigm shift which is anchored in the Constitution of Kenya, 2010 which lays emphasis on the proper management of public institutions to ensure that there is efficiency and accountability in the use and deployment of scarce public resources.[75] Mwongozo is therefore earmarked as the foundation for the management, governance and oversight of SCs.[76] It is grounded in the law and draws a lot of inference from the past gains in the form of the initial public sector reform initiatives.[77]

The lessons from Enron, Lehman Brothers, Woldcom, among others taught the corporate world that no corporation is immune from failure, no matter its size, whether financial or otherwise.[78] In response to the major corporate scandals associated with governance failures, countries the world over have formulated codes of good corporate governance practices. In formulating the codes, local circumstances and global best practices have often been considered. A survey of the available

[72] Centre for Governance and Development, 'A Decade of Parastatal Waste: A study of the Audited Accounts of State Corporations over the Period 1993-2002' (2005) 11-12.

[73] See <http://www.scac.go.ke/index.php/2015-02-16-09-34-58/mwongozo> accessed 9 May 2016.

[74] Public Service Commission and State Corporation Advisory Committee, *Mwongozo:* The Code of Governance for State Corporations (2015) iii.

[75] *Ibid*.

[76] *Ibid*.

[77] *Ibid*.

[78] I. Wilson, 'Regulatory and Institutional Challenges of Corporate Governance in Nigeria Post Banking Consolidation' (2006) 12(2) Nigerian Economic Summit Group.

literature on corporate governance reveals that substantial resources have been dedicated to the study of these codes.[79]

The Organisation for Economic Cooperation and Development (OECD) has developed the OECD Guidelines.[80] The guidelines seek to give world best practices for state-owned enterprises.[81] Further, the guidelines address issues of state ownership rights over those enterprises, the standards of accounting and auditing for those enterprises and the structure of the board and the insulation from political influence.[82] These guidelines are important, however, how they apply to the Kenya's SCs is a task worth pursuing.

Hambrick, Werder and Zajac[83] suggest that corporate governance practices within an organisation is developed within the unique internal and external environment of the organisation. Societal value systems are not stagnant. As they change also the corporate governance follow suit. The conclusion drawn from this point is that there is no single optimum corporate governance model. Therefore, Mwongozo is unlikely to be the single cure for the reforms in SCs.

Yusoff and Alhaji[84] point out that corporate governance is concerned with the social, political, economic and legal environment in which the corporation operates, systems, practices and procedures-the formal and informal rules that governed the corporation. They further posit that corporate governance is very vital in every organization, because good corporate governance contribute to better performance of the firm, it is expected for every other organization to enforce

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[79] D.C Hambrick,*et al*, 'New Directions in Corporate Governance Research' (2008) 19(3) Organization Science 381, 381.

[80] Organisation for Economic Cooperation and Development, Guidelines on Corporate Governance of State-Owned Enterprises.

[81] *Ibid* p. 9.

[82] *Ibid* p. 3.

[83] D.C Hambrick,*etal*,'New Directions in Corporate Governance Research' (2008) 19(3) Organization Science 381, 385.

[84] W. F. W. Yussof and I.AAlhaji, 'Insight of Corporate Governance Theories' (2012) 1(1) Journal of Business & Management 52.

corporate governance policy, in order to achieve a stated goal. Similarly Liang Guo *et al* in their critique of the corporate governance in China, establish that the Chinese Government had made efforts to strengthen the legal framework of corporate governance in state-owned enterprise by promulgating a large number of national laws and regulations.[85] However, they reveal that some corporate governance mechanisms that were effective in Western countries had no significant or had negative impact on firm performance in China. The apparent reason for this failure was the strong relationship between state-owned enterprises and the government.

Other literature considered for this study include reports issued by the Cadbury Committee (1992), Greenbury Committee (1995), Hampel Committee (1998), Turnbull Committee (2003), Sir Derek Higgs (2003), Kings report, various World Bank and IMF reports and the Guidelines on Corporate Governance Practices by Public Listed Companies in Kenya[86]. The main thrust of these reports is the identification of sectoral corporate governance problems in the context of the environment of which they exist, diagnose the problem and propose remedial actions to be taken.

1.7 Theoretical framework

There are many theories which are used to explain corporate governance in general, such as shareholder primacy theory, stakeholder theory, agency theory, stewardship theory, transaction cost theory, resource dependence theory, managerial hegemony theory and class hegemony theory. However, it is acknowledged that it has been a challenge to set out and examine all the theories applied in this research.[87] Nevertheless, for the purpose of this study only shareholder primacy theory, stakeholder theory and agency theory are going to be discussed. These theories have been central in promoting the understanding of the concept of corporate governance generally.

[85] L. Guo, et al, 'A critique of Corporate Governance in China' (2013) 55 (4) International Journal of Law and Management, 257, 260.

[86] Gazette Notice No. 3362, *The Capital Markets Act*, (Cap. 485A) Guidelines on Corporate Governance Practices by Public Listed Companies in Kenya.

[87] J.W Harris, *Legal Philosophies* (2nd edn, LexisNexis, Butterworth's) 1.

However, of specific relevance to this study, the hierarchical governance theory will be discussed and used to test the hypothesis of this study. This is because, the discussions in this study is with respect to corporate governance of SCs and not corporate governance generally.

1.7.1 Max Weber Bureaucracy Theory (Hierarchical Governance Theory)

The bureaucratic theory of management by Max Weber is herald as a powerful management tool.[88] Max Weber asserts that bureaucracy is the distinctive mark of the modern era.[89] He believed bureaucracy was the most efficient way to set up an organization and believed it was a better than traditional structures. The theory has two critical elements; a hierarchy and clear rules. Under this theory an organization is viewed as a type of social relationship which has regulations that are enforced. It is basically comprised of a few managers, middle managers and the low level people.[90] The orders come from the top to the bottom. The theory is dependent on the regulations and not persons. The responsibilities are specialized and every person has the requisite skills. The authorities of the employees differ where the top manager exercise control and the lower cadre though subjects have the right to appeal the decisions made by those in authority.

According to this theory, three types of power can be found in organizations; traditional power, charismatic power and legal power. Legal power is what is referred to as bureaucracy.[91] All aspects of a democracy are organised on the basis of rules and laws, making the principle of established jurisdiction prevail. The rationale of the legal power is for the reasons that regulations in the organizations guide the undertakings of the organization and they have to be understood. Any decision taken administratively has to be captured in writing. The selection of the employees is based on their qualifications and not in relation to one's social rank or relations. The compensation

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[88] Patty Mulder, Bureaucratic Theory (Weber) <https://www.toolshero.com/management/bureaucratic-theory-weber/> accessed 11 July 2017

[89] <http://www.cardiff.ac.uk/socsi/undergraduate/introsoc/weber12.html> accessed 11 July 2017

[90] Max Weber, From Max Weber: Essays in Sociology, ed. and trans. Hans H. Gerthand C. Wright MiHs (New York: Oxford University Press, 1946), pp. 196 to 294. (Originally published in 1922).

[91] Vincent de Gournay in 1745. See Fred Riggs, "Shifting Meanings of the Term'Bureaucracy,'" (1979) 31 International Social Science Journal 563 - 584

matches the skills and qualifications. The employees are professionals and they are rewarded by promotions based on seniority.

1.7.2 Shareholder Primacy Theory

Shareholder primacy theory is a corporate law doctrine that compels the corporation decision makers to do nothing else, but to focus on the shareholders' interests.[92] The theory has deliberately been incorporated in Mwongozo. First Mwongozo recognizes that in SCs the public are the shareholders.[93] Chapter 5 of Mwongozo is dedicated to shareholder rights and obligations. Mwongozo provides that the board of SC is accountable to shareholders and the strategies adopted by the board are to be aligned to the legitimate interests and expectations of shareholders –who are the public. The Chairperson of the board is specifically mandated to act as the link between the board and shareholders. The code also points out that the Corporation Secretary will provide effective communication to the shareholders.

This theory is controversial and its validity has been questioned by some scholars.[94] However, it is widely conceded that the goal of corporations is to maximize shareholders' benefits. This proposition has found the support from the courts too. In the case of *Dodge v. Ford Motor Company,* the Court held that a business corporation is organized primarily for the profit of the stockholders, as opposed to the community or its employees.[95]

As far back as the 17th century, the controversies generated by this theory were topics of intellectual analysis and public debate.[96] Adam Smith provoked this debate in 1776 through his book *An Inquiry into the Nature and Causes of the Wealth of Nations (popularly known as the Wealth of*

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[92] A.A Berle, 'Corporate Powers as Powers in Trust' (1931)44 Harvard Law Review 1049.

[93] Public Service Commission and State Corporation Advisory Committee, *Mwongozo:* The Code of Governance for State Corporations (2015) v.

[94] E. M Dodd, 'For Whom are Managers Trustees?' (1931) 45 Harvard Law Review 1145.

[95] 170 NW 668 (Mich 1919). See also *AP Smith Manufacturing Co v. Barlow* 39 ALR 2d 1179 (1953) or *Shlensky v. Wrigley*, 237 N.E. 2d. 776 (Ill. App. 1968).

[96] H. Wells, 'The Birth of Corporate Governance' (2010) 33(4) Seattle University Law Review 1251; Aristotelis Boukouras, 'Separation of Ownership and Control: Delegation as a Commitment Device (2011) 2.

Nations).[97] Scholars including Louis Brandeis[98], Walter Lippmann[99], ThorsteinVeblen[100], William Z. Ripley[101], Adolf A. Berle and Gardiner Means, Eugene F. Fama and Michael C. Jensen and William H. Meckling among others all grappled with the concept.[102] However, the debate became more prominent due to the work[103] of William Z. Ripley.[104] Thereafter the work of Berle and Means[105] further propelled this debate by giving more radical conclusions that resonated well with the public.[106] The debate further progressed in 1932-1954 between Professor Adolf Augustus Berle, Jr. of Columbia Law School and Professor Edwin Merrick Dodd of Harvard Law School (Berle-Dodd debate) in their exchange in the Harvard Law Review.[107]

The Berle-Dodd debate took two divergent positions. Prof. Dodd argued that managers should consider the needs of the different group of stakeholders of a corporation when making decision.[108]

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[97] Harwell Wells, 'The Birth of Corporate Governance' (2010) 33(4) Seattle University Law Review 1251.

[98] In his book titled *Other People's Money and How the Bankers Use It*,Brandeis addressed small-scale proprietary capitalism (Harwell Wells, 'The Birth of Corporate Governance' (2010) 33(4) Seattle University Law Review 1251).

[99] In his book *Drift and Mastery: An Attempt to Diagnose the Current Unrest,* Lippman discussed the separation of ownership and control, where he recognized that the consequence of this separation would be a change in the very notion of ownership and property (Harwell Wells, 'The Birth of Corporate Governance'(2010) 33(4) Seattle University Law Review 1258).

[100] Veblen examined the idea of separation of ownership and control in his books *Theory of the Business Enterprise* (1904) and *Absentee Ownership and Business Enterprise in recent times: The case of America* (1923) where he noted that the effect of modern finance is to dissociate ownership from management (Harwell Wells, 'The Birth of Corporate Governance' (2010)33(4) Seattle University Law Review1260).

[101] Ripley popularized this debate through his book titled *Main Street and Wall Street,* 1927; and in speeches and a series of articles in the *Atlantic Monthly* magazine (Harwell Wells, 'The Birth of Corporate Governance' (2010) 33(4) Seattle University Law Review 1251, 1262).

[102] *Ibid* p.129.

[103] In his book titled *Main Street and Wall Street* 1927.

[104] H. Wells, 'The Birth of Corporate Governance' (2010) 33(4) Seattle University Law Review 1251, 1292.

[105] *The Modern Corporation and Private Property.*

[106] H. Wells, 'The Birth of Corporate Governance' (2010) 33(4) Seattle University Law Review 1251, 1292.

[107](45 HLR 1145, 1146 and 44 HLR 1049).

[108] E.M Dodd, 'For Whom are Managers Trustees?' (1931) 45 Harvard Law Review 1145.

Prof. Berle on the other hand attacked this notion and argued for primacy of shareholders interests.[109]Berle argued that shareholders were owners of the corporations and directors were mere agents or trustees of these owners. Therefore, he believed that corporations should be run for shareholders' interests only.

Dodd responded that as economic institutions corporations have 'a social service as well as a profit-making function.'[110] He argued that directors 'should concern themselves with the interests of employees, customers and general public.'[111]Berle criticized this argument, holding that that it was impossible for directors to be accountable to all stakeholder constituencies.

This theory is relevant to this study because it demands that directors manage corporations with the sole purpose of maximising shareholders' wealth to the full extent possible within the confines of the law. Actually, this is the essence of business and it is practicable. It empowers the directors to undertake lawful activities that increase the shareholder's benefits. Nevertheless, this does not stop the directors from considering non-shareholders' interests unless in considering the same, it will adversely impact maximizing shareholders' wealth. This theory does not focus on the rights and interests of non-shareholder's constituencies because it holds that those rights and interests are gained and protected by virtue of legislation and contracts.

Just as the name suggests, shareholders in this theory are its only subject. Therefore, their interests take precedence over the other constituency's interests.

1.7.3 Stakeholder Theory

The stakeholder theory is a concept that compels corporations to be responsive to the various non-shareholders constituencies and balance the divergent interests that emanates from these constituencies.[112] For Mwongozo, the question of stake holder relationships is specifically

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[109] A.A Berle, 'Corporate Powers as Powers in Trust' (1931) 44 Harvard Law Review 1049.

[110] E. M Dodd, 'For Whom are Managers Trustees?' (1931) 45 Harvard Law Review 1145, 1148.

[111] *Ibid* p.1156.

[112] C. Fontaine, *et al*, 'The Stakeholder Theory' [2006] 4.

addressed in chapter 6. The board is obligated to carry out stakeholder mapping, develop a policy on the management of stake-holders, communicate with them effectively and take into account their expectations and concerns. Also of importance is having a good reputation with the stakeholders. In case, disputes arise clause 6.2 is to ensure that they are resolved effectively, efficiently and expeditiously. The boards are also to encourage and utilize ADR when such disputes arise.

Freeman defined a stakeholder as "any group or individual who is affected by or can affect the achievement of an organization's objectives."[113] Although the definition of stakeholders is quite broad, there are five main groups of stakeholders that have been accepted widely, namely, customers, employees, local community, shareholders, suppliers and distributors.[114]

The genesis of the stakeholder theory is from the debate between Berle and Dodd. Dodd believed that directors are the trustees of corporations. Therefore, the directors are obliged to balance the interests of all its constituents and act in a manner that is socially responsible.[115] Courts have recognized that directors could serve constituencies other than shareholders. In *Shlensky v Wrigley*[116] the directors of National League Ball Club Incorporated considered that, night games would have serious influence on the neighborhood. As such they rejected to install the lights at Wrigley Field Stadium, thereby the stadium failed to hold any night games. The shareholders of the club sued the directors as their interests were harmed by that decision. However, the directors' decision was upheld by the court, reasoning that directors have the discretion to give up shareholders' benefits to advance other profits.

Though stakeholders contribute to the success of the corporation, in law, compared to shareholders, stakeholders' interests in corporations, to a certain extent have been ignored. Even though they are affected by the actions of the corporation, their influence on the corporation is

[113] R. E Freeman, *Strategic Management: A stakeholder Approach* (Pitman 1984).

[114] C. Fontaine, *et al*, 'The Stakeholder Theory' [2006] 6.

[115] R. E Freeman, *A Stakeholder Theory of Modern Corporations*, *Ethical Theory and Business*, (7th edn 2004).

[116] 95 Ill. App. 2d 173, 237 N.E.2d 776 (App. Ct. 1968).

minimal. For instance, stakeholders do not have voting rights and they do not have the rights to trigger derivative actions against directors where they have breached their duties. This doctrine therefore seeks to address these perceived injustices.

There are three approaches of the theory namely instrumental power, descriptive accuracy and normative validity.[117] Instrumental power creates a framework for checking the connections between the practice of stakeholder management and the success of a corporation's performance.[118] The descriptive accuracy is used to describe particular corporations' behaviors. The normative validity is used to interpret the purpose of corporations. The normative validity is the core of the theory.[119]

The stakeholder theory has some link to corporate social responsibility. The theory holds that corporations are servants of the larger society. According to the stakeholder theory, managers are agents of all stakeholders and have two responsibilities: to ensure that no ethical rights of stakeholder are violated and to balance the legitimate interests of the stakeholders when making decisions. Ideally, the theory attempts to keep ethics and economics together with a view to achieve a successful goal of corporations. The objective is to balance profit maximization with the long-term ability of the corporation to remain a going concern.[120] Moreover, according to Berle the law allows directors some discretion to consider stakeholders other than a corporation's shareholders.[121]

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[117] T. Donaldson, and L.E Preston, 'The Stakeholder Theory of Corporation: Concepts, Evidence and Implication' (1995) 20(1) Academy of Management Review 65; C. Fontaine, et *al*, 'The Stakeholder Theory [2006] 14.

[118] T. Donaldson, and L. E Preston, 'The Stakeholder Theory of Corporation: Concepts, Evidence and Implication' (1995) 20(1) Academy of Management Review 65.

[119] C. Fontaine, *et al*, 'The Stakeholder Theory [2006] 14.

[120] Smith, H. J, 'The Shareholders vs. Stakeholders Debate' [2003] MITSloan Management Review <http://sloanreview.mit.edu/article/the-shareholders-vs-stakeholders-debate/> accessed 23 April 2015.

[121] *Ibid.*

1.7.4 Agency Theory or Principal/Agent Theory

This theory perceives the governance relationship as a contract agreement between principal and agent.[122] It is assumed that both are rational economic persons motivated solely by self-interest.[123]The agency relationship arises from the fact that corporations are often owned by a large number of shareholders and run by "professional managers".[124] These managers seldom own shares in the corporations.[125] With this segregation arises the 'agency problem' whereby the directors of the company are managers of the shareholders money and there is an element of risk that the directors will act in their own interests (opportunism[126]) rather than the interest of shareholders.[127] Holding the directors to account is not an easy task as was observed in the case of *Equitable Life Assurance Society v Bowley & others*[128]where the court held that no single mechanism can provide an answer to the problems presented by the separation of ownership and control'.

Paul Davis holds that this separation is proper because, where there are large group of shareholders, decisions would be impossible to make and that shareholders may not have the necessary expertise or commitment to run a large organization.

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[122] B. Tricker, *Corporate Governance-Principles, Policies and Practices* (2ndedn, Oxford University Press 2009) 60; M. C Jensen and W. H Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3(4) Journal of Financial Economics 305, 310.

[123] H. U Byuiyan, and P. K Biswas, 'Agency Problem and the Role of Corporate Governance' <http://ssrn.com/abstract=1250842> accessed 25 April 2015.

[124] V. G Sridharan, and F. Navissi, 'The Theoretical Foundations of Corporate Governance'.

[125] A. Boukouras, 'Separation of Ownership and Control: Delegation as a Commitment Device [2011] 2.

[126] Where the agent has the discretion to exercise for the benefit of the principle, the agent may exercise it to maximize his own utility instead (C. Udo Braendle, *Theories of the firm*, p. 8). Agency theorists view executives and directors as self-serving and opportunistic (M. Catherine Daily, R. Dan Dalton and A. Albert Cannella, Jr., 'Corporate Governance: Decades of Dialogue and Data' (2003) 28(3) Academy of Management Review 372). Opportunistic tendencies include paying themselves higher salaries, diverting firm's resources to their personal benefit or refusing to give up their jobs in the face of poor profit performance H. U Byuiyan, and P. K Biswas, 'Agency Problem and the Role of Corporate Governance' <http://ssrn.com/abstract=1250842> accessed 25 April 2015.

[127] G. Charreaux, 'Corporate Governance Theories: From Micro Theories to National Systems Theories' (2004) Working paper of FARGO n° 1041202.

[128] [2003] All ER (D) 308.

Agency problems may arise between shareholders and top management, between majority and minority shareholders[129] and between shareholders and creditors.[130] The sources of these conflicts are externalities arising from asymmetries of information, differences in risk appetite and difference in decision making rights.[131]

Agency theory studies this relationship and the dilemma that it presents. However the principal and agent may not always share the same interests.[132] 'How to ensure that the agent acts solely in the interest of the principal is the challenge.'[133]

Mitnick[134] identified the problems of agency as, the principal's problem[135], the agent's problem[136] and the policing mechanisms and incentives[137]. The problem with policing and incentives is that they create costs[138] for the principal; this creates a potential paradox in that it is only rational to

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[129] This conflict is prominent in firms with a concentrated ownership structure (U. C Braendle, 'Theories of the firm' 12).

[130] M. Z Islam, *et al*, 'Agency Problem and the Role of Audit Committee: Implications for Corporate Sector in Bangladesh' (2010) 2(3) International Journal of Economics and Finance 177, 179.

[131] *Ibid.*

[132] E. F Fama, and M. C Jensen, 'Agency Problems and Residual Claims' (1983) 26 Journal of Law and Economics 6.

[133] B. Tricker, *Corporate Governance- Principles, Policies and Practices* (2[nd]edn Oxford University Press, 2009) 59.

[134] B. M Mitnik, *Fiduciary Rationality and Public Policy: The Theory of Agency and Some Consequences*, Paper presented at the 1973 Annual Meeting of the American Political Science Association, New Orleans, LA.

[135] The principal's problem is to motivate the agent to act in a manner that will achieve the principal's goals, for example through financial incentives, prospect of sanctions, and supplying information to activate norms (such as loyalty or obedience) and preferences that coincide with the principal's goals.

[136] The agent's problem is that he may be faced with decisions to act either in the principal's interest, his own interest, or some compromise between the two when they do not coincide.

[137] Policing mechanisms are mechanisms and incentives intended to limit the agent's discretion, such as surveillance or specifically directed tasks. Incentive systems are mechanisms that offer rewards to the agent for acting in accordance with the principal's wishes, such as bonuses and increased pay (positive incentives) or fear of reprisals (negative incentives).

[138] Sources of agency costs include monitoring costs, bonding costs borne by the agent (such as bonding against malfeasance, contractual limitations on his power, which limits his ability to take full advantage of profitable

implement policing and incentive mechanisms if the increased return to the principal's objective outweighs the cost of policing and incentives. The nature of problems that may arise between the principal and the agent include moral hazard with hidden action, moral hazard with hidden information, adverse selection and signaling models.

Adam Smith in his book *the Wealth of Nations* criticized the *joint-stock company* corporate form because the separation of ownership and management could lead to inefficient management. He argued that: The directors of *[joint-stock] companies*, however, being the managers rather of other people's money than of their own, it cannot well be expected, that they should watch over it with the same anxious vigilance with which the partners in a private copartnery (partnership) frequently watch over their own. Like the stewards of a rich man, they are apt to consider attention to small matters as not for their master's honour, and very easily give themselves a dispensation from having it. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company."[139]

From this quote, Adam Smith recognized a dilemma that bedevils the corporation concept. It is as much a problem today, in our era of KAA, East African Portland Cement, , Uchumi, Enron, WorldCom, Adelphia, Tyco International, and the rest, as it was when Smith published his book in 1776. He characterized the formidable puzzle as "other people's money", that managers are using other people's money, rather than their own. He warned that "negligence and profusion" - profusion meaning extravagance - were an inevitable result.

He believed that joint stock companies could never prosper because the managers had no incentive to take care of the interests of the widely dispersed shareholders. He predicted that a company controlled by a person or group of people other than the owners, the objectives of the owners are more likely to be diluted than ideally fulfilled. What is the solution? According to him, there should

opportunities, foregoing certain non pecuniary benefits, etc.), and the wealth loss borne by the principal when the agent's actions do not maximize his welfare (referred to as "residual loss").

[139] A. Smith, 'An Inquiry into the Nature and Causes of the Wealth of Nations, The Electronic Classics Series' [2005] Pennsylvania State University 606.

not be separation of ownership from management.[140]That, where the owner of a company exercises full control over its operations, like in a sole proprietorship with few or no employees, there is no agency problem: the manager (owner) can be trusted to make whatever decisions that will maximize his profit and will even make appropriate tradeoffs between the short term and the long term.

In the real world, that is not practical. Nevertheless, there are several devices for mitigating agency problem[141] – by a vigilant and effectively structured board of directors, "concentrated ownership holdings that lead to active monitoring of executives"[142], by timely, accurate and sufficient disclosure of financial information[143], by transparency in the ownership structure, by incentives that align managerial behavior with the interests of shareholders for example compensation contracts that encourage a shareholder orientation and by takeover devices.[144]

1.8 Research methodology

This is a qualitative study which will take an analytical approach involving analyzing the various codes of corporate governance that were used in the development of the Mwongozo.

The data collection method will be two phased, that is, the use of both primary and secondary sources.

The primary sources include information from the Constitution, relevant national legislations, guidelines and codes of best practices.

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[140] Adam Smith argued that society benefits when individuals pursue their own self-interest, because the free market then produces the goods and services needed at low prices (B. Tricker, *Corporate Governace- Principles, Policies and Practices* (2ndedn Oxford University Press, 2009) 5.

[141] J. P Walsh and J. K Seward, 'On the efficiency of internal and external corporate control mechanisms' (1990) 15 Academy of Management Review 421.

[142] C. M Daily et al, 'Corporate Governance: Decades of Dialogue and Data' (2003) 28(3) Academy of Management Review 372.

[143] B. Tricker, *Corporate Governance - Principles, Policies and Practices* (2nd edn Oxford University Press, 2009) 59.

[144] S. G Marks, *The Separation of Ownership and Control*, in Boudewijn Bouckaert & Gerrit De Geest (eds.). Encyclopedia of Law and Economics (Cheltenham: Edward Elgar Publishing, 1999p.696).

The secondary sources of information on this subject are from text books, journals, periodicals, legal reports, case law (both local and international cases), seminar proceedings, newspapers and magazines.

These research materials are mainly sourced from the internet, bookshops, the libraries such as the University of Nairobi School of Law library, Jomo Kenyatta Memorial library and the High Court library and the resource centres at the Institute Certified Public Secretaries of Kenya, Institute of Directors and Centre for Corporate Governance.

1.9 Limitation of the study

This study is essentially a desk review research. This approach of data collection without collecting empirical data has its shortcomings.

To add, the study is limited to research on one code applicable to the state corporations in Kenya.

Also, the study is primarily based on the available literature materials. Availability of all the relevant materials from the libraries, bookshops and the internet may be a problem.

1.10 Chapter Breakdown

The study is organized as follows:

CHAPTER 1: Introduction

This is the introduction to the study. It sets out the background to the problem, statement of problem, objectives of the research, research question, research hypothesis, literature review, theoretical framework, the hypothesis and the research methodology.

CHAPTER 2: Application of Corporate Governance Principles in State Corporations in Kenya

This chapter reviews what exactly is corporate governance? Why is it necessary? Its application in Kenya, its legitimacy and why state corporations have to apply the principles of corporate governance.

CHAPTER 3: Review of Mwongozo Code of Governance for State Corporations

This chapter explores the architecture of the Mwongozo with regard to the regulatory approach advanced in Mwongozo. The chapter is divided into four parts and develops in following fashion. The first part examines the definition of a state corporation and the need to incorporate principles of corporate governance in their management. The second part examines the regulatory approach used in Mwongozo and the alternative to the approach of "comply or explain". The third part analyses the 8 themes addressed by Mwongozo. The fourth part is a summary of the findings of this chapter.

CHAPTER 4: Comparative Study

This chapter evaluates other similar codes in Malaysia, South Africa, United Kingdom, South Africa, the United States of America and China lessons for Kenya.

CHAPTER 5: Conclusion and recommendations

This chapter contains the conclusions and recommendations of the study.

CHAPTER TWO

APPLICATION OF CORPORATE GOVERNANCE PRINCIPLES IN STATE CORPORATIONS IN KENYA

2.1 Introduction

This chapter will define the term corporate governance, give the theoretical background underlying the concept and for the purposes of this research address three theories underlying the concept namely; the shareholder primacy theory, stakeholder theory and the agency theory. It will also address the public sector reform initiatives that informed the restructuring of State Corporations in Africa and particularly in Kenya. It will further describe State Corporations in Kenya, their performance, challenges and the necessity of incorporating corporate governance principles in their governance and management.

2.2 Corporate Governance

For a proper understanding of how SCs have incorporated the principles of corporate governance, it is important to first of all understand what corporate governance is all about and how the concept found its way in the region and in Kenya, more particularly in SCs. Whereas there is no universally accepted definition of the term 'corporate governance'[145] there are some generally acceptable elements of corporate governance which are commonly acknowledged. The reason behind this lack of a specific general accepted definition is because the concept has developed in different environments and has had to adopt and fuse with the economic culture of those different environments. This therefore results in the variations in the available definitions. The Australian standard,[146] for instance, defines corporate governance as an assemblage of the authority,

[145] Benjamin Mwanzia Mulili and Wong Peter, 'Corporate Governance Practices in Developing Countries: The Case for Kenya' (2011) 2(1), International Journal of Business Administration <www.sciedu.ca/ijba> accessed 25 July 2016. The author notes that the various definitions arise because countries differ from each other in terms of culture, legal systems and historical developments.

See also V. R Ramon, *Corporate Governance as Competitive Advantage in Asia: Managing Corporate Governance in Asia*, (Asian Institute of Management, Philippines 2001).

[146] Presented by Committee MB 004 of Business and Governance and approved on behalf of the Council of Standards Australia on 23rd May 2003. Published on 23rd June 2003 by the Standards International Australia <www.aphref.aph.gov.au-house-committee-laca-whistleblowing-subs-attachmenta16.pdf > accessed 25 July 2016.

accountability, stewardship, leadership, direction and control exercised in the managing of organizations. Thus an organization is perceived to adhere to the principle of corporate governance once it observes fidelity to the above definition.

The corporate governance concept has been in place for a better part of the 19th century though the usage of the term 'corporate governance' was just popularized recently in the 1980s.[147] The reason the concept was in existence even before the specific use of the term itself is because it has its origin from the very basic foundation of corporations which insists on the principle of separation of ownership from control.[148] Its foundation is therefore informed by the limited liability concept as one of the pillars of incorporation which intends to protect shareholders.

In civil law countries[149] it is posited that the concept of corporate governance is meant to balance the interests of the players involved in the formation and running of a corporation that is; the employees, suppliers, managers, owners and the general public. Within such a legal system, it is referred to as the insider model.[150] In the common law system[151] the concept focuses on shareholder returns and interests in what is referred to as the outsider model. In this model the shareholders can hold a firm's management accountable for achieving the corporations' objectives. As can be noted above, though the concept takes various models in the different legal systems there are identifiable similarities, key being that both conceptions provide that the management boards of corporations are to be elected by shareholders to set policies and then delegate to the

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[147] H. Parker, *Re-empowering the board: an agenda for action*, in R.A.G. Monks & N. Minow (eds.), *Watching the watchers: corporate governance for the 21st century*, (rev ed. Cambridge: Blackwell 1996).

[148] F. F Eugene and C. J Michael 'Separation of Ownership and Control' (1983) 26 Journal of Law and Economics, 301-325 Published by: The University of Chicago Press <http://www.wiwi.uni-bonn.de/kraehmer/Lehre/SeminarSS09/Papiere/Fama_Jensen_Separation_ownership_control.pdf> accessed 23 August 2016.

[149] J. Solomon& Solomon, *Corporate Governance and Accountability*, (Chichester Wiley 2004). The author mentions some of the countries include France, Germany, Italy and Netherlands.

[150] Department of the Treasury, Directors' Duties and Corporate Governance: facilitating innovation and protecting investors, Corporate Law Economic Reform Program Proposals for Reform (Paper No.3, Canberra: AGPS 1997). <http://archive.treasury.gov.au/documents/283/PDF/full.pdf> accessed 25 July 2016.

[151] *Ibid*. Some of these countries include Australia, United Kingdom, United States of America, Canada and New Zealand.

management the authority to manage the corporation. The two models are also interdependent as some countries apply and are at liberty to apply a mixture of the two models.[152]

2.3 Max Weber Bureaucracy Theory (Hierarchical Governance Theory)

The institutional structure and management of SCs borrows heavily from this theory whose pivot is 'bureaucracy'. The theory protects the professionals from unfair actions thus security to employees, creates an opportunity for employees and ensures that creativity and skills are promoted. The difficulty with the bureaucratic approach is that it is difficult to know who is responsible for a decision. The process is mechanical and cumbersome as you may need different approvals at different stages. The structure is also inflexible to effect changes quickly. The top down approach also doesn't utilize special skill at the bottom for decision making. Other shortcomings include overspecialization where people focus on their areas; having people operate in a robotic fashion because everything is written and rigidity of decision making. The theory's pivot is bureaucracy and mostly works in government systems and processes.

This theory mirrors that traditional management of SCs in the country. SCs in Kenya are governed by the *State Corporations Act* of 1986.[153] Section 3 of the Act provides that the President has the power to establish a state corporation. The President can then after assign ministerial responsibility to the Vice President (Deputy President) or other ministers (Cabinet Secretaries) as the President may determine.[154] Thus actions of the SC have to have ministerial approval. Moreover 6 members of the board are public officials. Literally the President controls the board. Decisions of the executive are not vetoed. However the shift of this legislation and the theory is that it is not necessarily true that the President or the Minister hire competent boards. Boards may be put in place for other political reasons. However boards can hire competent managers.

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[152] M. B Roger, 'Insiders, Outsiders, and Change in European Corporate Governance' (Council for European Studies Conference, Chicago, March 31, 2006) <http://councilforeuropeanstudies.org/files/Papers/Barker.pdf> accessed 23 August 2016.

[153] CAP 446.

[154] Under the new Constitution those responsibilities fall under the Deputy President and Cabinet Secretaries. The terms Vice President and Ministers have been done away with by the Constitution 2010.

2.4 Shareholder Primacy Theory

The theory posits that the interests of the shareholders are considered by the directors to be paramount over and above the interests of stakeholders such as employees.[155] The key objective in this respect is that the overriding goal of a corporation is to maximize the shareholders' wealth. The value of the shareholders' stock has to be increased and the corporation can do all that is permissible by law such as streamlining its operations, including restructuring and re-organization by getting into agreements of mergers and acquisition all for the interests of shareholders.[156] The end result is that the corporation has to protect and work in favor and for the benefit of the shareholders' interests. These processes of increasing profits for and on behalf of the shareholder may prejudice other stakeholders who may end up being casualties of these processes of restructuring, for instance employees can lose jobs when a company re-organizes its business.[157] The theory places an obligation on the part of directors to lay and make strategic decisions with the shareholder in mind even if it means making decisions that are unpopular, unfavorable and harmful to other stakeholders. The shareholder primacy theory in essence creates an agency relationship between the shareholders as the principals and the directors and professional managers as the agents.

Chapter 5 of Mwongozo code provides for shareholder rights and obligations.[158] The code provides that the board of directors has to protect all the rights of shareholders and optimize shareholder value. The board is mandated to have an effective shareholder dispute resolution

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[155] Gordon Smith, The Shareholder Primacy Norm, (2004) <http://heinonline.org> accessed 31 July 2016.The author quotes *Dodge v. Ford Motor Co.* 170 N.W. 668, 684 (Mich. 1919) as offering the most accurate modern definition:

> *A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the non-distribution of profits among stockholders in order to devote them to other purposes.*

[156] See the case of *Kenya Airways Limited v Aviation & Allied Workers Union Kenya & 3 others [2014] e KLR* where the national carrier declared most of its staff, some very competent redundant all for the sake of reducing operational costs and seeking profitability.

[157] In 2015 for instance the Kenya Ports Authority was to lay off 4000 workers in a bid to ensure efficiency, report from <http://www.ipsos.co.ke/NEWBASE_EXPORTS/Standard%20Chartered%20Bank2/151013_The%20Standard%20-%20Tuesday_18_a3b3b.pdf> accessed 14 July 2016.

[158] Mwongozo Code p 28 <http://www.icpsk.com/index.php/membership/e-library/finish/9-cs-practioners-corner/459-mwongozo-code-of-governance-for-state-corporations> accessed 25 October 2016.

mechanism; ensure shareholders receive adequate and timely information including financial statements. They also have to be consulted and they have to be involved in the key decision making. Importantly the shareholders have to be educated on their rights. These rights correspondingly beget obligations of monitoring the performance of the board, appoint the board through transparent and formal processes, approve the boards' remuneration, attend and actively participate in the general meetings, approve financial statements, approve the distribution of profits and material transactions. Key to this the shareholders need to allow the board an independent and conducive environment to work.

2.5 Stakeholder Theory

This theory was popularized and given prominence by Freeman[159] in the 1980s in response to what he perceived as the inefficiency of the traditional theories of organizational governance. According to him the traditional theories such as agency and stewardship theories were not helping managers to develop new strategic directions and to create new opportunities. There were indeed some economic, political and social changes in the 1980s that provoked the idea behind the theory. The changes ranged from expanded government activities, environmental concerns, increased foreign competition and the enhanced role of the media. The term 'stakeholder' was also a deliberate choice unlike the term stockholder which only focuses on the economic perspective of an organization.[160]

A stakeholder is defined as a person or persons that are affected by the actions and achievements of an organization. Though other authors have defined stakeholders to mean 'groups without whose support the organization would cease to exist' this latter approach brings a number of problems, such that it includes a categorization of persons who maybe too remote to be affected by the organization's actions. Additionally, the organization itself may not recognize them as stakeholders.[161] There may be groups or entities that are very remote but whose services and

[159] See R. E Freeman, *Strategic Management: A stakeholder Approach*. (Boston, MA: Pitman 1984).

[160] See the definition of a stakeholder; A stakeholder is anybody who can affect or is affected by an organization, strategy or project. They can be internal or external and they can be at senior or junior levels <http://www.stakeholdermap.com/stakeholder-definition.html> accessed 14 July 2016.

[161] Freeman Edward 'Stakeholder Theory of the Modern Corporation' [2012] <*http://businessethics.qwriting.qc.cuny.edu/files/2012/01/Freeman.pdf*> accessed 14 July 2016.

actions contribute to an organization's existence. Freeman opines that an organization itself is an assemblage of stakeholders and the objective of the organization is to manage their interests, needs and viewpoints.[162] The role of management is given to the managers by the board who are to manage the corporation for the benefit of the stakeholders whose rights and participation should be factored in. At the same time, the managers are agents of the stockholders. According to literature on this theory, it is categorized into three; the normative stakeholder theory, descriptive stakeholder theory and instrumental stakeholder theory. The normative stakeholder theory[163] indicates how managers or stakeholders should act and view the purpose of the organization based on an ethical principle, on the other hand the descriptive stakeholder theory indicates how stakeholders and managers actually behave. The instrumental stakeholder theory on its part demands how managers should act if they want to work for their own interests.

Under the normative theory, there is an attempt to answer the following two questions; what are the responsibilities of the company in respect of stakeholders? And why a corporation should take care of other interests other than those of its shareholders? To address the proposed questions the theory underlies the idea that the actions of a corporation are expected to be ethical. These actions and decisions also have to be consultative. In this model the managers have the same duties like those of employees however they are also supposed to safeguard the welfare of the organization.[164] Thus, it proposes a board that comprises of all the stakeholder groups and a chairperson elected by others. Freeman thus develops a list of 6 rules that include, the principle of entry and exit (when stakeholders can decide when to enter into a contract), the procedure of governance to be agreed upon unanimously, principle of externalities (where a party involved in the contract) has to be part

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[162] See Elena F Pérez Carrillo, 'Corporate Governance: Shareholders' Interests' and other Stakeholders' INTERESTS, Corporate Ownership & Control' (2007)4(4) <http://www.virtusinterpress.org/additional_files/journ_coc/full-text-papers-open-access/Paper006.pd> accessed 14 July 2016.

[163] Donaldson and L. E Preston, *The Stakeholder Theory of Corporation: Concepts, Evidence and Implication (Academy* of Management Review 1995)

[164] R. E Freeman, and W.M Evan, 'Corporate Governance: A stakeholder Interpretation' (1990) 19 Journal of Behaviour Economics, 337-59. The two authors offer the stakeholder fiduciary principle. Managers must act in the interests of the stakeholders as their agent in the interests of the corporation to ensure the survival of the firm.

of the contract, the principle of contracting cost, the agency principle and the principle of limited immortality.[165]

The descriptive approach on its part aims to understand how managers deal with stakeholders and how they represent their interests. In this regard the corporation is a constellation of interests, where some are competitive and others are co-operative. Lastly the instrumental approach studies the organizational consequences of taking into account stakeholders in management. It also examines the practice of stakeholder management and the achievement of the corporate governance goals.

Summarily Freeman classifies the following as the main group of stakeholders; customers, employees, local communities, suppliers and distributors, and shareholders. The other group includes; the media, public, business partners, posterity, past generation, academics, competitors, NGOs, trade unions, financiers and government. The theory serves to create systems to manage the different stakeholders that will result to a strategic fashion. The crux of the idea behind the theory is that managers are to implement systems that satisfy all of the groups that have a stake in the organization. The interests and relations of these groups are to be integrated so as to guarantee long term success.

Chapter 6 of Mwongozo is dedicated to stakeholders' relationships which it indicates are to be managed in a pro-active manner to ensure that the legitimate interests and expectations of the stakeholders are catered for.[166] The board has the mandate to carry out stakeholder mapping and to ensure that there is a policy in place to govern stakeholder relationships. The interests of stakeholders are to be documented and the legitimate ones are to be honoured. A system of dispute resolution where ADR mechanisms are to be encouraged has to be in place. Importantly and to capture the devolved governance, these relations have to be disclosed in the annual report, additionally there has to be pro-active steps taken by the board to manage relationships between

[165] See R. E Freeman, 'The Politics of Stakeholder Theory: Some Future Directions' (1994) 4(4) Business Ethics Quarterly <www.researchgate.net/publication/240323778_The_Politics_of_Stakeholder_Theory_Some_Future_Directions> accessed on 31 July 2016.

[166] *Ibid* p. 31.

the national and county governments. Lastly, actions of the board have to be in line with government policies including the Kenya Vision 2030.

2.6 Agency Theory

This theory takes the normal relationship of a principal and agent. Meckling and Jensen[167] observe that an agency relationship is an agreement where the principal engages the agent to perform some work on behalf of the principal. It entails the delegation of some decision making authority by the principal to the agent.[168]The agent is however still under some control and restraints which are put in place by the principal. The two authors agree that sometimes, the agent may-not be faithful in their duties to the principal. As such, the principal may have to come up with incentives and incur the costs of monitoring the agent so as to curb their deviant activities.[169] The delegation of the principal's authority to the agents means that professional managers are appointed to manage the organization. The major concern then is the relationship and handling the disputes that may arise between the owners and the managers. The managers are to work for the benefit of the owners. The theory assumes that there is uncertainty and lack of information on the part of the owners. This brings about a concern as to whether the agent is able to do the work they have been employed to do while observing fidelity to the owners. This theory thus makes an assumption that the managers being the professional staff involved in the day to day management of the organization have some superior knowledge as to the operations of the organization.

This theory therefore takes the model of separation of control and residual risk bearing by principals.[170] It is however noted that this model may not be a direct representation of what SCs

[167] Meckling, H. William and Jensen, C. Michael, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure* (1976).

See also C. Michael Jensen, 'A Theory of The Firm: Governance, Residual Claims and Organizational Forms', (1976) 3(4) Harvard University Press, 2000; Journal of Financial Economics.

[168] See 'Agency theory and corporate governance A study of the effectiveness of board in their monitoring of the CEO' <http://www.kantakji.com/media/9422/file689.pdf > accessed 8 November 2016.

[169] *Ibid* p. 8.

[170] W. H Charles, J. Thomas, 'Stakeholder-Agency Theory' (1992) 29 (2) Journal of Management Studies March <http://www.ensp.unl.pt/saboga/incentivos/texto_02.pdf>accessed on 23 August 2016.

were modelled to be. First this is because most SCs have multiple agents in the form of the electorate, politicians, the parent ministry and the board of directors. There is no clear ownership structure. In fact, some authors [171] indicate that the state's property including SCs 'intrinsically' belong to everyone. In as much as the state allocates and assigns responsibility to the board and the professional managers, the controlling ministry does not bear any residual risk and such risk is eventually transferred to the public. The structure of Mwongozo code maybe reflective of the competing interests of shareholders and stakeholders, whereas there may be specific shareholders, the government's stake can be claimed by all Kenyans because the state invests taxes from the coffers.

The concept gained major prominence in the 1980s after major corporations closed down because of failure as a result of poor governance.[172] There arose a need to place more obligation and responsibility in the hands of management. But then this was not the only motivation behind the concept, there was also a realization going forward that for growth and development of the economy, there was need to improve how corporations are managed.

2.7 The need for corporate governance in state corporations

The concept of corporate governance has permeated most economies globally. More SCs are becoming increasingly aware of the need to implement efficient management as they are increasingly being held accountable for their performance.[173] In as much as some of these SCs were established for some historical non-economic social functions, the same functions like Social Responsibility are likewise also being conducted by the private sector enterprises that still maintain profitability. The SCs are also faced with stiff competition meaning that they have to shape up or

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[171] See M. Mitnick, Barry, *Origin of the Theory of Agency: An Account by One of the Theory's Originators* (University of Pittsburg 2006, pg5).

[172] Gertz Geoffrey, 'Kenya's Trade Liberalization of the 1980s and 1990s: Policies, Impacts, and Implications' <http://carnegieendowment.org/files/kenya_background.pdf> accessed 18 August 2016.

[173] L. Thomas, R. Oliver Florian & F. Woitek, *Public Corporate Governance in Public Enterprises: Transparency in the Face of Divergent Positions of Interest* <http://www.wifa.uni-leipzig.de/fileadmin/user_upload/AP/UL-WiFa_AP78_Lenk_Rottmann_Woitek.pdf> accessed 23 August 2016.

ship out. Elected and/or appointed governments are also coming up with economic blue prints which focus on professional and efficient service delivery. [174]

2.8 Public sector reforms in Africa

The concept of corporate governance in SCs among African States has to be introspected under the broad lens of the public sector reform initiatives.[175] According to the Economic Commission for Africa, immediately after independence, most African governments embraced the colonial structure of a central government[176] so as to secure social justice for all citizens. The centralized government would take a role of distributing wealth to the populace. This was viewed as a way of uniting the nation. This system had the contrary effect of marginalization of certain groups who in turn took up arms hence the spread of military coups in the continent.[177] The coups in themselves did not address the problems and soon there was clamour for democracy, a more open political, social and economic space.[178] This had the effect of liberalizing the political, social and economic space. This precipitated the ambitious programmes in politics and public institutions. The aim of such reform initiatives was to create a conducive and enabling environment for both the private and public sector.

The 1980s in particular were defined as the 'lost decade' for Africa.[179] There had been a rise in the oil prices and a decline in the demand of the basic products produced by African states. There was growing external debt, conflicts both internal and external, increased population and needs, poverty among other major challenges. Thus the Bretton Woods institutions had to introduce

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[174] For instance Kenya Vision 2030 <www.vision2030.go.ke.> accessed 31 July 2016.

[175] See the Economic Commission for Africa, Public Sector Management Reforms in Africa: Lessons Learned, December 2003<http://www.uneca.org>accessed 31 July 2016.

[176] *Ibid* pg 1.

[177] See Habiba Ben Barka and MthuliNcube, 'Political Fragility in Africa: Are Military Coups d'etat a Never-Ending Phenomenon' (2012) <www.afdb.org> accessed 31 July 2016. The authors opine that the coup d'etats in Africa between the period 1960-1970 are attributed to three broad reasons, namely; social mobilization, cultural pluralism and political factors.

[178] *Ibid.*

[179] See William Easterly, 'The Lost Decades: Developing Countries Stagnation in spite of Policy Reform 1980-1998' [2001] <www.siteresources.worldbank.org> accessed 31 July 2016.

reforms as conditions for continued support for public institutions including SCs in what was christened as the Structural Adjustment programmes (SAPS)[180]. The SAPs aimed among other things to reduce the participation of the state in the production of goods and services.[181] This encouraged and eventually led to the path of privatization[182] of most public enterprises, the logic being reduction of the state's role in production of goods and service delivery where the private sector could chip-in. This was also for efficiency and effectiveness. Overtime the SAPs too faced considerable challenges as the privatization could not solve all the problems of public entities including SCs. There were gaps that the private sector could not fill such as in the health, education and housing sectors. This was because the private sector is mostly driven by the need for profits and some of the sectors mainly served the poor and therefore had no real tangible profits to report. The state had an obligation to produce most of these services and goods sometimes without any economic benefit accruing to it. The concept of privatization also had to be applied carefully among African states because globalization in itself required reinforcing state capacity, not deficiencies in its capacity to produce.

The challenges illustrated above concerned almost all African states and in the year 1980, African leaders adopted the Lagos Plan of Action for the Economic Development of Africa.[183] It was meant to ensure collective self-reliance and self-sustaining development. The African Priority Programme for Economic Recovery (APPER)[184] was also adopted, and was closely followed by the United Nations Plan of Action for African Economic Recovery and Development (UN-PAAERD).[185] In the 1990s there was also the United Nations New Agenda for the Development

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[180] William Easterly, *The IMF and World Bank Structural Adjustment Programs and Poverty*, (University of Chicago Press 2003) <www.nber.org/chapters/c9656.pdf> accessed 27 August 2016.

[181] *Ibid*.

[182] William Easterly, *The IMF and World Bank Structural Adjustment Programs and Poverty*, (University of Chicago Press 2003. At p. 364, Easterly notes that;

> *Conditionally associated with these loans is well known: macroeconomic conditions like reduced budget deficits, devaluation and reduced domestic credit expansion, and structural conditions like freeing controlled prices and interest rates, reducing trade barriers, and privatizing state enterprises.*

[183] The Lagos Plan of Action <www.merit.unu.edu> accessed 18 July 2016.

[184] <www.info.worldbank.org> accessed 18 July 2016.

[185] The APPER was later converted to the UN-PAAERD.

of Africa. Finally, though not specifically for African states, the Millennium Development Goals were eventually adopted in the year 2000. The MDGs have since been replaced by the Sustainable Development Goals.[186] All these initiatives were desirable and much needed though some of them have had to be adjusted on account of unsatisfactory results.

Specifically, with regards to the management of SCs, African states initially took the path of privatization which is basically the transfer of control and government functions to the private sector. According to Hope[187], this took different forms. There was commercialization of government services to outside agencies. There were also joint ventures between African governments and the private sector. Some governments also contracted the private sector for specific functions. There was also the complete sale of some public enterprises to private investors. There was leasing of government assets and concessions. This privatization helped governments close fiscal gaps and avoid funding loss making enterprises which impact the economy negatively.

2.9 Public sector reform in Kenya

The efforts by the Kenyan government to create a culture of performance and quality service in the public sector kicked off early in 1965[188] right from the time Sessional Paper number 1 came to force.[189] This was a well laid down guideline that was meant to enhance productivity of goods and services and efficiency in the working of the public sector. These efforts were however frustrated with what the World Bank attributed to declining productivity, corruption, over staffing, low ethics, morale and discipline in the public sector.[190] In realizing the problems at hand, the

[186] Millennium Development Goals, <www.un.org> accessed 31 July 2016.

[187] K. R Hope, 'The New Public Management: Context and Practice in Africa', (2001) 4 (2) International Public Management Journal.

[188] M. Isahakia 'Preface in OPM/PSTD (Office of the Prime Minister/Public Sector Transformation Department), Public Sector Transformation Strategy: From Reform to Transformation 2010-14' (2010) Nairobi Pp 5-6 <www.macrothink.org> accessed 25 July 2016.

[189] See African Socialism and its application in Kenya <http://siteresources.worldbank.org/INTAFRICA/Resources/257994-1335471959878/Sessional-Paper-No-10-(1965).pdf> accessed 14 July 2016.

[190] World Bank (2001) Implementation Completion Report on a Credit in the Amount of SDRs 17.2 Million to the Government of the Republic of Kenya for an Institutional Development and Civil Service Reform Project. Washington DC. World Bank.

government of Kenya specifically undertook to conduct public sector reform in phases. The first phase of this reform was the launch of the Civil Service Reform Program CSRP[191] which aimed to enhance public sector delivery and efficiency. It covered five broad policy areas that included; streamlining the civil service organization so as to define clear roles, functions and job descriptions and specification; downsizing the staff to remain with a lean but properly trained and well-motivated staff; improved pay and benefits; proper personnel training and management; and accountable and efficient financial and performance management. This phase had a number of achievements. First the early retirement schemes were a success and there was scrapping off of more than 26,000 positions.[192] An integrated payroll system was also put up. There was development in terms of training and this saw the elimination of many ghost workers in the public service. On its part this first phase experienced challenges ranging from budgetary implications to the problem of proper planning.

The first phase informed the initiation of the second phase in the form of CSRP II[193] between the years 1999-2002. The second phase had specific priority areas which were; rationalization of ministerial functions and structures which included identifying functions that can be commercialized, contracted out and privatized. It entailed; reviewing organizational structures; staff rationalization and management of the wage bill; pay and benefit reforms; performance improvement initiatives in the public sector i.e. introduction of results based management and re-orientation of the organization's goals and objectives of the work force towards cost effectiveness and responsiveness to customer demands; and training and capacity. The second phase also experienced major challenges just as the first phase and the World Bank eventually described both CSRP I and II as unsatisfactory. This was contributed to by both internal and external factors.

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[191] S. M Marwaand M. Zairi, 'In pursuit of Performance-Oriented Civil Service Reforms (CSRs): A Kenyan Perspective,' (2009)13 (2) Measuring Business Excellence, Pp 34-43.

[192] G. Nzioka *Kenya* in K. Kiragu (ed) *Civil Service Reform in Southern & Eastern Africa; Lessons of Experience* (1998) <http://www.utumishi.go.tz/index2.php?option=docman&task=doc_view&gid=59&Itemid=57> accessed 27 July 2016.

[193] S. M Marwaand M. Zairi, 'In pursuit of Performance-Oriented Civil Service Reforms (CSRs): A Kenyan Perspective,' (2009)13 (2) Measuring Business Excellence, Pp 34-43.

Some authors have argued that besides the average performance the two phases also had to deal with many extraneous factors such as a weak economy that affected positive results.[194]

The initiatives continued and as from the year 2002 when a new government took over, it sought to implement the Economic Recovery Strategy (ERS) [195]for wealth and employment creation. This was hinged to the fact that an efficient and effective public service was crucial in achieving rapid and sustained economic growth and poverty reduction. This covered the third period which ran from 2003 to 2007.

The government had as a result initiated various public service reform programmes for this purpose. In September 2004, [196] the government established the Public Sector Reform and Development secretariat. The office of the President took a lead to spearhead a comprehensive and integrated public sector reform programme. One of the reform components under this programme was the rationalization of SCs. The key pillar under this phase was the strengthening of institutions of governance. As of June 2004, this initiative achieved a number of identifiable goals, key of which was to place all permanent secretaries (now principal secretaries) and Chief Executives of SCs on performance contracts.

The fourth phase is the present phase that started from December 2007 after the hotly contested election. The incumbent government retained power and released its Medium Term Plan 2008-2012. [197] These initiatives have continued to the current regime that culminated into the 'Mwongozo' Code of Governance that is the subject of this research.

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[194] See W. O Oyugi, 'Public Service Reform in Kenya: Lessons of Experience', in K Kiragu and G Mutahaba (eds), *Public Service Reform in Southern & Eastern Africa: Issues and Challenges*, (Mkukina Nyota Publishers Dar es Salaam 2006 Pp 3-65).

[195]Kempe Ronald Hope, 'Managing the Public Sector in Kenya: Reform and Transformation for Improved Performance', (2012) 2(4) Journal of Public Administration and Governance.

[196] See Hon. Ole Ntimama William, 'Public Sector Reform and Institutional Capacity Building' (Kenya Consultative Group Meeting held in Nairobi, Kenya 11th – 12th April, 2005) <http://siteresources.worldbank.org/INTKENYA/Resources/ps_reform_cb_ntimama.pdf> accessed 14 July 2016.

[197]Kempe Ronald Hope, 'Managing the Public Sector in Kenya: Reform and Transformation for Improved Performance', (2012) 2(4) Journal of Public Administration and Governance.

2.10 State Corporations in Kenya

The direct participation of governments in trade and business under the umbrella of SCs is purposely made to enable the state to participate in the economy and also importantly for the state to achieve some social goals some of which are non-economic.[198]The Kenyan government took over and established more SCs during the post-independence period. This is because at independence, the government had to take the leading role on a populace that was still battling poverty, ignorance and disease.[199] During the colonial period, the colonial government had established the first SCs to provide services that had initially been unavailable before the advent of colonialism.[200] The reason why it was the colonial government that had to build the first SCs was because it was the only power that had the capacity and knowledge to build the infrastructural services that were required at the time. They could also simply import the infrastructure, technology and knowledge from home.

The SCs required huge capital investments that the private sector could not provide at the time. Such investment included the building of the port, railways, airlines and the telecommunication network from scratch. The private sector at the time had also not expanded enough to address the much needed essential services that included water, electricity, transport, agriculture and health. As already pointed out, some of these SCs were already established parastatals in the UK and abroad and had only come to set up branches in their spheres of influence. It was also important that at the time the colonial government had to provide some of the services for the benefit of the settlers and the African middle class. It is those African middle class that took over commercial

[198]Kiarie Mwaura, 'The Failure of Corporate Governance in State Owned Enterprises and the Need for Restructured Governance in Fully and Partially Privatized Enterprises: The Case of Kenya' (2007)31(1) Fordham International Law Journal.

[199] See Mary Omosa, 'Research Utility and National Development Goals: The interplay between poverty alleviation strategies and social science research in Kenya', <www.portal.unesco.org/...-pdf/Omosa-EN.pdf> accessed 25 July 2016. The author notes that at independence poverty, hunger and disease were identified as Kenya's main developmental challenges.

[200]Omosa Josiah Morara Mauithi, 'Failure of Good Corporate Governance in State owned Corporations in Kenya: Towards a more effective Parliamentary Monitoring Role' (LL.M thesis, UoN 2014) <http://erepository.uonbi.ac.ke:8080/bitstream/handle/11295/76815/Omosa_Failure%20of%20good%20corporate%20governance%20in%20state%20owned%20corporations%20in%20Kenya%20towards%20a%20more%20effective%20parliamentary%20monitoring%20role(1).pdf?sequence=4&isAllowed=y> accessed 31 July 2016.

farming later. These settlers and later on the African farmers required capital that had to be provided in the form of loans and as such, there was the emergence of SCs such as the Agricultural Finance Corporation.[201] The main activity for these settlers was cash crop farming of coffee, tea, pyrethrum and wheat and there was need for marketing boards and industries to process these products.[202] The structure of these SCs was that they were entirely controlled by the colonial government.

The post-colonial African government took over some of these institutions which would serve the young nation.[203] They had to establish other SCs because there had been a fear of nationalization of colonial enterprises which had led to withdrawals by some foreign colonial enterprises.[204] The state, thus, had a duty to fill the gap and assure investors of their market security and one of the ways was by the government itself to directly participate in trade and business. There was also the need to provide some essential services which could not yield profit or would yield low profits hence unattractive to private investors. These important non-economic social benefits provided by some of these SCs eventually provided an appropriate excuse of why they were performing poorly. But soon enough after the public institutions experienced challenges, the government sought help from international bodies, specifically the IMF and the World Bank. The two imposed conditions in the form of SAPs. One of the conditions was that the government was to surrender and privatize some of its SCs which could be better run by the private sector, this was also meant to reduce the burden among the coffers. Whereas the government promptly let go some of these SCs, it could still not let go off all of them. Some of the SCs offered essential services i.e. health, water which the private sector was not ready to offer. The private sector at the time could also not fill the huge gap that had been created by the withdrawal of government.

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[201] See the background of the AFC from <www.agrifinance.org> accessed 28 July 2001. It is a wholly owned government development finance institution that was established in 1963 initially as the subsidiary of the Land and Agricultural Bank. In 1969 it was incorporated as a fully-fledged financial institution under the *Agricultural Finance Corporation Act Cap 323*.

[202] The AFC was meant to also help farmers inject capital and spur development.

[203] See for instance the Kenya Bus Service which has its origins from the Overseas Transport Company in London that introduced buses in Kenya in 1934, <www.kenyabus.net/history.html> accessed 30 July 2016. Others include East Africa Portland Cement from the Associated Portland Cement in the UK.

[204] See the *Foreign Investment Protection Act 1964,* which was enacted to curb the severe outflow of foreign capital, as foreign investment was reacting to what they perceived would be the effects of 'Kenyanization'.

Although privatization of SCs is one of the solutions that had been championed earlier to address the issue of mismanagement and performance of SCs, it was realized that it is not the only way. The government has had to balance its own roles. First there was the issue of globalization and changing trends and technology. Secondly under the Constitution the state has an obligation to provide water, social security, food[205] among others. This means that the state would not go on to privatize these essential services when there is no assurance that the same will be delivered. Privatization also brings about the issue of unpredictability, as private businesses can relocate at any time due to unfavorable economic prospects.[206]

As already indicated above, in the year 2002, there was a wave of change, in the form of a new regime that came under the banner of reform and performance.[207] The government had also sought to popularize the notion that the Kenyan people needed to take charge of their own activities. The SAPs, which were partly effective during the pre-2010 period, had been an imposition by donors and foreign forces. Placing reliance on what donors required was seen as a way that could hinder a government in achieving its promises to the populace. A change of tact was therefore necessary where the government could still privatize some of its corporations when the services offered could be better provided for by the private sector but at the same time improve and enhance performance of some SCs which it had to maintain under its stead. The problems of these SCs had long been identified. First and foremost, the hiring of the board and management had been and is still political where many at times other factors other than merit come into play. Secondly lack of autonomy in the execution of these SCs mandates also hinders performance, lastly multiple and bureaucratic systems also stifle performance. This diagnosis called for an immediate cure which has now been prescribed as the 'Mwongozo' Code of Governance which will be scrutinized in the next chapter.

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[205] See for instance *Article 43 of the Constitution of Kenya 2010* that provides for socio-economic rights.

[206] Companies such as Eveready East Africa Ltd closed its dry cell factory in Nakuru opting to transfer its operations to Egypt. See the Business Daily 29th September 2014, <www.businessdailyafrica.com> accessed 30 July 2016.

[207] The National Alliance Rainbow Coalition in the year 2002 ousted KANU which had in power from independence 1963.

2.11 Performance of SCs in Kenya

The Centre for Governance and Development CGD in conjunction with USAID evaluated the performance of SCs between the years 1993 to 2002 and published its report in the year 2005.[208]The CGD studied audited reports aforesaid from the Auditor General. It also looked at 7 reports of the Parliamentary Public Investment Committee. The CGD observes that reading the Auditors General reports was a daunting and depressing exercise. First out of 100 reports from the parastatals examined by the Auditor General only 8 reports were satisfactory. From the 130 parastatals examined, only 23 were satisfactory in terms of financial performance.[209] Generally the CGD observed that the narrative is one of 'loss, fraud and gross mismanagement.' Between the periods aforementioned the CGD approximates that a total of KSHS 54 Billion may have been lost where 14 billion was irrecoverable and about 40 Billion had slim chances of ever being recovered. The loss could be much higher as the report observes that figures from the auditor general are just but a sample since some SCs were excluded from the audits. But then the CGD report identified several specific problems.

2.11.1 Financial distress

Most of the SCs were technically insolvent, they could not timely meet their financial obligations as they fell due.[210] They entirely depended on bail outs from government and other partners.[211]The report points out that the decline was also worrying, for instance Kenya Railways made incremental losses every year i.e. it had a deficit of 124 million in the year 1990 and in 1997 it had a cumulative deficit of KSHS 4.45 Billion with the report observing that the problem was as a result of inefficiency, corruption and lethargy.

2.11.2 Failure to service loans

Most of the corporations are also heavily in debt. SCs such as the Kenya Broadcasting Corporation had accumulated a debt of 5.2 Billion by the year 1999 and could not service its loan obligations.

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[208] See Centre for Governance and Development, 'A Decade of Parastatal Waste: A study of the Audited Accounts of State Corporations over the Period 1993-2002 (2005)' <www.cgd.or.ke> accessed 29 July 2016.

[209] *Ibid* p. 13.

[210] See Centre for Governance and Development, 'A Decade of Parastatal Waste: A study of the Audited Accounts of State Corporations over the Period 1993-2002 (2005)' <www.cgd.or.ke> accessed 29 July 2016.

[211] *Ibid* p. 13 and 14.

This prompted the treasury to pay 1.5 Billion for the broadcaster. Interestingly in the same year, KBC had been unable to pay VAT of KSHS 95 million and had a negative working capital of KSHS 1.84 Billion.

2.11.3 Assets and investments

The Report of the commission of Inquiry into the illegal/irregular allocation of Public Land 'popularly known as the 'Ndung'u Land Report' observes that the government allocates land to SCs to enable them carry out their mandate.[212] This land is usually excised from un-alienated government land or set apart from Trust land. The commission established that SCs land was illegally allocated to individuals and corporations in total disregard of the law and public interest.[213]

The report observes that under this head, there were complaints about the assets register where most SCs did not maintain proper records of assets.[214] Without a proper record, it is possible to lose or fail to have track of these assets. The SCs which had this perennial problem were listed as 18 in number. There was also the question of land which was conspicuously excluded from the records. SCs such as KEFRI, KEMRI, KARI, LABDA, National Museums, KRA, KPA, KAA own large tracts of land but did not have title to the entire tracts of land that they own. The lands ministry could and had even leased parts of these SCs land without their knowledge and involvement. The report observes that, in some cases, it was about voluntary surrender of land where the SCs themselves irregularly surrendered land it owned. A case example is the African Development Corporation in 1997 that transferred land to the Settlement Fund Trustees for allotment to the landless, though it was surprising that most of the land ended up with private individuals.[215] So was the case with the Kenya Post Telecommunications Corporation where a

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[212] Government of the Republic of Kenya, 'Report on the Commission of Inquiry into the Illegal/Irregular Allocation of Public Land,' (June 2004).

[213] *Ibid* p. 89.

[214] Centre for Governance and Development, 'A Decade of Parastatal Waste: A study of the Audited Accounts of State Corporations over the Period 1993-2002 (2005)' <www.cgd.or.ke> accessed 29 July 2016 p.17.

[215] Government of the Republic of Kenya, 'Report on the Commission of Inquiry into the Illegal/Irregular Allocation of Public Land,' (June 2004).p. 90.

principal officer surrendered 14 plots and buildings to the commissioner of lands without the board's approval in 1995.[216] The Kenya railways directors on their part allocated themselves plots meant to erect housing for staff. Similar issues obtained at the Kerio Valley Development Authority.

Some of the investments were also questionable, because whereas there is a clear government policy on how and where SCs should invest that is in treasury bonds and bills, there were many clandestine investments. For instance NSSF had for a long time been unable to redeem KSHS 2.7 Billion held by the National Bank of Kenya and had to eventually convert it into equity. It also had a non interest earning amount of KSHS 2.67 Billion in call deposits. It also had 5.2 Billion at Prudential Building Society which consisted of this bank's 86% deposits.[217] On the other hand Moi University ran and operated more than 50 bank accounts. The financial books did not add up, there was stock overstatements, un-reconciled accounts, poor record keeping, huge disparities between the ledger and the cash book, bounced cheques among many other financial anomalies. There was also a deficiency on recovering debts. There was a lot of laxity in debt collection. Over this period the Kenya Railways Corporation had an uncollected debt of KSHS 3 Billion, while the Cereals and Sugar Finance Company had about 5 Billion of the uncollected debt.

As for procurement, there were many variations, from irregular procurement to breach of express procurement laws and rules. Over ambitious projects that had the main goal of sourcing for kickbacks. Work not in the bill of quantities which was eventually heavily paid for. The evidence of kickbacks was that at times, tenders were awarded to the highest bidder. The Kenya Ports Authority, for instance, in its engine overhaul of the VIP launch in Mkizi, spent KSHS 21 million on repairs when new engines would have cost only 3.7 million. The Kenyan Milling Corporation was sold for KSHS 150 million yet the highest bid had been KSHS 195 million and the successful bidder only paid an initial deposit of 10% and was given complete control of the corporation.

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[216] Centre for Governance and Development, 'A Decade of Parastatal Waste: A study of the Audited Accounts of State Corporations over the Period 1993-2002 (2005)' <www.cgd.or.ke> accessed 29 July 2016 p.12.

[217] *Ibid* p 19.

2.12 Summary of the CGD report on SCs

In its report the CGD identified what it termed as the nature of the problem. Its first problem is what it identified as politicization and poor corporate governance. According to the report, the bad management practices were contributed to by a number of factors; key of which was political patronage. The report observes that there is a problem on how SCs are viewed, first they are not viewed as corporations whose aim is to maximize profits and value and that SCs can only achieve efficiency if, operationally the corporation organizes its workings and contractual relations within the best management systems. The operations of a corporation have to be governed by the macro economics, laws, regulations, technology, and globalization among other good principles that can drive productivity. This, according to the report, has been contrary to how the same has been viewed in Kenya. The SCs have been viewed as entities and/or vehicles to accumulate wealth and reward patronage.[218] As a result, the objectives of the corporation are sometimes not concise and even when they are, they are not implemented. The operations are also sometimes not properly aligned such that the same SC may be performing both regulatory and commercial functions which essentially should be divided.

There has been the case of laws that are not progressive. For instance under the State's Corporation Act, the President is clothed with the power to declare a SC not to be a SC for purposes of the Act. He or she can also give general or specific directions to the board. This clearly hampers independence of boards to offer sound guidance and put in place efficient policies. The President also has the power to appoint the chairpersons and some members of boards and abolish the boards. Both the regulators i.e. the State Corporations Advisory Committees SCAC and the Inspector of State Corporations are also under the President's control. The supervisory mechanisms were observed to be inferior. First, most corporations are supervised by the line ministry, which in most cases also have their own internal problems and it would be difficult to expect them to handle and solve other extraneous problems. The ministries also have principal secretaries or their alternates sitting on the boards of most SCs and as a result they would not be expected to audit and/or evaluate

[218] See for instance the case of *Benson Riitho Mureithi v J.W Wakhungu& 2 Others* (2014) e KLR where the court holds that the appointment of Ferdinand Waititu as the chair of Athi Water Services Board is null and void because the appointment was not made on merit and it did not adhere to the Constitutional dictates.

their own decisions. The other body which is the SCAC, does what its name suggest 'advice'. Advice can be taken or ignored/disregarded.

The structure of the boards was also highlighted as a major problem in this regard. Most boards are constituted by line cabinet secretaries and even where there are elections in boards if the government holds majority shares it automatically influences the members elected to the board. In very few cases are the boards constituted in an open, transparent and merit based processes. This makes it hard to deal with patronage and cronyism. There have been and there continues to be cases where appointments are made of candidates who lack the knowledge and expertise in the fields they are appointed to, some are even illiterate or semi illiterate. There is usually massive lobbying before the appointments are made and in most cases they are made to secure political interests. There is also the case of absentee board members, whereby some of the appointees and even the government views such positions as temporary positions or positions that do not require a lot of dedication. As a result, we have board members who are absent on duty, some physically present but technically absent yet these are the same people that are to determine policy directions the SC is to set to follow.

Then there is also the all-important issue of funding. First, any business would require enough capital for it to be able to work effectively and thrive. The SCs mostly rely on funding from the government, sometimes directly through the line ministry. This can and has led to many cases of under-funding because the funding from government is entirely dependent on budgetary allocations that also have to balance and cater for other non-business sectors. This creates room for borrowing where most of the SCs are heavy in debt with a good number failing to meet their financial obligations in time or at all. The financial reporting systems and auditing were also indicated to be poor.

The report gave various recommendations. First of all, the exemption rule was to be done away with where all the SCs were to submit to a uniform code.[219] There was also a recommendation of

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[219] Centre for Governance and Development, 'A Decade of Parastatal Waste: A study of the Audited Accounts of State Corporations over the Period 1993-2002 (2005)' <www.cgd.or.ke> accessed 29 July 2016 p.39.

accountability where both the management and the board are to take responsibility of their actions and could be sued for corruption, abuse of office and related crimes. That despite there being massive evidence in the PIC reports, some CEOs had been left off the hook and were surprisingly just transferred to other government entities. There had also been, for some reason, deliberate efforts by SCs not to comply with PIC reports. The PIC reports which were presented and accepted by parliament were to be implemented by treasury. Since most of the said reports also indicted the treasury in its failure to monitor, manage, control and safeguard the coffers, they were unlikely to be implemented by it. Many recommendations of PIC were disregarded, for instance there had been a proposal to amend the State Corporations Act to deal with SCs that misappropriated public funds, and this never saw the light of day. Some projects that PIC had halted ended up being implemented.

The report eventually gives a summation of what it considers as the recommendations that it considers key. It proposes the implementation and strengthening of the Anti-Corruption and Economic Crimes Act (now repealed).[220] This aimed to deal with members of the board and the management who misappropriated SCs funds. There were also proposals on the amendment of the Exchequer & Audit Act and the State Corporations Act so as to majorly streamline procurement procedures and put in place guiding regulations. *The Privatization Bill (now Act of 2005)* was also given prominence as it was viewed as one of the key ways to deal with SCs. Other general recommendations included strengthening and proper funding to the office of the auditor, reducing the powers of the executive specifically the President's with regard to SC control and management, enactment of a new Constitution, increased power by the PIC, co-ordinated and streamlined operations between regulators.

2.13 Conclusion

From what can be discerned above, the challenges that face some of the SCs is lack of the agenda for profits. As has already been identified some SCs are established to perform non economic social functions. As a result they lose out on the benefit of competition. Such corporations include the electricity supplying service providers, whereby the government has recently introduced projects to ensure that all schools and homesteads are connected to the power grid. Such

[220] *Article 79 Constitution of Kenya, 2010*.

corporations would have to achieve this purpose regardless whether they make a profit or not from such an exercise.

The other challenge which still obtains is executive control, whereby not only does the President have great sway on who becomes a member of the board, he has representatives sitting in the same board i.e. the principal secretary from the parent ministry, principal secretary from treasury or their alternates. This has resulted in boards whose appointments are political in nature and the persons appointed sometimes have no or little expertise. Such members of the board may advance political agenda which may not be financially beneficial to a corporation.

Human resource is the most important component of any organization. An organization has to be able to attract and retain the proper persons with the proper skills. Such people are only attracted to the organization basing on the terms and conditions of service. A major challenge that has affected the public sector is the remuneration. In Kenya, for instance, since 1979 when the Ndegwa committee was appointed and it set the maximum salaries for SCs CEOs, the SCs lost a lot of competent managers to the private sector that attracted heavy perks. Currently the Constitution of Kenya, 2010 established the Salaries and Remuneration Commission which sets salaries for members of the public service. Comparably, salaries from the private sector sector still tower the ones in the public sector and as a result, the private sector has been able to attract competent persons with the necessary skills. It is also pointed out that the salaries of staff in the public sector are classified into job groups. Low salaries affect motivation and also discourage observance of strict business ethics.

SCs have also faced the challenge of overlapping and multiple regulations. First they are under the control of the parent ministry, the President and the National Assembly including departmental committees of parliament such as the public accounts committee and the public investments committee, the auditor general and the inspector general of state corporations. They are also accountable to the treasury which approves their budgetary concerns. In such scenarios, we are faced with situations where the policy and the objectives of the SCs are set by an outside force from the board of directors. These multiple regulations can also affect the operations of a SC and

its ability to make commercially sound business decisions. The approval stages for certain decisions to be made may prove bureaucratic.

The political control of the SCs brings about another challenge in the form of fraudulent transactions. These political interests may undermine the proper functioning of the SCs. First once politicians are appointed to such boards, they have other interests such as seeking finance to fund future campaigns. It is thus not strange for the board members to start trading with the SCs in the form of tendering.

CHAPTER THREE
REVIEW OF MWONGOZO CODE OF GOVERNACE FOR STATE CORPORATIONS

3.1 Introduction

This chapter addresses how Mwongozo code was developed and highlights its key substantive provisions. The chapter will demonstrate that the code is a weak public policy document because as an executive order, it can be revoked at will by the President, it is low in the hierarchy of norms and it was not subjected through adequate public participation which is a fundamental Constitutional norm. Further its substantive provisions conflict with the provisions of other codes and statute hence it may not address comprehensively the problems bedeviling state corporations. The chapter also makes the argument that the code heavily borrows from different jurisdiction without adapting the same to our economic environment hence it may not flourish. The chapter will highlight key aspects in our legal system and the multiplicity of other laws and regulations that also affect how SCs are run and managed. The chapter will also point to the fact that the same challenges that affected the Corporate Governance Guidelines (2002) also pose a risk to the present code.

3.2 Categories of State Corporations in Kenya

SCs are divided into four groups.[221] The first category are the utilities, which are monopolies with little or no competition from the private sector; the second category are the regulatory parastatals, which are semi monopolies with specific roles to play such as sub sector regulation of production and prices; the third category comprises of commercial or industrial parastatals which engage the private sector in serious competition; and lastly we have the development finance parastatals.

3.3 The Legal Framework of State Corporations

SCs in Kenya are governed by the *State Corporations Act* of 1986.[222] Under section 3 of the Act the President has the power to establish a state corporation. The President after establishing a SC

[221] Kiarie Mwaura, 'The Failure of Corporate Governance in State Owned Enterprises and the need for Restructured Governance in Fully and Partially Privatized Enterprises: The Case of Kenya, (2007)31(1) Fordham International Law Journal 46.
[222] CAP 446.

assigns ministerial responsibility to the Vice President (Deputy President) or other ministers (Cabinet Secretaries) as the President may determine.[223] Section 5 of the Act provides for the general powers of State Corporations which include among others the power to raise funds with the authority and approval of the minister and treasury. As can be noted even at this preliminary stage, behind every State Corporation there is the powerful authority of the President who acts through the ministers.[224]Most SCs are formed in the same manner as other corporations while others are established by statute. SCs that are established as ordinary companies are registered under the *State Corporations Act* whereas those that are established by Acts of Parliament are regulated by the legislation creating them. The SCs which are formed like other corporations have similar powers like other corporations only that their operations are limited by the State Corporation Act which gives the minister the power to appoint the board and to give directions of a specific or general nature.

Section 6 provides for the composition of the boards.[225] Unless otherwise provided for, the chairman of the board is appointed by the President. Of the entire composition of the board, about 6 members are public officials. The minister is also empowered to dismiss a member of the board if in his opinion the board member deserves to be dismissed. The minister also has the powers to appoint alternate members to the board. Section 7 solidifies the supremacy of the President[226] because he or she can issue specific and general directions to the board. The board has to meet a minimum of 4 times in a year. During the sessions of the board, any member of the board who has an interest in the profits or any contracts or proposed work has to declare his interest and the

[223] Under the new Constitution those responsibilities fall under the Deputy President and Cabinet Secretaries. The terms Vice President and Ministers have been done away with by the Constitution 2010.

[224] The Cabinet Secretary who is appointed by the President is more likely to appoint with the authority and/or approval of the President.

[225] Chairman; Chief Executive Officer; Permanent Secretary of the parent ministry; Permanent Secretary of Treasury; and not more than 7 other members of whom not more than 3 shall be public officers appointed by the President.

[226] The supremacy of the President over State Corporations also finds basis because the President can establish a State Corporation by an executive order, meaning that the President essentially creates and/or influences the creation of State Corporations. See section 2 of CAP 446.

member will be exempted from that specific decision making process. This provision insinuates that there are circumstances where a board member can be allowed to transact privately with the SC.[227]

From the provisions of *State Corporations Act* one problem that immediately arises is the balance between commercial and political interests.[228] As is manifest the President holds a lot of sway on who become members of the board and the general direction the SCs take. Whereas this influence seems to be cut down by Mwongozo, the same is just a mere policy document. The provisions of the Act remain superior.[229] The pertinent conflict is that whereas the survival of most corporations is a strong balance sheet, profits, dividends and investments in viable projects the interests of the political class may be different.[230] Being public enterprises SCs have to balance political, social and commercial interests. This makes SCs susceptible to conflict of interests. Mwongozo code points out that one of the main reasons of its enactment is to address the complex structure of relationships between the executive, parliament, ministries and the board. The code places responsibility on individual board members to disclose any conflict of interest.[231]

The code further requires the corporation secretary to maintain and update a register of conflicts.[232] This is in addition to the SC having a policy on conflict of interest. The code provides that conflict

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[227] Kiarie Catherine, 'Turnaround strategies adopted by Uchumi Supermarket Ltd; Under Receivership,' MBA research report (2009) submitted to the UoN, identifies one of the causes of the business decline of Uchumi as ' conflict of interest among the company's board members as some of the board members doubled up as major suppliers of the chains merchandise <http://erepository.uonbi.ac.ke> accessed 9 October 2016.

[228] South Africa's Presidential Review Committee, Balancing of Social, Political and Economic Imperatives in Delivering Objectives for State Owned Entities 2012 <http://www.thepresidency.gov.za/electronicreport/downloads/volume_3/discussion_papers-edited_by_expert_writer/Balancing_of_Social_Political_and_Eco.pdf> access 9 October 2016.

[229] In Kenya appointment of politicians to head State Corporation is common, see the case of *Benson Riitho Murethi v J W Wakhungu & 2 Others [2014] e KLR* which the Petitioner sought to challenge the appointment of Ferdinand Waititu as chairman of the Athi Water Services Board.

[230] *Section 3 of The Judicature Act* CAP 8 provides for the sources of law. Statute come second after the Constitution in the hierarchy.

[231] See Clauses 1.3, 1.16.

[232] P 14 of the Code.

of interest arises when private interests of a board member and/or that of his/her relations conflict and affect or influence the decision of that member. The board members are to avoid such situations and in the event they occur the same should be disclosed, noted and the member to withdraw from that decision making.[233] The definition is insufficient because it does not capture the aspect of 'political interference/conflict' which is an imminent threat to SCs. This is because, the President is a politician with political interests, if left to control the general and specific direction of a SC, then in essence the boards can only make and implement decisions that are sanctioned by the executive.[234]

Thabo Mokwena[235] notes that public enterprises are supposed to accommodate business and the extended secondary non-commercial universal service objectives. He refers to them as social, political and economic imperatives. These extended activities carry along an additional task to the SC, impose unnecessary pressure on the business and are also not planned and/or allocated funds in the SCs budget. In some cases these political considerations are there for a good cause and may relate to a legislation that is in place and the political objectives of the government that is place.[236]Noting that any government has to set up political priorities based on what the people need and/or have a manifesto on how to achieve their policies.

The OECD guidelines[237] on conflict of interest point out that if not properly recognized and controlled conflicts of interest can undermine the fundamental integrity of officials, decisions, agencies and governments. At the very basic level, conflict of interest is when a public official has

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[233] P 49 of the Code.

[234] See Magambo, Donald O (2012) <Challenges of strategy implementation in public corporations in Kenya acceessed from http://erepository.uonbi.ac.ke/discover> accessed 10 October 2016.

[235] Mokwena Thabo, 'Restructuring of State Owned Enterprise in South Africa' [2012] <http://www.thepresidency.gov.za/electronicreport/downloads/volume_3/discussion_papersedited_by_expert_writer/Draft_Restructuring%20of%20SOE%20in%20South%20Africa.pdf> accessed 11 August 2016.

[236] Some financially troubled State Corporations such as Mumias Sugar Company Limited have been revived by the jubilee administration in the year 2016 as part of its agenda for economic empowerment.

[237] OECD tool kit Managing Conflict of Interest in the Public Sector.

'private capacity interests' [238] which can improperly influence the performance of their professional duties and responsibilities. The term public official is a generic term under the code and it refers to public servants, civil servants, public employees, elected officials, state officials and any other official who performs public functions. It involves a conflict of a public official's personal interests and his or her duties as a civil servant. These conflicts are potentially harmful to the public trust bestowed upon the civil servant.

The Constitution of Kenya provides that[239], a public office is a public trust entrusted upon an official. Since the public official holds a position and authority that affects the rights of private citizens, then the authority can only be exercised in the public interest and within the law. As already pointed out this trust bestowed upon the public official can easily be damaged on the mere suspicion that the public officials duties could be affected by a personal conflict of interest.[240]Real or actual conflict occurs when an official's private capacity interests are known to the organization and to the public at large. A clear example is when a public official takes advantage of their public position to give an improper advantage to themselves or to some other private interests. The breach of trust could also involve an act of dishonesty, breach of the law, misuse of funds, abuse of position or failure to perform an official duty correctly.[241]

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[238] *Ibid* p 13.

[239] Chapter 6 of the Constitution of Kenya, 2010.

[240] Article 73 (1)(a)(iv) of the Constitution of Kenya, 2010 provides that authority assigned to a state officer should promote public confidence in the integrity of the office.

[241] The tort of malfeasance in public office has been judicially defined in, *Jones v. Swansea City Council* [1990] 1 WLR 55, at p.71 (*per Slade, L.J.*):

> *"The essence of the tort, as I understand it, is that someone holding public office has misconducted himself by purporting to exercise powers which were conferred on him not for his personal advantage but for the benefit of the public or a section of the public, either with intent to injure another or in the knowledge that he was acting ultra vires."*

The OECD principles suggest a number of ways of managing the conflict of interest. First it can be done by divestment of the public official's control or ownership of the private interest.[242] This can be done by giving another person complete and independent control.[243] This is meant to prevent the public official's interest from affecting their public action. The official has to demonstrate publicly that their interests are at arms-length from official decisions and actions which they are involved in as public officials.

Another way of dealing with conflict of interest is by withdrawal and having another official perform the duties that would otherwise be affected by the conflict. However, the recusal has to effectively implemented within good administrative procedures. The nature of appointments in the country point to a return of a favour. In most cases it has been touted that most appointees to SCs were supporters and/or contributed to the election of the public official.[244] Even though the Kenyan Constitution stipulates that a public official cannot accept a gift for performance of duty, it is practically difficult to enforce.[245] The considerations that have to be put in place include; a determination whether the gift is genuine. This is to mean that a public official has to ask whether the gift given to them is in appreciation of something they have done as a public official and if the same was encouraged or requested for. Another consideration is whether the gift is independent in the official's future decision. The public official has to then ask if the gift is free of any obligation that would entail to do something in return to the person giving the gift and or any other person they recommend. Lastly, the public official will consider whether he or she is ready to declare the gift to the public and its source.

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[242] One of the defenses that former EACC boss Phillip Kinisu had when he was accused of conflict of interest in an ongoing probe was that he had resigned as a director in his company Esaki Ltd which was being run and managed by the wife and daughter. See <www.businessdailyafrica.com> accessed 20 July 2016.

[243] Such as establishing a blind trust.

[244] See the case of *Benson Riitho Murethi v JW Wakhungu& 2 Others* [2014] eKLR.

[245] *Article 76 of the Constitution of Kenya 2010*.

3.4 Public participation in public policy making

As already pointed out, Mwongozo Code of Governance on State Corporations is a result of the recommendations that were given by the Parastatal Reforms Implementation Committee.[246] H E the President of the Republic had formed the implementation committee whose work was to implement the recommendations of the Abdikadir Mohammed and Mr. Isaac Awuondo led Taskforce. The Mwongozo Code of Governance for State Corporations was issued jointly by the Public Service Commission (PSC) and the State Corporations Advisory Committee (SCAC) in January 2015.Mwongozo was specifically designed to align the leadership, governance and management of State Corporations with the Constitution of Kenya. The Constitution of Kenya had sought to address the protection and efficient use of the available public resources.

From the code it is evident that the code was formulated by the implementation committee working together with its secretariat. It was also presented to the Public Service Commission for review on whether its provisions adhered to Articles 10 and 232 of the Constitution. The code was also submitted to the Constitution Implementation Committee and subjected to a round table where the World Bank team led by Alexander Berg made their input. The entire process of coming up with Mwongozo was facilitated by the SCAC which engaged other stakeholders, specifically Institute of Certified Public Secretaries of Kenya ICPSK who assisted in the development and validation of Mwongozo. The code is modelled on comply or explain[247] basis. This was in appreciation of the fact that there would be different levels of compliance. The code indicates that it would be read together with sector specific codes and in case the provisions of the code are in conflict with any specific code, the higher standard will prevail.

The code is applicable to all SCs and is to be reviewed after every 5 years to respond to the national and the global environment. The code indicates that the obligation of its implementation is placed on the CEO, the Corporation Secretary and the entire board. The CEO and the board are to take

[246] See <www.scac.go.ke> accessed 9 October 2016.

[247] The alternative 'apply or explain' approach recognizes that there is need for flexibility and that no single set of rules are applicable to all types of companies. Accordingly where a standard applied is lower than the one prescribed in the code, the listed company will have to explain non application of the recommended standards to the shareholders and the authority.

full responsibility for implementation of the code. What is curious to note is that the Presidential Taskforce on Parastatal reforms did all its work in a total of 6 weeks and the code is meant to implement those recommendations. Surprisingly the public who are the beneficiaries and consumers of services of SCs and or their elected representatives were not involved.

Article 10 of the Constitution provides for the national values and principles of governance that bind all state organs, state officers, public officers and all persons whenever any of them makes or implements public policy decisions. [248] The national values indicated above include the participation of the people. This requirement is a Constitutional norm and is therefore not an option. The particular provision in the Kenyan Constitution is similar to the South African Constitution which makes public participation mandatory in its legislative processes and other public policy processes.[249] Public participation in the context of the Constitution of South Africa entails facilitation of the peoples' involvement, conducting the business in an open manner and getting the views of the people concerned and/or affected to the largest possible extent.

In the Doctors for Life Case[250] public participation is described as a fundamental human right which is also set out in the international bill of rights.[251] The court described the right as having two faces to it; the general right to participate in the conduct of public affairs and the specific right to vote/and or be elected into office. This right should not only be provided on text, the state has the duty to facilitate the participation of the People i.e. in public hearings and gatherings. For the citizens to participate they need to have the necessary information so as to be able to participate

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[248] *Article 4(2) of the Constitution* provides that;

(2) The Republic of Kenya shall be a multi-party democratic State founded on the national values and principles of governance referred to in Article 10.

[249] See *section 72 of the South African Constitution*.

[250] 2006 (12) BCLR 1399(CC) (S. Afri).

[251] See Art 25 of the International Convention of Civil and Political Rights:
Every Citizen shall have the right and opportunity without any of the distinctions mentioned in article 2 and without unreasonable restrictions

1. To take part in the conduct of public affairs, directly or through freely choosen representatives.
2. To vote and to be elected.
3. To have access, on general terms of equality to public service in his country.

effectively. Public participation serves to ensure that the Citizens are engaged on a continuous basis on matters that affect them, they are involved in the public affairs, they identify themselves with the institutions of governance and most fundamentally they are part of the solution and they also own those solutions.

The extent of public participation required has to meet reasonable standards. This means that whereas it is not practically possible to involve everyone, it has to involve a significant number considering all the circumstances. Sachs J in the *New Clicks* case[252]observes that whereas the degree of participation can vary, there has to be a reasonable opportunity offered to members of the public and all those interested to know the issues and to have an adequate say. Reasonableness according to the Doctors for Life case[253] is an objective standard and will depend on the factors involved. It has to be guided by the nature of the subject i.e if it affects a great number of the populace, time and expense involved. However, with regard to time, it cannot be an excuse of denying the people meaningful opportunities to be involved. If a law and or a public policy document needs to be urgently dealt with, the onus is on the persons or bodies overseeing the same to indeed prove that the time could not allow the required participation.

Owegi[254] notes that Kenyans have always desired to have a system that allows them to participate in the decision making process. The concept though always narrowly perceived as relating only to the electoral process and involving only the elite is far wider. It is a tenet of good governance and is a reflection of focused citizens and a responsive government that respects the consent of the governed and makes them responsible for holding the government into account.[255] The concept of public participation has its guiding principles. There has to be the aspect of proactivity where the

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[252] *Minister of Health v New Clicks SA (Pty) Ltd & Others [2006] JOL 17488 (CC).*

253 (CCT12/05) [2006] ZACC 11; 2006 (12) BCLR 1399 (CC); 2006 (6) SA 416 (CC) (17 August 2006)

[254] Owegi John, 'Public Participation in the new constitutional dispensation' [2011] <www.academia.edu/4989865/PUBLIC_PARTICIPATION_IN_THE_NEW_CONSTITUTIONAL_DISPENSATION> accessed 9 October 2016.

[255] Department for International Development (2006) White Paper on International Development, eliminating world poverty: making governance work for the poor Crown Department for International Development, Norwich UK.

government, citizens and even the civil society take initiatives to enrich the process of decision making. There has to be inclusivity, where there is full participation by all those who are interested and/or affected by the decision. There has to be shared responsibility and more fundamentally there has to be transparency.

In Kenya public participation is a constitutional norm[256], where it is identified as a national value and principle. Owegi points out that public participation has to reflect transparency, accountability, inclusiveness, equality, non-discrimination and protection of the marginalized. It is not a validation forum to rubberstamp decisions made by a group and or clique. In the case of *Robert N Gakuru& Others v Governor Kiambu County* [2014] eKLR the court addressed the concept of public participation placing reliance on the South African jurisprudence specifically the *Doctors for Life* case.

Calistus Mboya[257] establishes what he perceives to be the threshold of determining whether sufficient public participation has been conducted before the coming into force of a law or a public policy. First he identifies time as a key factor. The time frame within which the public is required to contribute is indicative of the degree of sufficiency of public participation. The reasoning here is that if the time afforded for public participation is short then it can be concluded that it was not sufficient. Short periods block out the concerned People as they may not have sufficient time to present their contributions. Secondly there is the degree and notice of participation. The law/policy making body has the obligation to communicate effectively and efficiently with the affected people to enable them be aware and to prepare. The public can only be involved sufficiently if they are aware in time that they are to give their contributions. Even in this era of modern technology, courts have ruled that a mere post on a social network is not sufficient notice, neither is the publication on a gazette. In a case of legislation, the courts have opined that in addition to a publication in the Kenyan gazette, the same has to be brought to the attention of the public in

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[256] See Article 10, 69,118,196 and 201 of the Constitution of Kenya, 2010.

[257] Mboya Calistus, 'The Concept of Public Participation in Law Making Process in Kenya with reference to the Jurisprudence in South Africa' [2016] <www.academia.edu/Documents/in/Constitutional_Theory> accessed 9 October 2016.

barazas, mosques, temples and churches.[258] The intention is that the public practically get the information as opposed to a mere publication that the people don't access and read.

Calistus also observes that mere notification is not enough, positive steps have to be taken to ensure that participation is achieved. There has to be civic education and awareness so as to ensure active participation. The concerned people have to be notified of all the avenues they can participate and their contributions have to be registered. There also has to be reasonable participation. This reasonableness has to be looked at with regard to the level of importance of the law or policy. The more a particular law or policy affects the populace, the more demands on the public participation that is required. Calistus Mboya argues that since public participation is a constitutional requirement then the involvement of the public ensures that the resultant law or policy caters and has a component of public interest. The body mandated to come up with a law or policy has to do away with formalistic approaches where short notices are given to exclusive persons and bodies. The process is also not a cosmetic process where it is done just for the purpose of adducing evidence to the effect that public participation was conducted. To do otherwise is similar to render the concept meaningless in a democracy such as ours. The South African case of *Matatiele Municipality and Others vs. President of the Republic of South Africa and Others*[259], illustrated this position aptly.

3.5 Executive Orders in the hierarchy of norms

Mwongozo code was passed as an executive order. Kenneth R Mayer[260] defines an executive order as a presidential directive that requires or authorizes some action within the executive branch. It

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[258] In *Robert N Gakuru& Others v Governor Kiambu County* [2014] eKLR, the court observes that getting a few people in a hotel to contribute their views does not meet the threshold of public participation.

[259] 2006 5 BCLR 622.Ncobo J observed;

> *The nature of the legislation and its effect on the provinces undoubtedly plays a role in determining the degree of facilitation that is reasonable and the mechanisms that are most appropriate to achieve public involvement. Thus, contrary to the submission by the government, it is not enough to point to standing rules of the legislature that provide generally for public involvement as evidence that public involvement took place; what matters is that the legislature acted reasonably in the manner that it facilitated public involvement in the particular circumstances of a given case.*

[260] Mayer R. Kenneth, *With the Stroke of a Pen* (Princeton University Press 2001), accessed from press.princeton.edu/chapters/s7095.pdf on 9/10/2016.

can be used to establish policy, reorganize the executive branch, alter administrative and regulatory processes, affect the implementation of legislation and take whatever action is permitted within the law. Vivian Chu and Todd Garvey[261] observe that executive orders are instruments used by President's to achieve policy goals. Whereas the same are not necessarily provided in Constitutions, they are accepted as an inherent aspect of Presidential power. In Kenya the power of the President to issue an executive order is founded in the Constitution.[262] It is a way in which the President exercises authority. It is one among the many ways that the President can exercise authority and like all the other ways has to be based on the Constitution or statute. In the US 1957 report by the House Government Committee,[263] executive orders are defined as written documents by the President and directed to government officials or agents and they affect private citizens directly or indirectly. The emphasis in this definition is that executive orders have to be based in law.

An executive order has to be made public and once the same is done even courts are bound to take notice and give effect to it.[264] Presidential authority is usually drawn from the Constitution. Many Presidents have utilized executive orders for various issues but the general observation is that most Presidents utilize executive power on matters that may have heightened scrutiny and or contentious matters that they do not wish to have challenged or go through rigorous processes.

Executive orders however still have many challenges. First there is the perception that it amounts to unilateral executive law making that impacts the interests of private citizens and encroaches upon the power of parliament. In the US case of *Youngstown Sheet & Tube v Sawyer*, the US Supreme Court found the executive order issued by President Harry Truman in 1952 to avert worker's strikes during the Korean Civil war, in the country's steel mills unconstitutional.[265] The

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[261] See Chu S. Vivian, Todd Garvey, 'Executive Orders: Issuance, Modification, and Revocation', [2014] Congressional Research Service <https://www.fas.org/sgp/crs/misc/RS20846.pdf> accessed on 10 October 2016.

[262] *Article 135 of the Constitution 2010.*

[263] See <http://www.archives.gov/research/guide-fed-records/groups/233.html on 10/10/2016> accessed 10 October 2016.

[264] In Kenya, it has to be written, signed, sealed and published.

[265] 343 U.S. 579 (1952).

president had issued an executive order to the effect that the Secretary of Commerce to take possession of the country's steel mill and ensure continued production. Justice Jackson in a concurring opinion in the judgment observes that presidential action of issuing an executive order is analyzed depending on the 3 levels he established. On the first level is when the President is acting on the direct authority of the legislature. In such an instance his or her powers are at the maximum. The second level is where the President and the legislature have concurrent authority where the distribution of the said authority is uncertain, in such a case if the president issues an executive order and parliament is silent, the same would be allowed. The third level is where the President's actions of issuing an executive order go contrary to the will of the legislature.

Executive orders lack stability as the President is free to revoke, modify or supersede his own orders or those issued by his predecessor. Whereas some scholars[266] on the subject opine that executive orders are an important instrument of executive power and can be used to implement important policy other scholars argue that executive orders are useful only for routine and administrative tasks. The same being touted to be used for limited and temporary alternative for policy initiatives.

3.6 Multiplicity of regulations

The National Treasury gazetted the Code of Corporate Governance Practices for Issuers of Securities to the Public on 4th March 2016.[267] The code is issued in accordance with sections 11(3)(v) of the Capital Markets Act Cap 485 A. The new code replaces the Corporate Governance Guidelines 2002 which was based on a 'comply or explain' approach to the 'apply or explain' approach. The code is intended to provide minimum standards required from shareholders, directors, managers of listed and unlisted companies that issue securities to the public so as to promote high standards of conduct as well as ensure that they exercise their duties and responsibilities with clarity, assurance and effectiveness. The 'apply or explain approach

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[266] Peter MShane and Harold H Bruff, *The Law Of Presidential Power: Cases And Materials* (Carolina Academic Press 1988)

[267] See <http://www.cma.or.ke/> accessed 10 July 2016

recognizes that there is need for flexibility and that no single set of rules are applicable to all types of companies. Accordingly, where a standard applied is lower than the one prescribed in the code, the listed company will have to explain non application of the recommended standards to the shareholders and the authority.[268] The code provides for executive pay provisions, where remuneration of board members is to be fair and responsible. The same are to be disclosed in the annual report. The code also provides for levels of remuneration for directors where an independent committee is to recommend the appropriate remuneration. The code also sets the age limit for board members at 70 years unless retained by a vote by the annual general meeting. There are also provisions of term limits for directors to 9 years and board diversity.[269]

3.7 Adoption of foreign codes without adaptation to the state of the country

Lois Musikali[270] observes that with regard to corporate governance, Kenya adopted a combination of codes from developed countries with little thought to the underlying conditions. She further notes that such foreign codes are bound to be ineffective because they are not adapted to the prevailing circumstances. Musikali further notes that Kenya may not be able to achieve adherence to corporate governance principles based on codes of governance because Kenya has been unable to cope with self-regulation of its corporations. She points out that most companies have been used as instruments of fraud. She also identifies corruption and political interference as part of the problem. She notes that at the face value, Kenya appears to have all the elements that are necessary to achieve corporate governance; market regulation that is similar to the ones in developed countries, a regulatory agency and a corporate governance code. The Corporate Governance Code 2002 was developed by the Centre of corporate governance which is an affiliate of the commonwealth association of corporate governance.[271] The 2002 guidelines were therefore as a

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[268] The Code has moved away from the "Comply or Explain" approach to "Apply or Explain". This approach is principle-based rather than rule-based, and recognizes that a satisfactory explanation for any non-compliance will be acceptable in certain circumstances.

[269] Contradiction with Mwongozo Code which provides the same to be 6 years.

[270] Musikali M. Lois, 'The Law Affecting Corporate Governance in Kenya: A Need for Review,' (2008)19(7)International Company and Commercial Law Review*213-227.*

[271] See <http://www.oecd.org/corporate/ca/corporategovernanceprinciples/31557724.pdf on 10/10/2016> accessed on 10 October 2016.

result of many principles which were drawn from different jurisdictions. In particular the code indicated that it was developed taking into account similar codes in the United Kingdom, Malaysia and South Africa.[272]

According to Musikali, the country has had a weak legal system which could not support the corporate governance principles.[273] The Companies Act Cap 486 (now repealed) was copied from the United Kingdom Companies Act 1948. The Act dealt with director's duties and shareholder protection. Section 45 of the Companies Act which provided that directors are held personally liable for misstatements in company prospectus also allows directors an array of defences. They could not be held liable if they never gave their consent, or if they withdrew their consent or if they relied on public documents. Thus there was no incentive by the directors to exercise due diligence. Section 188 of the Act also absolved directors of any blame on liquidation if they had no intention to defraud. Sections 189 on the other hand implied that a person guilty of previous company fraud can be allowed to be a director of other companies if allowed to by court and or if the fraud happened more than 5 years ago. This explains why directors who had run down some parastatals were appointed for other directorships.

Notably under the repealed Act, the minority shareholders could not bring a suit unless the same is approved by the board. This in effect means that minority shareholders who are in most cases vulnerable could not bring an action against the company. The minority shareholders could not sue the directors of the company in the company's name where a breach to the director's duties is ratifiable. Musikali specifically pointed out that for Kenya to incorporate corporate governance principles then it ought to restrict foreign influences upon its legal system to those rules of corporate governance that have been successful in other jurisdictions. The reasoning here being that even when market conditions are similar the policies in a country could be different. Additionally, the size and nature of business, the people's education on company law and

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[272] Published in Kenya Gazette as GAZETTE NOTICE NO.3362 <https://www.nse.co.ke> accessed 10 July 2016.

[273] Musikali M Lois, 'The Law Affecting Corporate Governance in Kenya: A Need for Review' [2008] International Company and Commercial Law Review 18.

sophistication maybe different. Thus Musikali's thesis finds base from Lord Denning MR as he then was in the case of *Nyali Ltd v. AG*[274].

3.8 Provisions of Mwongozo

The Corporate Governance Guidelines (2002) sought to among other separate the role of the CEO and the chairperson of the board.[275] This is because it was intended to reduce agency costs and the effectiveness of greater independence in decision making. According to Musikali this is not a bigger problem because the bigger problem is between minority and majority shareholders. Majority shareholders are the controllers of companies in Kenya and the board is unlikely to act so as to interfere with the interests of majority shareholders. An effective control mechanism is that which targets the independence of the board not from within itself but from external influences of the majority shareholders.[276] For these guidelines they relied on the 'comply or explain principle.'

The 2002 guidelines had section 1.1 provide for shareholder protection. The stake-holders interests were only to be taken into account in realizing shareholders long term value. This meant that the code paid attention to the needs of stakeholders. At any given time more than half of the best performing companies at the NSE are foreign owned and controlled. Thus it was the opinion of Musikali that the interests of stakeholders (Kenyan community) were not taken care off. The nature of the minority shareholder also exacerbates the problem where a significant number of these shareholders are under-informed about the rights of shareholders and are also not sufficiently educated on corporate governance issues to discover if there is anything to complain about. A group of these shareholders also perceived investment as gambling and bad returns signified a bad deal. Such a shareholder would associate growth of investment as luck and the role (in) effectiveness of the managers is not seen as a factor.

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[274] [1963] E.A. 371.

[275] Clause 2.2 of the code <https://www.nse.co.ke/.../capital-markets-authority-Downloads/corporate%20governance%20guidelines%202002%20(1).pdf> accessed 18 September 2016.

[276] Clause 2.1.4.

Board structure and remuneration was also a key area for consideration. Many state corporations such as Uchumi have had dysfunctional boards. In the United States, Enron's directors failed to monitor the financial activities of management. The directors mainly relied on the information and explanation from directors without questioning the same. We have had documented cases of executives who attend board meetings as a routine and have no idea of how the corporations are being managed. According to Eshiwani[277], most non performing boards in Kenya are composed of typically elderly people and the discussions that take place are those that have little to do with the objectives of the company. These board members are mostly taking up the positions as a semi-retirement. There is also a huge disparity on the earnings of employees as compared to that of management. The remuneration of the board is on the other hand not tied to performance.

3.8.1 The appointment of the Board of Directors

This is the most critical provision as the success of the corporate governance principles squarely lies with the board and the management. The code provides that SCs should be led by an effective Board of Directors[278], who should be competent, diverse and qualified persons who are able to exercise sound and independent judgment. The independence of the board is emphasized with the board expected to have fidelity to the shareholders and to act responsibly towards stakeholders. The board is generally governed by governance principles that insist on independence, equitable representation and merit. For the appointment of the board, the guiding law is Article 27 of the Constitution.[279] The process of appointment is one that is also transparent. The code caps the number of board members between 7 and 9. The code does prescribe that at least one of the board members should have expertise in financial management. The board also has to have at least a third of it independent. What constitutes independence has been prescribed to mean; not being in the service of government both national and county, not under the employment of the SC in an executive capacity in the preceding 5 years, is not associated with an advisor or consultant to a SC, no contract with a SC or a member of its senior management.

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[277] Eshiwani, 'Director Liability in the Wake of Uchumi (Collapse)' [2006] Institute of Directors (Kenya) <http://erepository.uonbi.ac.ke/> accessed 27 September 2016.

[278] Mwongozo Code, Chapter 1.

[279] *Article 27 of the Constitution provides for equality and freedom from discrimination.*

As for the appointment, the chairperson is appointed by the President, the board members on the other hand are appointed by the Cabinet Secretary.[280] The appointment is done formally and announced through a Kenya gazette. Board members are appointed by name and act personally without an option to alternate. After appointments, the members have to signify acceptance expressly in writing. The board itself has the power to recommend the removal of a member based on absenteeism, poor performance, and misconduct among other unethical behavior that maybe prescribed.

3.8.2 Role and functions of the Board

The code itemizes the roles and functions of the board.[281] The board is generally responsible collectively and it determines the organization's mission, vision, purpose and core values. It specifically sets the general strategy and policies. The board also approves the organizational structure and the annual budget. Their role in monitoring and supervision also ensures the organizations runs as outlined by the board. The board also hires the CEO and is in charge of communication.

The code also places duties and responsibilities on individual board members.[282] The board members are expected to exercise the highest degree of care, skill and diligence while discharging their duties. They are to place the organization first. They should also avoid scenarios that bring their personal interests in conflict with those of the organization. Importantly among the duties is that the board owe the organization and not the appointing or nominating authority. The chairperson of the board is endowed with the power to lead and importantly a key participant in the formulation of the agenda for the board. The chairperson is also to monitor and maintain a working relationship with the CEO. He or she is responsible to provide quarterly reports to the CS and the SCAC.[283]

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[280] Similar provision as in the CAP 446.

[281] Mwongozo Code, p. 3.

[282] The same code also provides that board members shall act collectively.

[283] The authority of the Cabinet Secretary and the executive still manifest.

The board also has term limits, which is not to exceed six years, or two terms of three years each. In such a case the renewal of the board member's tenure is subject to a favorable evaluation. The members of the board can also not hold two board positions at a time, to ensure effective participation.[284] This excludes the chairperson who cannot hold another position in another SC when serving as the chairperson in another board. The board is organized into committees which shall not be more than 4 committees. Of importance is the mandatory requirement of the being on place of an audit committee.

The other committees are to deal with matters on; governance, risk, compliance, finance, technical matters, strategy and human resources. Each of the committees is headed by a chairperson other than the general chairperson. The code now specifically places emphasis on board meetings where adequate time and effort has to be directed towards them. The code introduces a work plan for the board and a board evaluation.[285] The remuneration of the board is also to be done in an open and transparent manner. There is also the aspect of board independence where the code expects the board to exercise independence judgment. The board members are to be held liable for their transgressions. It is the function of the board to appoint the Chief Executive Officer. This is similar to the intention of the previous Corporate Governance Guidelines (2002) which sought to have the Chairperson and the CEO to be separate individuals.[286] Of the key roles of the CEO is to be

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[284] This is intended to avoid board members who take up positions as some form of semi-retirement.

[285] 1. Board members should ensure the development of an annual Board work plan.
2. The Board work plan should at a minimum focus on:

(a) A review of management's implementation of strategies, policies and plans.
(b) Risk Assessment and Management.
(c) Budgeting and Financial Management.
(d) Quality Assurance Processes.
(e) Board Evaluation.
(f) Strategic planning and review.
(g) Governance and compliance.
(h) Competence development for Board members.

[286] See <https://www.nse.co.ke> accessed 9 October 2016.

responsible for stakeholder management and the enhancement of the corporate image. The appointment and roles of the corporation secretary are also set out.

Also importantly set out is the separation of roles between the board and the management. There is a distinction between the role of the CEO and the chairperson; the corporation secretary and the CEO.[287]

In the governance statement the code provides that the board is to ensure that the annual report includes a statement of policy and indicate the aspects of Mwongozo that have been complied with. The board is also mandated to disclose the key shareholders and the extent of their shareholding; the key stakeholders and their influence on organizational performance and stability. The board composition and structures are also to be disclosed. Their remuneration is also disclosed. The financial reporting is to disclose the key factors that affect financial condition of the organization.[288] Procurement procedures also have to be outlined. Importantly also is the reporting on compliance with rules, regulations and standards. If aspects of the rules/law are not being complied with then the reasons have to be adduced.

Chapter 3 provides for accountability, risk management and internal control.[289] The same insist on proper accounting, procurement and the technological systems. Under ethics and corporate citizenship, the board is mandated to lead by example by setting standards on ethics and integrity. They do this by setting the core values of the organization which are to be aligned to the Constitution 2010 and ensure that all members adhere to the core values. The board is expected to ensure that the code of conduct and ethics is developed.

The code provides that it is the duty of the board to secure the interests of shareholders this is to include among others a dispute resolution mechanism. The board also has the role to ensure that

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[287] The Corporation Secretary is expected to advice the board on an array of governance matters including legal matters.

[288] As already indicated that for a corporation the balance sheet and profits are pivotal to determine success.

[289] Mwongozo Code,p. 20.

minority shareholders participate in decision making and are also protected. The code further takes note of the stakeholder relationship. It observes that the effective management of stakeholders creates goodwill and promotes a positive image of the organization.

Lastly the code aims to ensure that the SCs comply with the laws and regulations. The applicable laws that have been identified include; the Constitution, the Leadership and Integrity Act and the Public Officers Ethics Act. Compliance is to be attained through observance of internal procedures.

3.9 Conclusion

Whereas the code has very desirable aspects, the practicalities of implementing the same are missing. First there is the aspect of executive control of boards as boards of SCs are still being appointed on the basis of political patronage. Retired career civil servants and former politicians are being appointed to boards by the executive, some even without the necessary qualifications. It is proving difficult for the executive to strike a balance between the need to hire boards competitively and on merit as desired in Mwongozo and the authority of the President under the State Corporations Act (Cap 446) to appoint boards of state corporations at his discretion, since the President is a politician who has political interests. Even after appointment, the independence of boards is still at the behest of the executive who are able to give general and specific directions on how business is to be conducted.

Secondly the code is subordinate to the State Corporation Act in the hierarchy of norms and thus can be ignored. There is no compulsion to adhere to the code. The Code additionally lacks in public participation. The copy and paste made where public policy documents in other jurisdictions such as the King III report are implanted and adopted without alterations, modifications or exceptions. Among the goals of the Implementation Committee was to propose legislation to repeal the State Corporations Act.[290]The Government Owned Entities Bill, 2014, was thus proposed to repeal the State Corporations Act Cap 446 and provide clear and consistent rules on definition, classification, ownership, oversight, accountability and governance of SCs. The new framework is to eliminate

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[290] See the progress report of the implementation report accessed from <http://www.scac.go.ke/index.php/2015-02-16-09-34-58/implementation-commitee> accessed 20 July 2017.

the current multiplicity of laws governing SCs and reduce the burden of compliance with numerous existing legislations that are sometimes conflicting. Unfortunately this has not been prioritized by government and the same has stalled. The implementation committee has also noted that there are still bloated boards, lack of proper skills mix, lack of uniformity in management of board affairs, conflicting guidelines in appointment of CEO's, lack of understanding of the role of board members by borad directors and the fusion of Chief Executive and Board Secretary roles.[291]

Issues of procurement and corruption also pose a big challenge to the operations of SCs, first the procurement laws allow for single sourcing in some instances making it possible for corruption to flourish where goods and services are highly inflated. The boards sit at the pleasure of the President, a clear example is the recent case in 2016 where a majority of the board members of Kenya Airways Limited were sent packing in the middle of financial woes facing the national carrier, some of the board members had just had their terms renewed but owing to the difficulties the executive through the CS for Transport cracked the whip. This untimely appointment and replacement of boards poses a great risk. In other instances there are reported cases of boards not having adequate induction processes.

But the most visible assessment is that first the proposed merger by the Presidential Taskforce of SCs that perform the same function and the doing away with SCs whose roles are not clear has not been effected completely. There are SCs whose roles remain duplicated and/or unknown. One such body is the Oversight Board of Strategic Food Reserve Fund. In 2016, the Chair of the Board in a meeting of SCs bosses at the Kenya School of Government decried that he was not involved and was idle. He claimed that the role of the Fund [292]was apparently being undertaken by other public bodies without his knowledge and involvement.

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[291] See report of the implementation committee <https://www.google.com/search?q=parastatls+in+kenya+2017&oq=parastatls+in+kenya+2017&aqs=chrome..69i57j0.22919j0j8&sourceid=chrome&ie=UTF-8#q=Mwongozo+implementation+committee+report > accessed 20 July 2017.

[292] Aggrey Mutambo ' I can do better things than an ineffective State job, Noah Wekesa, published on 26th May 2017 <http://www.businessdailyafrica.com/news/I-can-do-better-things-than-an-ineffective-State-job-Wekesa/539546-3943402-nbq0lhz/index.html> accessed 10 July 2017.

CHAPTER 4
COMPARATIVE STUDY

4.1 Introduction

This chapter compares how the principles of corporate governance have been applied in other jurisdictions specifically; Malaysia, the United Kingdom, South Africa, the United States of America and China. In particular the chapter will address the topic of corporate governance generally and its application in state corporation in the respective countries. The chapter observes that whereas most jurisdictions apply the principles of corporate governance on the basis of 'apply or explain' the United States of America applies the 'explain or else' model which imposes sanctions for non-compliance. Additionally, most of the jurisdictions have codified the principles and thus Kenya could learn from them.

4.2 Malaysia

According to Abbduk, Fazilah and Ishak, corporate governance in Malaysia got prominence in the second half of 1997 during the period of the economic crisis.[293] Both the private and public sector had to take cognizance of the corporate governance principles as a way of dealing with the crisis. The financial crisis had affected all the other East Asian Countries starting from Thailand where foreign investors lost confidence and began withdrawing capital as a result of currency devaluation.[294]Particularly in Malaysia the efforts to contain devaluation of currency caused high credit rates and credit contraction. Whereas many reasons were advanced for the crisis, the most pertinent reasons included; state directed loan policies, lack of competition, lack of prudential regulations and too much exposure of the banking sector to accommodate the economic boom in the early 1990s. The IMF report in 1999 identified the cause of the crisis as domestic policy weakness.[295]The IMF observed that there were large current account deficits, concentration of bank loans on real estate development, poor domestic financial system, poor governance and risk

[293] Abdul Hadi bin Zulkafi, Failahbt Abdul Samad and MdIshak Ismail, 'Corporate Governance in Malaysia' [1999] <http://www.gomalaysiatour.com/administrator/admin/pdf/4dcf82cb5b8dc.pdf> accessed 10 October 2016.

[294] R. M Haniffa and T. E Cooke, 'Culture, Corporate Governance and Disclosure in Malaysian Corporations' (2002)38(3) Abacus 317-349.

[295] IMF Staff Country Report n.o 99/86, Malaysia : Selected Issues, <www.imf.org> accessed 20 October 2016.

management and too much external borrowing in the corporate sector.[296] The World Bank in 1998 also similarly identified the same problems as the IMF.[297] The result of this was that there were many non-performing loans and institutions that now had to be supported, merged or liquidated. Mohamad observes that remuneration, selection of the board, weak investor relations, low transparency levels and the ineffectiveness of regulatory agencies in enforcing legislation are the reasons that led to the collapse of several Malaysian companies.[298]

It became extremely necessary for Malaysia to adopt the corporate governance principles both in the private and public sector. The failure to regulate and have good governance had affected the effective mobilization of funds. There was need to focus both on the shareholder and stakeholder protection. The Malaysian government had to implement corporate reforms through policy. The reform and development of corporate governance is contained in; the Malaysian Code on Corporate Governance, Capital Market Master Plan and Financial Sector Master Plan.

4.2.1 Government Linked Companies in Malaysia

These are companies that have a primary commercial objective and which the Malaysian Government has a direct controlling stake.[299]According to Nazrul and Huson GLC's account to about 36% of market capitalization at Bursa Malaysia.Nurul and Rashidah note that GLCs are key drivers of the Malaysian economy. Even though the study by Nurul and Rashidah shows that non-government entities tend to perform better than the government counterparts, the latter have a positive impact on investors as many of them believe that GLCs are backed by the government which will not let them down.[300] Due to globalization, technological changes and an open market,

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[296] *Ibid pg 55.*

[297] The World Bank Report on the Observance of Standards and Codes (ROSC) <www.worldbank.org> accessed 20 October 2016.

[298] N. Mohamad, 'Corporate Governance in Malaysia'(PhD Dissertation, University of Birmingham 2002).

[299] See NazrulHisyam Ab Razak, Rubi Ahmad and Huson Aliahmed Joher, 'Does Government Linked Companies (GLCs) perform better than non- GLCs?' Evidence from Malaysian listed Companies (2011) <http://www.scienpress.com/Upload/JAFB/Vol%201_1_10.pdf> accessed 20 October 2016.

[300] See J S Ang, DK Ding, 'Government Ownership and the performance of government linked companies: The Case of Singapore' (2005) The Journal of Multiple Financial Management 1-25.

the government of Malaysia realized that for it to support economic development and to compete effectively it had to transform the GLC into high performing organization. The GLCs in Malaysia are majorly controlled by the government through Khazanah, Ministry of Finance (MOF), Kumpulan Wang Amanah Pencen (KWAP) and Bank Negara (BNM). Some are also controlled by government linked agencies. Just like in many other economies GLCs in Malaysia have been criticized for being risk aversive and lacking in enough entrepreneurial drive. There have also been claims that most GLCs advance political rather than commercial interests.

This necessitated the GLCs Transformation Program which was initiated in May 2004 and launched in July 2005. The program aimed at enhancing corporate governance, developing social obligations for GLCs.[301]The program took notice that GLC in Malaysia provide critical services such as transportation, energy, telecommunication, and financial services which are key to the any commercial concern in Malaysia. Nurul and Rashidah conclude by indicating that the incorporation of corporate governance, the openness of the Malaysian economy, intense foreign competition have seen GLCs performance comparable to the private sector.[302]

4.2.2 Malaysian Code on Corporate Governance

In 1998, the Malaysian government formed the Finance Committee on Corporate Governance which was composed of both the public and private sector.[303] The committee released the Malaysian Code on Corporate Governance in March 2000. So far the code of governance has been revised twice, in 2007 and in 2012.[304] The blue print aims to achieve excellence in corporate governance where good business is viewed not only as a commercial entity but as one that is also ethical and sustainable. In drafting the code of corporate governance 2012 many stakeholders were involved. The aim was to understand the practical aspects of the code, the challenges and the expectations of having a strong and best practice policy document. [305]Some of the key stakeholders

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[301] GLC Transformation Program <www.pcg.gov.my/about_us_overview.asp> accessed 20 October 2016.

[302]Nurul Afzan and Rashidah, 'Government Ownership and Performance of Malaysian Government-Linked Companies' (2011) International Research Journal of Finance and Economics.'

[303]See the Finance Committee Report on Corporate Governance <www.sc.com.my/finance-committee-report-on-corporate-governance/> accessed 20 October 2016.

[304]See <www.sc.com> accessed 17 October 2016.

[305]This is in line with the principle of public participation.

included; Bursa Malaysia, Federation of Public Listed Companies, Malaysian Institute of Corporate Governance, Malaysian Directors Academy, Minority Shareholders Watchdog group, Malaysian Institute of Chartered Secretaries and Administrators, Malaysian Alliance of Corporate Directors and international corporate governance experts.

Since its inception the code has come along with many institutional and legal accompaniments. It led to the establishment of the Audit Oversight Board and the Securities Industry Dispute Resolution Centre.[306] The 2012 code retains the same name as the first one and defines corporate governance as the structure that is used to direct and manage business and affairs of the company towards enhancing business prosperity and corporate accountability with the ultimate objective of realizing long term share-holder value, whilst taking into account the interests of other stakeholders. It sets out specific principles and recommendations to be adopted. Currently the Securities Commission has published the Malaysian Corporate Governance 2016 for public consultations. The Code on Corporate Governance is a standard and applies to all listed companies on Bursa Malaysia.[307]

4.2.3 Specific principles and recommendations

The first principle is the establishment of clear roles and responsibilities.[308] The board is to establish clear functions of the board and of management. There also has to be a distinction of roles by the board when discharging its fiduciary duties and when discharging leadership functions. The board is further required to come up with a code on the ethical standard and then ensure its compliance. Members ought to access information and advice when they require the same. It (the board) should have sustainable policies and should recruit a competent and qualified

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[306] See Part III A of the Securities Commission Act 1993.

[307] Bursa Malaysia was formerly known as Kuala Lumpur Stock Exchange. It is an exchange holding company approved under Section 15 of the Capital Markets and Services Act 2007. It operates a fully integrated exchange, offering the complete range of exchange-related services including trading, clearing, settlement and depository services. See <http://www.bursamalaysia.com/market/> accessed 20 October 2016.

[308] The board together with the Chief Executive Officer (CEO) should develop the descriptions for their respective functions. In addition, the board should develop and agree with the CEO, the corporate objectives, which include performance targets and long-term goals of the business, to be met by the CEO. Regular review of the division of responsibilities should be conducted to ensure that the needs of the company are consistently met. This allocation of responsibilities should reflect the dynamic nature of the relationship necessary for the company to adapt to changing circumstances.

company secretary. Also captured under this principle is the need for the board to formalize, periodically review and make public its board charter. The reason advanced is that the roles have to be clearly set out for accountability purposes. The job description of the CEO and the board have to be clearly spelt out. This description has to include the corporate objectives, performance targets and long term targets of the CEO. These descriptions have to be reviewed to ensure that the needs of the company are consistently met. The board also has the role of reviewing and adopting a strategic plan for the company. The board also has to oversee the company's business by having a collegial relationship which is supportive yet vigilant. It is also incumbent on the board to ensure succession planning on senior management.[309]

The second principle is for the board to strengthen composition whereby the board should establish a nominating committee. This committee is to be composed of exclusively non- executive directors, a majority of whom must be independent. It is the committee that should develop, maintain and review the criteria to be used in the recruitment process and annual assessment of directors. Under this head it is the function of the board to establish formal and transparent remuneration policies and procedures to attract and retain directors. The Nominating Committee's responsibilities are to assess and recommend to the board the candidature of directors, review the board's succession plan, recruit directors on the basis of merit and conduct induction and training programmes. In all these the board should formulate a boardroom diversity including having regard for gender. The board's remuneration has to be aligned to the responsibilities, expertise and complexity of role. This has to be done by a remuneration committee.

The third principles places responsibility on the board to reinforce independence.[310] The board has the duty to undertake an assessment of its independent directors annually. It imposes a term limit

[309] It is a systematic approach to ensuring leadership continuity within an organization by recruiting and/or encouraging individual employee growth and development. See <https://masc.sc/SiteCollectionDocuments/Human%20Resources/Succession%20Planning.pdf> accessed 20 October 2016.

[310] See *Independence as a concept of corporate governance* where independence is defined as a quality that can be possessed by individuals and is an essential component of professionalism and professional behaviour. It refers to the avoidance of being unduly influenced by a vested interest and to being free from any constraints that would prevent a correct course of action being taken. It is an ability to 'stand apart' from inappropriate influences and to be free of managerial capture, to be able to make the correct and uncontaminated decision on a given issue <http://upload.news.esnai.com/2013/0328/1364448709545.pdf> accessed 20 October 2016.

on an independent director to a cumulative term of 9 years. The independent director may however continue to serve after the lapse of their term but after the re-designation as a non- independent director. This can however only be done after the shareholders' approval. The positions of chairman and CEO should be held by different individuals whereby the chairman must be a non-executive member of the board. The board must also comprise a majority of independent directors where the chairman of the board is not an independent director. The insistence on independence ensures independent and objective judgment. The director's background, economic and family relationships have to be assessed. The criterion to measure independence has been applied upon admission, annually and when new interests develop.

The fourth principle is for the board to foster commitment, where the board is to set out expectations on time commitment for its members and the protocols for accepting new directorships. Importantly under this principle is for the board to ensure that members have access to appropriate continuing education programmes.[311] The fifth principle is on integrity and financial reporting where the audit committee should ensure financial statements comply with applicable financial reporting standards.[312]The audit committee has to have policies and procedures to assess the suitability and independence of external auditors. The directors need to devote sufficient time to work and enhance their knowledge and skills to enable them participate actively in the board deliberations. The audit committee has to observe the highest degree of integrity and ensure that the source of financial information is reliable.[313]

The Sixth principle is for the recognition and management of risks where the board should establish a sound framework for risk management. The board should also establish an internal audit function which reports directly to the Audit committee. The seventh principle is on timely

[311]The commentary indicates that in a dynamic and complex business environment, it is imperative that directors devote sufficient time to update their knowledge and enhance their skills through appropriate continuing education programmes and life-long learning. This will enable directors to sustain their active participation in board deliberations.

[312]This is integral to the reliability of financial statements.

[313] See section 5-2 of the code.

and high quality disclosure.[314] Under this head, the board has to ensure that the company has appropriate corporate disclosure policies and procedures. The company also has to leverage on information technology for effective dissemination of information. The last principle is on the board to strengthen relationship between the company and shareholders. The board has to take reasonable steps to encourage shareholder participation at the general meeting, encourage poll voting and promote effective communication and pro-active engagements with shareholders. The board has to have an internal auditor who reports to the audit committee. This head of the audit committee has to have the relevant qualifications. As for disclosure the board is to have internal corporate disclosure policies and procedures that are not only practical but include feedback from management. The use of information technology in communicating with stakeholders is also encouraged.

4.2.4 Capital Markets Master Plan

It was adopted by the Securities Commission to complement the reforms on corporate governance. It was first announced in August 1996 and eventually launched in February 2001.[315] The terms of reference for the master plan was to; formulate a comprehensive vision and programme for the development of the Malaysian Capital Market going forward; formulate a framework for the orderly and effective sequencing of further deregulation and liberalization; and to identify and map the direction for the strategic positioning of the Malaysian capital market both domestically and externally. The Securities Commission undertook extensive consultations with all the stakeholders. The Securities Commission consulted government authorities, participants of the stock market, individual consultants, local and foreign experts, regulators and the general public.[316] It aims for efficient mobilization of funds and a high degree of confidence on the market participants. It has a mandatory disclosure on the state of compliance with the Malaysian Code on Corporate Governance. The capital markets master plan is a comprehensive plan meant for

[314] These policies and procedures should ensure compliance with the disclosure requirements as set out in the Bursa Malaysia Listing Requirements. In formulating these policies and procedures, the board should be guided by best practices.

[315] See the two Capital Markets Master Plans <,https://www.sc.com.my/wp-content/uploads/eng/html/cmp2/cmp2_final.pdf> accessed 20 October 2016.

[316] Confirms the element of public participation by the common citizens in the coming up of a public policy.

strategic positioning and direction of the capital market in Malaysia. It provides specific objectives and goals that have to be attained within a specified duration. Importantly the plan is to support national growth and development.[317]

One of the key element that has been identified as contributing to the progress of the Malaysian capital market is the establishment of a robust regulatory framework which includes the incorporation of corporate governance reforms. The capital market thus has to be transparent, accountable, performance oriented corporate sector that offers value based opportunities. The capital markets is mandated to apply the principles of Corporate governance through incentives and mechanisms for better corporate governance and shareholder value recognition by timely implementing the Finance Committee Report; promote shareholder activism through further improving the avenues for minority shareholders to exercise and enforce their rights with respect to companies that they invest in; enhancing awareness of and accountability for the fiduciary duties and obligations of company director, management and officers of public-listed companies; ensuring high standards of financial reporting and the continuous disclosure of timely, relevant and accurate corporate information.

4.2.5 Financial Sector Master Plan

It was launched in March 2001 by the Bank Negara Malaysia for the reason to chart the future direction of the financial sector.[318] It is aimed as at developing a more resilient, competitive and dynamic financial system. The master plan incorporates promotion of shareholder and consumer activism, regulatory control and priority sector financing. It sets out the broad strategies for the governance and development of the financial sector. The aim of the plan is to make the financial system more competitive, resilient and dynamic. The plan has 119 recommendations which are almost fully implemented. For the banking sector it was specifically recommended and

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[317] The executive summary to the master plans indicates that;

> *As an integral part and indicator of the nation's development, the capital market represents a vital part of the financial market infrastructure which, together with the banking sector, supports the economic growth of the country. The success of the Malaysian capital market contributes to the overall strength of the economy. A fair, efficient and liquid capital market facilitates the mobilisation and allocation of funds within the domestic economy, and acts as a gateway to Malaysia for global investors.*

[318] Bank Negara is the central bank of Malaysia. The Financial Sector Master plan <http://www.bnm.gov.my/index.php?ch=en_publication_catalogue&pg=en_publication_blueprint&ac=19&lang=en&eId=box1> accessed 20 October 2016.

implemented that the board has to establish committees namely, the Nominating Committee and Compensation and risk management which have enhanced corporate governance principles.[319]For the insurance sector the recommendations aimed at an effective industry which strengthens and protects policyholders and shareholders' value. Consumer education programmes are to empower consumers to make informed choices.[320] The recommendations also provide for the inclusion of a competent board. The recommendations also touch on Islamic banking and *takaful*, where the issuance of guidelines on the establishment of board committees, minimum qualifications, training and independence of board members all aim at strengthening Islamic banking.[321]

4.2.6 Institutional reforms

4.2.6.1 Malaysian Institute of Corporate Governance

It was established in 1998 by the High Level Finance Committee on Corporate Governance. The corporation is a not for profit organization limited by guarantee and comprises of members from the Federation of Public Listed Companies (FPLC), Malaysian Institute of Accountants (MIA), Malaysian Associations of Certified Public Accountants (MICPA), Malaysian Institute of Chartered Secretaries and Administrators (MAICSA) and Malaysian Institute of Directors (MID).[322] It has both ordinary members and corporate members. It works in cohorts with a host of other organizations such as the Institute of Directors in the East Asian region, Asian Pacific and Development, UNDP, Pacific Economic Cooperation Council Peer Assistance and Review Network (PECC PARNET).[323]The Mandate of MICG was to raise the awareness and practice of good corporate governance. It is funded by the government running a balanced budget every tear. It is also indicated as a training centre in the report on corporate governance that led to its

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[319] See chapter 3 of the FSMP where the Nominating Committee is responsible for nomination of directors and committee assignments. This committee should comprise of only non-executive directors. The purpose of a Nominating Committee is to counter-balance the influence of executive directors, in response to legitimate concerns of over powering and dominant stature of some owner-managers, to ensure that appointees are suitably qualified. The Nominating Committee should also be responsible for overseeing the composition of the BOD.

[320] See chapter 4 of the FSMP.

[321] Chapter 5 FSMP.

[322] See the website of MICC <http://www.micg.org.my/> accessed 21 October 2016.

[323] *Ibid.*

establishment. Its role includes facilitating corporate governance development in the country through its education programme in corporate governance. It is to hold and has held roundtables, other forums, dialogues, public seminar and conferences to address corporate governance issues. It is to offer linkages and partnerships with other research organizations on the topic of corporate governance. It also complements the regulators such as the Securities Commission. The institute also conducts corporate governance ratings.[324] It also publicizes information on corporate governance but most importantly, it is to inspire companies in creating longer term shareholder value and to bring business prosperity in nation building and to contribute to sound economic system of the well being of the Malaysian Society at large.

The institute's vision is to be a leading advocate of corporate governance in Malaysia. Its mission is to promote corporate governance in Malaysia; to define corporate governance; and to facilitate the adoption of corporate governance best practices.[325]

4.2.7 Lessons for Kenya from Malaysia

As of 1999 Malaysian SCs were in the same position as most Kenyan SCs now, they had huge account deficits, poor governance and risk management. There were unclear guidelines on selection of the board, remuneration, low transparency levels, weak investor relations and ineffective regulatory agencies. As a result there was a stagnation of funds. To address this there was fusion of both the public and private sector in the finance committee on corporate governance. The committee proposed a merger of SCs that were performing similar roles. The SCs were to focus on both the shareholder and stakeholders. The process as already identified was participatory where all the shareholders and stake-holders. Various institutions were put in place to implement the code, notably there was the creation of the Malaysian Institute of Corporate Governance, Audit Oversight Board and the Securities Industry Dispute Resolution Center. The roles of the boards were clarified and distinguished with each having distinct roles. The Malaysian Code requires inclusion of all gender in boards and management of SCs. As for remunerations, a specific

[324] This is meant to encourage compliance and also for public information.

[325] The concept is broad and has permeated markets globally, it becomes important to see how the principles take shape in various jurisdictions.

committee for remuneration was put in place. The code encourages continuous education among board members and management. Importantly the communication between boards and shareholders and stake holders has to be transparent and effective.Though the architecture of Mwongozo accommodated private sector views, there is no evidence that they have been involved any further, their involvement in the process seems to be ad-hoc as they simply gave their views to the Presidential Taskforce. There are no implementing institutions rather there is an implementation committee that gives no updates.[326] As pointed out the Presidential Taskforce did not take the views of the public.

4.3 United Kingdom

Corporate governance has a very long history in the UK. Adrian Cadbury observes that as early as 31st December 1600, a royal charter was granted to the company of Merchants of London trading into the East Indies.[327] The company was governed by directors who were then being referred to as committees. The structure of governance included the Court of proprietors and the court of directors. Accordingly, the court of proprietors was made up of those with voting rights and with an investment of up to 200 pounds. It was the supreme authority and its sanction was needed to raise funds. However owing to the huge numbers of shareholders it meets infrequently. The court of directors on the other hand was the executive body and was responsible for the day to day running of a company. This court of directors consisted of the Governor, Deputy Governor and 24 other directors. The company also had other committees dealing with specific issues such as purchase, sales and information. Even though there is a variance with what happens in current corporations, there are similarities where the court of proprietors were shareholders, the court directors were the board.[328]

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[326] The website has documents dated 2015.

[327] See Landow P. George, The British East India Company — the Company that Owned a Nation (or Two) <http://www.saylor.org/site/wp-content/uploads/2011/02/The-British-East-India-Company.pdf> accessed 21 October 2016 notes:

> *The East India Company is, or rather was, an anomaly without a parallel in the history of the world. It originated from sub-scriptions, trifling in amount, of a few private individuals. It gradually became a commercial body with gigantic resources, and by the force of unforeseen circumstances assumed the form of a sovereign power, while those by whom its affairs were directed continued, in their individual capacities, to be without power or political influence. — Bentley's Miscellany 43 (1858).*

[328] P. Bruce Buchan, 'The East India Company 1749-1800: The Evolution of a Territorial Strategy and The Changing Role of the Directors,'(1994) 23(1) Business And Economic History, Copyright ¸by the Business History

The court of directors appointed the CEO. [329]As regards the raising of capital the court of directors could recommend a new voyage to the court of proprietors and if they agreed, a subscription book was opened to raise the amounts required. This in essence meant that directors were directly accountable to the shareholders for expenditure. Cadbury thus notes that the same challenges that faced the East India Company are comparable to the same challenges that face modern corporations. There were different types of investors; those who were long term investors and the short term investors. The short term investors were interested in returning their money after each voyage others were investing for the long-term. The model of this company, hundreds of years ago indicate that corporate governance in the UK has existed for a very long time albeit it was not formally recognized as it is currently. The key issues which were there then and are still there now are the issues of power and accountability.

In the 18th century Adam Smith published his seminal work 'The Wealth of Nations' where he poses that the directors of joint stock companies being the managers of other People's money cannot be expected to watch over it with the same anxiousness and vigilance as in a private copartnery frequently.[330] The work of Adam Smith spoke of the agency problem. It is a problem because it concerns the inherent relationship between the providers of capital and their agents who make use of the capital. This in some way is reflective of the current position where directors and executives decide to fund expansion plans instead of maximizing shareholder returns.[331]

The 19th century also brought with it its fair share of development. The incorporation of companies under Company Law.[332] The joint stock Companies of 1844 had required all businesses with more

Conference <http://coursesa.matrix.msu.edu/~business/bhcweb/publications/BEHprint/v023n1/p0052-p0061.pdf on> 21 October 2016.

[329] *Ibid* p. 54.

[330] Adams Smith, *Wealth of Nations* (W. Strahan and T. Cadell, London1776) <http://political-economy.com/wealth-of-nations-adam-smith/> accessed 21 October 2016.

[331] See the Kenyan situation of Kenya Airways.

[332] See the Bubble Act of 1720, Trading Companies Act of 1834, The Chartered Companies Act of 1837 and the Joint Stock Companies Act of 1844.

than 25 persons to be incorporated. Those businesses simply had to register to be incorporated and to enjoy legal personality of their own. For this registration to take place companies had to file their constitutions and annual accounts hence providing a degree of disclosure. The Limited Liability Act was enacted in 1855 which limited the liability of shareholders according to the amount of share capital which they had invested in.[333] This Act resulted into the registration of many corporations.

4.3.1 The Report of the Committee on Financial Aspects of Corporate Governance 'Cadbury report'

The Committee was established in May 1991 with the FRC in conjunction with the London Stock Exchange and the Accountancy profession in the UK to address the financial aspects of corporate governance.[334] The report was in response to a concern by stakeholders on the low levels of confidence both in the financial reporting and on the auditors reporting to safeguard shareholders. The reason for the report was because it was perceived by stakeholders that there was looseness in accounting, lack of a framework to monitor the activities of directors and the competitiveness among corporations such that the expert opinions of auditors was not taken into consideration.[335] There were also reported cases of corporate system failures. The committee also looked at various reports that had been in existence. The committee drew its facts and analysis from these reports and a wide range of submissions from interested parties and the draft report was issued for public comment. By the time of its final report the committee had received and taken into consideration over 200 reports and proposals.[336]

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[333] This Act provided that any company registered under the Act of 1844 might limit the liability of its members for its debts and obligations generally to the amount unpaid of their shares. The Act was repealed within a few months. The Joint Stock Companies Act, 1856 replaced both the Acts of 1844 and 1855. Under this Act, the company legislation assumed for the first time a form which has been broadly handed down almost to the present day, subject to various amendments which were made from time to time to suit various exigencies.

[334] The Cadbury Report <http://www.ecgi.org/codes/documents/cadbury.pdf> accessed 21 October 2016.

[335] *Ibid* p. 13 and 14.

[336] The list of contributors appears as appendix 7 of the report.

The Cadbury report defines corporate governance as a system by which companies are directed and controlled.[337] This is normally a responsibility of the board who are appointed by the shareholders. It is the board that sets the strategic aims of the company, implements , supervise the management and then eventually report to shareholders. Since the boards are also in-charge of the financial aspects of corporate governance including the setting up of financial policy, implementation controls and reports the same had to be set up within acceptable best standards. This financial aspect thus made it necessary for the role of auditors to be introspected because they are the ones that provide shareholders with an external and objective check on the financial statements from directors.

The Cadbury committee came up with the code on corporate governance and in the summary for recommendations observed that all listed companies registered in the UK are to comply with the code. Other companies are also encouraged to apply the code. The companies applying the code have to make a statement about compliance. These statements of compliance are to be reviewed by the auditors before publication. The code is also to be reviewed periodically.[338]

The report was in realization of the fact that the economy of Britain depended on the drive and efficiency of its companies. The boards that had been mandated to run companies had to do so in an open and transparent manner to ensure maximum productivity. The committees' area of concern was on the reporting functions of the board and the role of auditors in the accountability of companies in the UK.[339]

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[337] The basic definition still forms the foundation of subsequent definitions, see the OECD ' Corporate Governance Principles, accessed from http://www.oecd.org/daf/ca/Corporate-Governance-Principles-ENG.pdf on 21/10/2016

> *Set of rules that define the relationship between stakeholders, management, and board of directors of a company and influence how that company is operating. At its most basic level, corporate governance deals with issues that result from the separation of ownership and control. But corporate governance goes beyond simply establishing a clear relationship between shareholders and managers". "Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined."* (OECD 2004).

[338] Adrian Cadbury, '*Report of the Committee on the Financial Aspects of Corporate Governance'* (1992) clause 3.12.

[339] Adrian Cadbury, '*Report of the Committee on the Financial Aspects of Corporate Governance'* (1992) clause 1.2.

The key components of the Cadbury Code, were; that there ought to be a clear division of responsibilities at the top, primarily that the position of Chairman of the Board be separated from that of Chief Executive, or that there be a strong independent element on the board; that the majority of the Board be comprised of outside directors; that remuneration committees for Board members be made up in the majority of non-executive directors; and that the Board should appoint an Audit Committee including at least three non-executive directors.[340]

The provisions of the Code are now provided by statute to the extent that the London Stock Exchange required listed companies to 'comply or explain'; that is, to enumerate to what extent they conform to the Code and, where they do not, state exactly to what degree and why. The detail of this explanation, and the level of implied censure on companies which do not adhere to the Code, have both varied over time, but the basic 'comply or explain' principle has endured over the intervening years and become the cornerstone of UK corporate governance practice.[341]

4.3.2 Government Owned Corporations

As of 31st March 2014, it was approximated that 3038 companies were related to the 17 central government departments. This was information based on various public reports as there was no way of ascertaining the exact number from a single source. These are companies where government has whole or partial ownership where the government owns all or partially all the shares.[342] There is also the other group of government controlled companies, where the government exercises control by; being able to appoint and remove directors; provides funding and control how the funding is spent; owns a share that confers a special right or where the government is able to set the policy. These government owned companies operate on the basis of a reforms policy which aims to rationalize the number of public bodies, increase accountability,

[340] This is to foster independence of the committee.

[341] Subrata Sarkar, 'The Comply-or-Explain Approach for Enforcing Governance Norms' [2015] Indira Gandhi Institute of Development Research, Mumbai <http://www.igidr.ac.in/pdf/publication/WP-2015-022.pdf> accessed 21 October 2016.

[342] See Companies in Government <https://www.nao.org.uk/wp-content/uploads/2015/12/Companies-in-Government_updated.pdf> accessed 21 October 2016.

and explore new and innovative ways to ensure the best delivery of services. All the government owned companies have to observe the principles of corporate governance.[343]

The UK government has put in place the corporate governance in central government departments-Code of Practice 2011.The code was first published in 2005 for the first time. It aims to incorporate best practices, sets out the role and function of the board. It focuses on principles of leadership, effectiveness, accountability and sustainability.[344] The code does not alter the operations of government but rather introduces new aspects to support, help and challenge the manner in which departments are managed and how they deliver. The code is intended to be very flexible as the manner in which the board behaves with emphasis on equality. Each department has to be pragmatic as to the manner in which they implement the principles which are outlined in the code. The end result is that in as much as government is a not purely for profit, there needs to be a business like mind to ensure sustainability. As regards the board which is the key component of any organization, the code advises on 5 main areas which are that, there needs to be strategic clarity by the board where the clear mission and vision have to be in place and to be implemented. The venture also needs to make commercial sense.[345]

4.3.3 State of corporate governance now

Corporate governance principles in the UK are promoted and enforced by the Financial Reporting Council.[346] It is the UK's and the Republic of Ireland's independent regulator responsible for promoting corporate governance and reporting to foster investment. According to its website the FRC is mandated to promote high standards of corporate governance through the UK Corporate

[343] See Corporate Governance in Central Government Departments: Code of Good Practice <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/220645/corporate_governance_good_practice_july2011.pdf> accessed 21 October 2016.

[344] *Ibid* p. 5.

[345] This entails approving the distribution of responsibilities; advising on signoff of large operational projects or programmes; ensuring sound financial management; scrutinizing the allocation of financial and human resources to achieve the plan; ensuring organizational design supports attaining strategic objectives; setting the Department's risk appetite and ensuring controls are in place to manage risk; evaluation of the board and its members, and succession planning.

[346] See <https://www.frc.org.uk/> accessed 21 October 2016.

Governance Code and encourage engagement between investors and boards. The FRC also sets standards on reporting, audit and actuarial practice and also monitor and enforce accounting and audit standards.[347]

The UK corporate governance came to light in 1992 through the Cadbury committee. The code has been reviewed several times and the current version took effect from 17th June 2016 and it applies to all companies with a premium listing of equity shares whether formed in or out of the UK.[348] The code is anchored on the 'comply or explain' approach which is touted as the trademark of corporate governance in the UK. The code indicates that the model has been applied and imitated internationally. The code basically consists of principles and companies are to apply them and thereafter report to shareholders on how they have done so. In the event that a principle cannot be applied then it has to be explained and the reasons have to also be adduced. It may be the case that there are better ways of achieving on objective. This alternative to following the provision has to be justified in particular circumstances if good governance can be achieved by other means. Here the company will have to illustrate how its practice is consistent with the principle to which the provision relates, contributes to good governance and promotes delivery of the objective. It would give the background, the rationale of taking the action, the mitigating factors, additional risks and conformity with the relevant principle.

The code is divided into distinct heads. The first one is Leadership. Every company should be headed by an effective board that is collectively responsible for the long term success of the company. The roles should be divided in that there should be a distinction between who is at the head of the company board and the management. This is akin to the principle of separation of powers. The role of the chairman of the board is to ensure effective leadership. The second section covers effectiveness, whereby board committees should have a balance of the skills, independence, experience and knowledge to enable them discharge their duties and responsibilities. The recruitment and selection of board members should be transparent, thorough and formal. The

[347] *Ibid*.

[348] See the updated code <https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-April-2016.pdf> accessed 21 October 2016.

directors have to understand that they are serving on serious roles and they have to devout their time. The board needs to have all the information they need to enable them discharge their duties. The board also needs to evaluate itself. The directors need to be subjected to re-election at definite intervals.[349]

The third segment covers accountability, where the board is to present a fair, balanced and understandable assessment of the company's position and prospects. The nature and extent of the risks that the company is willing to take have to be disclosed. Formal and transparent arrangements on corporate reporting, risk management and internal control principles have to be maintained. There should be formal and transparent dealings so as to also maintain an appropriate relationship with the company's auditors.

There is also the aspect of remuneration that should be designed to promote long term success of the company. The dealings should focus on performance and should thus be transparent, stretching and rigorously applied. The policy for remuneration should be open. Lastly there has to be a dialogue with shareholders based on the understanding of objectives. The board as a whole has to ensure that the conversations are sufficient and the meetings including Annual General Meetings are held with maximum participation.[350]

4.3.4 Lessons from the UK

Just like Malaysia, the UK corporate governance system has been replicated world-over. The Cadbury report gave the foundation of principles that have been enhanced and advance till today. The Cadbury report of 1992 was presented by the Committee on the Financial Aspects of Corporate Governance. As at the time of the report the committee had taken into account more than 200 reports and proposals. This is an indication that the process was sufficiently participatory. As already pointed out the code insists on transparency by the board and management of public entities. Transparency ensures productivity. The role of the CEO and the board is adequately separated and the independence of the boards is insisted. The hall mark of the UK system is the

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[349] Election enables directors who perform poorly to be voted out.

[350] The 2016 UK Code p.15.

'comply or explain model'. Importantly there are institutions that ensure compliance and implementation such as the Financial Reporting Council which ensures reporting, audit and actuarial practices.

The architecture of Mwongozo was not participatory, unlike the Cadbury report which was submitted for public comment. The relatively short time of about 6 weeks and the limited discussions and proposals on the code limit its legitimacy and acceptance. There is no institution in charge of implementation and the committee in place is just an ad-hoc committee whose members are committed on other government duties.[351] The boards of SCs are still not independent and the implementation of Mwongozo is not as robust and quick as its unveiling.

4.4 South Africa

4.4.1 Public entities in South Africa

State Corporations in South Africa have undergone various phases of restructuring. The first phase is the pre 1994 period, post 1994 to 2004 and the period thereafter.[352] The pre 1994 phase was during the apartheid regime, the regime was facing sanctions because of the insistence of a lean government by the UK and other western powers. In 1987 the National Party produced a white paper on *'Privatization and Deregulation'* where the government sought to limit its involvement in commercial enterprises. To this end the Department of Privatization was established.[353] The Presidential Review Committee on the Restructuring of State Owned Enterprise in South Africa observes that this restructuring was probable as an effort to undermine the new democratic government by hindering its economic growth.[354]

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[351] Committee is headed by the State's Chief of Staff.

[352] See a review by Mokwena Thabo, 'Restructuring of State Owned Enterprise in South Africa' [2012] <http://www.thepresidency.gov.za/electronicreport/downloads/volume_3/discussion_papers-edited_by_expert_writer/Draft_Restructuring%20of%20SOE%20in%20South%20Africa.pdf> accessed 21 October 2016.

[353] See Nkosana Mfuku, 'Privatisation and Deregulation Policies in South Africa' (Masters Thesis Public Administration, University of the Western Cape School of Government, 2006) <http://etd.uwc.ac.za/xmlui/bitstream/handle/11394/1809/Mfuku_MPA_2006.pdf?sequence=1> accessed 21 October 2016.

[354] The black majority rule taking over from the white minority rule.

The Post 1994 restructuring continued with the privatization efforts where there was the need to prioritize the introduction of the private sector into the key areas. The state corporations were then prevented from investing in new capacity. There was also the establishment of municipal entities with the aim of propelling economic growth. In 1996 the World Bank had noted that for most government owned entities the restructuring was necessary because they had poor and/or inadequate governance and management.[355]The post 2004 restructuring was thus to focus on deploying public enterprises to achieve specific national objectives. Some of the identified modes of restructuring include' redesigning the management, sourcing other strategic partners, divestment of equity, turnaround initiatives, privatization, public/private partnership, commercialization and outsourcing.

4.4.2 King III

The King III report of 2009 on Governance is the basic document governing corporate governance in South Africa. [356]The report indicates that it was necessary for the report because of the changing law on companies in South Africa and on the global change in governance of companies. The King III report drew so much on the experience of Sir Adrian Cadbury of the famous Cadbury report in the UK. The King III report was the 3rd report after 2 previous reports. The report had 9 sub-committees that dealt with the various aspects of the report.

Just like the many European countries and in particular the UK, the King III report adopts the 'comply or explain' mode. This is in realization of the fact that many companies are structured differently, have different aims and visions such that room has to be left for the companies that may want to adopt other modalities for effectiveness or improvement. All that this companies need to do is to explain why they did not adopt the principles. This is in contrast to the American mode which through the Sarbanes- Oxley Act has codified some of the governance issues in statute and apply 'comply or else'.[357] This is where sanctions attract non-compliance to a principle. The ratio

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[355] See the World Bank Report <http://documents.worldbank.org> accessed 21 October 2016.

[356] See <http://www.ecgi.org/codes/documents/king3.pdf> accessed 21 October 2016.

[357] Sarbanes-Oxley Act of 2002.

for such a basis is that the directors of a company are always expected to deal in good faith and in the best interest of the company, such that under the comply or explain rule if in the opinion of the directors it is not prudent and in the best interest of a company to take a particular route, then reasons can be adduced. The report notes that South African listed companies are regarded as being among the best governed in the emerging economies and the code aims to keep this good reputation. The report therefore argues that whereas the first priority of stakeholders of a company is the quality of its products and service, trust and confidence come in second.[358]

The report also highlights a very key issue, the nexus between the law and the governance principles.[359] There has to be a connection because the starting point of any issue relating to governance is the law. The directors and management of a company have to adhere to the existing laws and regulations. The work of a good corporate governance system is to set up structures and processes that can enable directors and the management to discharge their duties. For government owned entities the South African legislation affords them more scrutiny. From a legal point directors have two primary duties; the duty of care. This duty mandates directors to manage the company (business) in a reasonable manner with the skill and care that any reasonable man would take in dealing with their own affairs. For a person with knowledge, skill and experience like a director, and then the same has to be utilized to the benefit of the company.[360]We also have fiduciary duties on the part of the directors. This duty mandates the directors to act in the best interests of the company whereby directors are to avoid conflicts of interests that would pit their own interests against those of the company. The directors are not to make secret profits from the company and they are not to use their power as directors to gain extraneous economic advantages.

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[358] The main benefits of building good relationships with your stakeholders are: informed decision making for your strategic plans, cooperative solutions to an organisation's goals, increased organisational effectiveness, improved corporate reputation and avoidance of negative press.

[359] The King III Report, p.6.

[360] Bernard S. Black, 'The Principal Fiduciary Duties of Boards of Directors' (Third Asian Roundtable on Corporate Governance Singapore, 4 April 2001) <http://www.oecd.org/daf/ca/corporategovernanceprinciples/1872746.pdf accessed> 21 October 2016.

Just like the Cadbury report, the King III report places emphasis on specific principles.[361] The acts of corporations have thus to adhere to these principles. The first principle provides for effective leadership. The report indicates that leadership has to be responsive, provide direction and establish the ethos. The ethos and will then determine the culture and behavior that can either spur growth or hinder development. There is also the principle of sustainability, the activities of a company have to give hope of a better tomorrow for the company. The company should be dependable and predictable and this can only happen through prudent decision making with the vision of the future. The activities of a company today should be supportive of growth and should not be for the purpose of crippling the venture. Closely related is the principle of innovation, fairness and collaboration. Innovation simply encourages a new way of doing things. There also has to be an element of fairness and participation of the stakeholders in the venture. The report also includes the very important principle of integration, sustainability and transformation. This particular principle is in place because of the apartheid regime which created cracks and fragmentations within the society. The principle is meant to create a conducive environment by reconciling all the economic ills of the apartheid regime.[362]

There is also the principle of sustainability reporting where companies are expected to implement the practice of sustainable development. The code applies to all manner of entities regardless of the manner and form of incorporation.[363] Chapter one of the code is dedicated to the board of directors, where the board is to act as the focal point of corporate governance. It is thus the responsibility of the board to be actively involved in the activities of the company by having a charter setting out its responsibilities, the board has to also be the link between shareholders, stakeholders and the management. The board also has the responsibility of setting the standards on integrity, ethics and good judgment.[364] As a corporate citizen the code expects the company to

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[361] The key concepts are; leadership, sustainability and corporate citizenship.

[362] Haroon Bhorat, Alan Hirsch, Ravi Kanbur and Mthuli Ncube, 'Economic Policy in South Africa Past, Present, and Future [2013] <http://kanbur.dyson.cornell.edu/papers/EconomicPolicyInSouthAfrica.pdf> accessed 21 October 2016.

[363] The King III Report, p.16.

[364] The King III Report, p.52 of where Describing conduct as 'good' or 'right' means measuring it against standards, called 'values'. Ethical values are convictions we hold about what is important in our character and interactions with

put in place measures that are sustainable for the present and the future generations. The code places the responsibility of hiring the CEO on the board who shall also have their input in the hiring of other senior staff. After this is done there has to be delegation of power. The report also observes that the composition of the board has to balance between executive and non-executive directors. This ensures the different experiences and skills combine to make independent and objective decisions. Such a combination also ensures that there is appropriate power balance and no person or group of persons is able to dominate the decision of the board. There is a further provision that the board has to be led by an independent non-executive chairman who should not be the CEO of the company.[365]

The appointment of the board is to be done by the shareholders and the processes are to be formal, open and transparent. After appointment the board members are to be inducted and trained on the roles they are to partake. This development training is not only limited to the incoming directors but is also to train the existing directors. The appointment of a company secretary is mandatory specifically in public companies with a share capital. The company secretary has the pivotal role of ensuring that the board keeps abreast with its responsibilities and that it adheres to the charter that has been put in place. Annual performance appraisals of the board collectively and individually have to be put in place.

4.4.3 Lessons for Kenya and King IV

South Africa published King IV report in 2016 whose objectives are to promote good corporate governance as an integral part of running a business.[366] The report emphasizes on enhancing ethical culture; enhance performance and value creation; enable the governing body to exercise adequate and effective control; and for building and protecting trust in the organization. King III does not depart from the philosophical underpinning of King III but only refines the concepts. It for instance indicates that leadership starts with each person charged with governance. The board

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others. Examples of ethical values are integrity, respect, honesty (truthfulness), responsibility, accountability, fairness, transparency, and loyalty.

[365] The King III Report, p.24.

[366] See sample code IV report <http://www.adamsadamsip.com/wp-content/uploads/2016/05/King_IV_Report_draft.pdf> accessed 21 October 2016.

as the governing body has to set the ethical standards to be adhered. King III has been wholly adopted in Kenya and is part and parcel of Mwongozo, however the practice in Kenya doesn't seem to adhere to the espoused principles. First management of SCs do not owe a duty of care to shareholders and stakeholders. A clear example is the KQ issue where even after the audit report implicated the board, they simply resign and no action is taken to penalize these acts of 'negligence.[367]' The board and management do not seem to give responsive leadership and make prudent decisions.

4.5 The United States of America

As early as the 1820s the New York Stock Exchange was the most active market for corporate securities in the USA and across the world.[368] Most of the corporations trading were banks and insurance companies and by 1825 about 67 corporations that traded on Wall Street were highly profitable. This was attributed to the high demand for financial services to fund the growing American economy. Even though ascertaining ownership in this era was difficult New York state implemented a requirement where every corporation was to submit a list of the stock holders to government. Accordingly, public ownership structures have a wide range of ownership structures. In the mid-19th century the process of registration of a company was not merely a contract between the incorporators but also a contract between the incorporators and the government. The state had to pass a law whereby the contents of the law were the agreement between the incorporators and the state. The state had the authority to vary and re-negotiate terms of the charter whereby they could for instance grant a charter for a limited duration. The state also limited the issuance of charters to specific industries such as the banking industry, with the purpose of raising the value of the charters it had granted.[369]

[367] For the financial year 2015/2016 KQ losses went up by more than 70%. See the 2015/2016 financial report onhttps://www.kenya-airways.com/uploadedFiles/Content/About_Us/Investor_Information/KQ_Annual_Report_2016.PDF accessed on 19 July 2017.

[368]Richard Sylla, 'U.S. Securities Markets and the Banking System 1790-1840 Review' [1998] <http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.202.3975&rep=rep1&type=pdf> accessed 21 October 2016.

[369]*Ibid.*

Gower observes that the American corporation law did not inherit a well-developed British corporation system.[370] In as much as corporation law in England was well advanced and developed from as early as the 16th century, it remained in a primitive state in America. Most American corporations after the American Revolution followed tradition rather than law. The law was silent on many aspects such as 'if the directors were to disclose their own transactions with the corporation to shareholders, the extent the directors could utilize the resources of the corporation to their own advantage.'[371] The law did not provide answers to these questions, the answers lay in the practice. The corporation charters specified what rights the shareholders had. Basically the shareholders were entitled to vote in annual meetings and the charter also specified how they would participate in electing the directors. Hilt observes that the early corporations in USA had other distinct features, first was in the payment of dividends whereby in as much as most corporations were financially opaque, managers committed themselves to be making regular dividend payments as a way of showing investors that they would not expropriate the assets of the company. Secondly was the composition of the boards, most boards were composed of wealthy and influential businessmen who were politically connected. The names of the board members were well publicized. The influential and politically connected men in the boards were a reflection of the political forces behind the incorporation of the company and represented the political interests in the company which would result in favors such as renewal of the charter on favorable terms. As already indicated the operations and management of these corporations was not governed by law but by tradition. Even the little areas that were addressed in law would be circumvented. This kind of operations could only run based on the will of the men that ran those companies. But the cracks of such a system were experienced soon thereafter.[372]

In 1826 some businessmen who were not politically connected took up running the insurance and since they could not get the banking charter they defied the state law and entered the banking business and started issuing bank-note like instruments. They operated in a shadow and their

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[370]L. C. B Gower, 'Some Contrasts Between British and American Corporation Law' (1956)69(8) Harvard Law Review 1369-1402.

[371]Hilt Eric, 'History of American Corporate Governance: Law, Institutions, And Politics' [2014] National Bureau of Economic Research <http://www.nber.org/papers/w20356.pdf> accessed 21 October 2016.

[372]*Ibid* p. 8 and 9.

transactions started violating traditions, whereby they for instance used the assets of the company as collateral to obtain loans. As the economic downturn hit England, the recession had effects on New York as stock prices fell and the risks spread to financial markets. Many banks and insurances went under, but the most important revelation was that most of these ventures had been deeply insolvent. The boards had actually continuously paid dividends on borrowed money. It was also revealed that several of these prominent and politically connected directors had not attended any board meetings.[373] This was a clear manifestation that traditional solutions had failed. Soon thereafter many prosecutions were conducted on the men who were at the center of the scandals and as a result the chancery courts in New York became overwhelmed. This even set up precedents where stockholders were allowed to sue directors who had used a company's capital as collateral in an unsuccessful attempt to take over bank. That was the precursor to the precedent that allowed derivative suits where minority shareholders had the right to sue directors of a corporation for malfeasance. The case of *Robinson v Smith*[374] is a clear case in this regard. The state government also reacted by enacting a raft of laws that specifically were to prohibit many of the transactions that were fraudulent, imposed financial reporting requirements, prohibited loans to directors and made directors individually and collectively accountable for fraudulent activities.

In the mid-19th century in Massachusetts, the state owned the greatest number of business corporations and Massachusetts became the center of many manufacturing industries.[375] These industries were largely successful though there were concerns relating to excessive payment of salaries to directors. The directors also influenced and had many of their relatives and friends employed in the same companies they managed, sold the corporation products through mercantile firms and as a result drew high commissions, the directors also solicited proxy votes through duplicitous means. Though some of the acts did not pose a direct challenge to investor confidence, Massachusetts enacted changes to its corporation law where it became a requirement for a corporation to make its books of accounts accessible to shareholders and the other amendment

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[373] Thus never actually participated by decision making of the company.

[374] 3 Paige Ch. 222. (N.Y. 1832).

[375] Wright, Robert E. *Corporation Nation. Philadelphia*: (University of Pennsylvania Press 2013).

prohibited directors from voting more than 20 shares by proxy.[376] In the 1920s the USA experienced stable macro-economic growth, innovations in technology and growth of the financial markets. As a result of the changes there was a growing interest in the management and governance of corporations both private and public. In 1934 the Securities Exchange Act was passed which established the SEC which required publicly traded companies to file periodic financial statements, company insiders to report their securities transactions. The SEC law also outlawed insider trading and regulated proxy solicitation.

Erick Hilt observes that all over the world today there is a co-relationship between legal institutions and financial development.[377] Countries that provide sufficient legal protection to shareholders and stakeholders have larger equity markets. In particular Hilt notes that the USA affords strong legal protection to investors thus making its economy very strong. Bengt Holmstrom and Steven Kaplan observe that quite contrary to the criticism on the USA corporate governance system, the US economy and stock market has continued to outperform other stock markets in other countries.[378]The two authors' further note that the US market has since 1982 generated higher returns similar to the European and Pacific markets. Right from the 1980s there has been a drastic shift in the USA corporate governance. Prior to the 1980s the focus of the US corporate governance was not on the 'shareholder' but rather on the corporation. The managers of big US public corporations tended to think themselves as representative of the shareholders, it was not the goal of the corporations to maximize shareholder wealth but it was for the corporation to ensure growth. The post 1980 period saw an increase in the interest in the aspects of corporate governance. First there was change in executive compensation. From the period 1980-1994 the compensation of CEOs tripled in real time. Between the years 1994 to 2001, the compensation of CEO had increased further.[379]These increases in executive compensation generated enormous controversy. The board

[376] V. G Sridharan, and F. Navissi, 'The Theoretical Foundations of Corporate Governance,' p. 13.

[377] Hilt Eric, 'History of American Corporate Governance: Law, Institutions, And Politics' [2014] National Bureau of Economic Research <http://www.nber.org/papers/w20356.pdf> accessed 21 October 2016.

[378] Bengt Holmstrom, Steven N. Kaplan, 'The State of U.S. Corporate Governance: What's Right and What's Wrong?' [2003] NBER WORKING PAPER SERIES <http://www.nber.org/papers/w9613.pdf> accessed 21 October 2016.

[379] *Ibid*. The authors note that a study published in the late '90s reported that during the 15-year period from 1980 to 1994, the average compensation of CEOs of large U.S. companies tripled in real terms. The study also concluded

of directors also experienced a shift chief being board selection by a nominating committee; more equity compensation for directors and more director control of board meeting with an independent chairperson and annual CEO reviews.

4.5.1 The Sarbenes Oxley Act of 2002

The SOX Act was enacted in 2002 and it provides for a number of changes in the management of publicly traded companies.[380]The Act is meant to restore investor confidence in markets and close loopholes for public companies from defrauding investors. The NYSE and NASDAQ also provided changes for the listed firms. It provides for changes that touch on executive compensation, shareholder monitoring and board monitoring. There is a restriction on insider trading and enhanced disclosure. The Act requires executives of corporations to report sales or purchase of company stock in 2 days.[381] There is a requirement of disclosure of the balance sheet. The power of the, responsibility and independence of the audit committee has been enhanced. The audit commit is to hire an outside auditor and the committee is to consist of directors who have no financial relationship with the company. The Act imposes penalties for financial misreporting. As a result, there is an increased responsibility as the executive have to take time on matters of accounting.[382] In as much as provisions of the Act deal with corporate governance issues directly and indirectly some of its requirements were already in place and had been institutionalized by most US companies. The Act also importantly imposes strict criminal penalties for securities fraud.

The management has the responsibility to personally certify the accuracy of financial reports. If a manger knowingly or willfully makes a false certification he or she faces 10 to 20 years imprisonment, if the company is forced to restate its books of accounts due to the management's misconduct then the managers have to give up their bonuses and profits. A manager who has been

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that the average annual CEO option grant (valued at issuance) increased roughly sevenfold and, as a result, equity-based compensation in 1994 made up almost 50% of total CEO compensation (up from less than 20% in 1980).9 Moreover, as reported in a more recent study, this trend continued from 1994 to 2001, with CEO pay more than doubling and option-based compensation increasing at an even faster rate.

[380]See <https://www.sec.gov/about/laws/soa2002.pdf> accessed 21 October 2016.

[381] See section 101 to 109 of the Act.

[382]See section 801 to 906 of the Act.

previously convicted then is not allowed to serve in the same role in another company. The Act additionally imposes penalties for obstructing justice, securities fraud, mail fraud and wire fraud, if the same is committed by a company, a heavy penalty is imposed. The Act establishes the Public Accounting Oversight Board which provides for standards of public accountants, limits conflict of interest and limits the term of auditors.[383]

4.6 China

China does not observe a capitalist system therefore most big corporations in China were previously state owned corporations.[384] As of the year 2010 out of the top 500 Chinese enterprises, 65.8% were owned by the state. Whilst some of them continue to be wholly owned by government others have had government stake reduce. Thus there are only four types of corporations in China three of which have government presence. We have corporations that are wholly owned by government, others are majorly owned by government, others have government with minority shareholding whilst the last category has no government ownership. This is a result of the more than three decades' market reform.

Government and government agencies continue to be extensively involved in the management and governance of these corporations. Section 6 and 7 of the Constitution of China provide that the economy of China is based on socialist public ownership of the means of production.[385] The state thus controls most of the big corporations in China and these SOE have played a major role in the Chinese economy. These SC in China have a goal other than advancing economic growth which is to deal with the social responsibilities. From the year 1978 to 1986, the government of the Peoples Republic of China began a process of decentralization of power so as to allow SCs to retain profits, from 1987 to 1992 professional managers were hired and between 1993 to 1998 modern corporate governance principles were embraced. From 1999 the government has began allowing more space for private owned entities. The Chinese government however remains the

[383] See StoyanTenev, Chunlin Zhang, and Loup Brefort 'Corporate Governance and Enterprise Reform in China, Building the Institutions of modern markets' [2002] World Bank and the International Finance Corporation.

[384] Zhaofeng Wang, 'Corporate Governance Under State Control: The Chinese Experience' (2012) 13 Theoretical Inquiries in Law <www7.tau.ac.il/ojs/index.php/til/article/download/168/145> accessed 21 October 2016.

[385] Constitution of the People's Republic of China <http://e-chaupak.net/database/chicon/2004/2004.pdf> accessed 21 October 2016.

largest shareholder in most of the public corporations and can therefore appoint representatives to the board of directors and allow or direct the decisions and path to be taken in the business. This enables the government to influence both the direction of the company so as to align it to the government national development policies.

With the structure outlined, the Chinese government has the ability to influence its enterprises through imposing price restrictions, industrial structures, nationwide human resource policies and implementing government friendly strategies. State Corporations in China are managed by State Owned Assets Supervision and Administration Commission (SASAC). The corporations under SASAC are structured and managed as outlined. First the governing body of the state corporation is a combination of Party Committee and the Board of Directors. The corporations have 3 committees; the board of directors, board of supervisors and shareholder general assembly. In this there are members of the Chinese Communist Party. SASAC officers sit in the board of directors and on the board of supervisors. The CPC members are the most important members. The SASAC has the power to dismiss or impeach the chairperson of the board of directors. Secondly since the SOEs are the economic arm of the Chinese government, the government's goals have to inform the operations of the enterprise. Notably though these corporations have to pursue stable development, long-term competitiveness and profitability. The state corporations are to observe employee requirements and serve as a good example to other non-business enterprises.[386]

The Chinese structure of SCs has led to a complex evaluation criterion.[387] While on one hand there is the issue of profitability which is at the center of an enterprise performance, there are political considerations where the corporation's executives are like the local politicians and are evaluated on individual character and loyalty to the party. The SASAC has put in place a number of requirements to address this aspect that may lead to conflicting roles. The SASAC passed the Interim Measures of Assessing the Operation Performance of Persons in Charge of Enterprises 2010 provides that managers shall be evaluated on the basis of success in maintaining and enhancing the value of state-owned assets, to maximize shareholder value and attaining sustainable

[386]See <http://en.sasac.gov.cn/> accessed 21 October 2016.

[387] *Ibid*.

development The same requirement provide that managers have to be rewarded strictly based on performance whereby every evaluation has to be based in accordance with the specific industry.

The management of corporations is similar to state officers depending on the SCs size and position in the national economy. The SCs executives can be promoted based on performance and this serves as a strong incentive for good performance. In 2011 for instance 183 officers in government at the level of deputy ministers, 56 had experience in SCs. Performance is also key even for executives appointed by government because in China political position is an important factor in establishing social status.

The management of SCs in China brings into question a complex agency relationship, where agents watch over agents. Since the Constitution of China dictates that all state owned assets belong to the entire nation the SASAC is a controlling shareholder in SCs where it acts as an agent of the state, the SASAC thereafter recruits professional managers to run the corporation, which creates another agency relationship. The SASAC monitors the performance of SCs and implements a punishment and reward mechanism. There is usually an implicit and explicit contract between the Principal and the Agent where a contract is signed articulating the executive duties key of which is performance. Zhaofeng Wang observes that from 1995 there has been improved performance of Chinese SC as compared to the period 1985 to 1995.

In 2010 for instance the Chinese SCs made an overall profit of 2trillion Yuan as compared from 50 billion Yuan in 1998. The government backing has enabled technological innovation in industries such as railways, telecommunication, aerospace, defense and steel. In as much as there has been an implementation of corporate governance principles there remain a number of challenges. There is the issue of conflict of interests as there are a number of groups managing corporations, SASAC authorizes the executives to run business and thus the interests of shareholders may not be captured. Wang proposes reforms on SASAC to make it accountable, to enhance board independence and to treat employees as owners.

4.7 Lessons from USA and China

The major difference between the other outlined systems of corporate governance and the USA is the aspect of penalizing financial improprieties such as misreporting. The USA system and laws outlined above penalize securities fraud and individual managers and boards risk up-to 20 years in prison. The convicted persons are thereafter ineligible to serve in the boards of other corporations. The Public Accounting Oversight Board is established as a body to check and conduct financial audits. The system in the USA as has been elaborated above has a strong background but of importance is the guard against conflict of interest, where boards secretly trade with the corporations they are in charge, boards over borrowing and paying dividends on borrowed money, boards that are absent in the affairs of the corporation. The establishment of the SEC was to ensure that corporate fraud is addressed. This system though harsh has shown that sufficient legal protection from the State breeds large equity markets such as the New York Stock Exchange.[388]

As for China, its system is very different from what Mwongozo prescribes. The environment being very different too because China owns more than 60% of corporations. However to note is that it has decentralized to ensure that SCs retain profits. It emphasizes on hiring of professional managers. However the state controls most aspects of SCs where in every board there are members of the Socialist Party to ensure the corporation is run as required by the party. Mwongozo does not take a compulsory approach as in the USA but perhaps Kenya has a lot to learn especially when we are littered with cases of corporate fraud and managers leaving big going concerns as empty shells and no action being taken against them. As for the government control in China the system would not work as part of the reason that informed and necessitated Mwongozo was the overreaching arm of government in SCs.

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[388] A 2010 report on the NYSE notes:

> *The New York Stock Exchange ("NYSE") has long been a leading proponent for the highest standards of corporate governance and ethical behavior. The NYSE's listing standards have included governance rules for approximately 150 years: it was the NYSE that first required companies to issue regular financial statements, as well as to provide quarterly earnings announcements and conduct independent audits of financial statements, all of which were included as part of the NYSE's listing standards before any of the federal securities legislation coming out of the Great Depression. The leadership role of the NYSE on governance matters continued during the middle of the 20th century, when the NYSE pioneered such developments as required proxy statement distribution, a minimum number of outside directors, and audit committees made up entirely of independent directors.*

See report from <http://www.ecgi.org/codes/documents/nyse_cgreport_23sep2010_en.pdf> accessed on 19 July 2017.

4.8 Conclusion

As is evident, most jurisdictions apply the "comply or explain" approach which has its origin from the UK's Cadbury Report. The USA is among the few jurisdiction which applies the ''comply or else'' model which makes it compulsory to apply the principles of corporate governance or face sanctions. Majority of EU Member States have taken the same direction to implement like codes on a "comply or explain" basis. Outside the EU, many countries have borrowed extensively from the Code, including Canada, Australia, Hong Kong, South Africa, Kenya and Uganda. In adopting a voluntary platform, the belief is that while rules with legislative clout would guarantee compliance, companies vary significantly e.g. in size and ownership structure. The "one size fits all" statutory approach would necessitate the imposition of minimum standards at the drafting stage; standards capable of discharge by all listed companies. This was undesirable. It would also bar individual companies from adopting governance practices that best suited their culture and organisation and there would be a greater risk of boards complying with the letter of statutory measures, rather than the spirit of their requirements. A voluntary approach would allow the drafters of the Code to incorporate optimal governance principles which companies were not bound to follow. This was done through the "comply or explain" approach. However the comply or else model applied in the US has also been effective considering the economic position of the USA government owned enterprises and even private sector.

CHAPTER FIVE
CONCLUSION AND RECOMMENDATIONS

5.1 Conclusion

The study sought to critique Mwongozo and advance the argument that it is weak and bereft of sufficient legal impetus to promote corporate governance in SCs. It also sought to point out that some of the principles in Mwongozo are borrowed and applying the same without adaptations, exceptions or modifications may be ineffective. However of great concern is that the gusto to implement Mwongozo seems to have fizzled out. The study has rotated around the three questions posed by Ndii that should inform the coming into force of a new policy document, why, what and how? Whereas it is easier to answer the first question, the second and third present difficulties. These difficulties in addressing the latter questions then make the code susceptible to being ignored all together.

Why Mwongozo came to being was as a result of recommendations from the Presidential Taskforce on SCs. The formation of the taskforce was necessitated by the change in laws notably the coming into force of the Constitution of Kenya, 2010 that demands efficient control of public resources and the need to keep SCs profitable so as to promote and improve the State's economy. Rightly, the taskforce had pointed out that there was need to streamline and align the operations and management of SCs with corporate governance principles because of the increasing demand and the ever growing population which needs to be employed and also needs efficient and reliable supply of goods and services. SCs as previously structured could not be able to do this because they were riddled by majorly weak management and governance structures. A look at economies in Southeast Asia point to a fact that Kenya as a country lagged behind while other countries such as Malaysia which were economically weaker than it were able to transform and advance so fast.

What needed to be done was perhaps to come up with a uniform code and this could be in a binding form. Mwongozo though issued as an executive order is weak in the hierarchy of norms and thus SCs can and cannot apply it. The application of Mwongozo is discretionary. As already observed the legal status of an executive order is such that it can be withdrawn anytime by the President. The President on the other hand uses the State Corporations Act to most of the times make

unilateral appointments to the boards of SCs. The implementation committee is hosted by the executive and this does not diffuse the power initially reflected by the provisions of the State Corporations Act. There is insufficient goodwill to implement Mwongozo because the implementation committee has simply gone mute. Its recommendations of the Government Entities Bill 2014 have stalled in parliament. Some of the immediate recommendations have not been completed such as the idea of merging SCs that perform or are assigned similar functions. Such SCs with similar roles still exist with some boards, management and staff being idle yet they are remunerated by the government. What needs to be done has to depart from previous failed attempts such as the CMA guidelines. In many ways the code is similar to the CMA guideline which was not effective. If the solution lies in the law then the law with the requisite provisions has to be enacted.

How, the principles need to be infused has to take cognizance of the legal, social and economic framework prevalent in the country. There is need to involve the public who are the shareholders. The Presidential Taskforce had 6 weeks only to collect views and make recommendations. The Cadbury report in the UK for instance was subjected to public comment and additionally received more than 200 reports and proposals. The process took sufficient time to enable all the shareholders and stakeholders to participate. The participation is all inclusive and cannot distinguish between members of the public and private sector. The comparative analysis reveals that in the identified countries both the private sector and the public sector had to work together and this led to formation of strong institutions to implement the principles among SCs. SCs can learn from the private sector and adopt the principles as applied by the latter. Expectedly Mwongozo borrows from other jurisdictions notably the UK and South Africa. South Africa's King III is imported wholly and incorporated in Mwongozo. Though the circumstances in South Africa and Kenya are to some extent similar, King III can only work well if it is adopted with exceptions, variations and adaptations to the Kenyan environment just as it was posited in the East African case of ***Nyali v AG*** where the judges were of the view that importing legal principles from the UK and applying them in the East African countries is synonymous with 'planting an English Oak tree in the Kenya and expecting it to flourish.'

5.2 Recommendations

5.2.1 Public participation in public policy making

The human relations theory demonstrates that the public appreciates attention and want to have a voice in decision making.[389] The people of Kenya were to be involved in the formulation of Mwongozo Code because they are the investors and consumers of goods and services from SCs. The Mwongozo Code of Governance on State Corporations is a result of the recommendations that were given by the Parastatal Reforms Implementation Committee. H E the President of the Republic formed the implementation committee whose work was to implement the recommendations of the Abdikadir Mohammed and Mr. Isaac Awuondo led Taskforce. The Mwongozo Code of Governance for State Corporations was issued jointly by the Public Service Commission (PSC) and the State Corporations Advisory Committee (SCAC) in January 2015.Mwongozo was specifically designed to align the leadership, governance and management of State Corporations with the Constitution of Kenya.

The Constitution of Kenya had sought to address the protection and efficient use of the available public resources. From the code it is evident that the code was formulated by the implementation committee working together with its secretariat. It was also presented to the Public Service Commission for review on whether its provisions adhered to Articles 10 and 232 of the Constitution.

The code was also submitted to the Constitution Implementation Committee and subjected a round table where the World Bank team led by Alexander Berg made their input. The entire process of coming up with Mwongozo was facilitated by the SCAC which engaged other stakeholders, specifically Institute of Certified Public Secretaries of Kenya ICPSK who assisted in the development and validation of Mwongozo. The code is modelled on comply or explain basis. The code is applicable to all SCs and is to be reviewed after every 5 years to respond to the national and the global environment. What is curious to note is that the Presidential Taskforce on Parastatal reforms did all its work in a total of 6 weeks and the code is meant to implement those recommendations.

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[389] Patty Mulder, Bureaucratic Theory (Weber) <https://www.toolshero.com/management/bureaucratic-theory-weber/> accessed 11 July 2017.

5.2.2 Mwongozo should be a binding legal norm

Every country faces its unique challenge. In the USA they had to codify and impose sanctions for corporations to apply the principles of corporate governance. The system of 'explain or else' imposes sanctions when the principles of corporate governance are flouted. Whereas there are criticisms about the system, the US economy remains strong and solid. For the other countries such as Malaysia, China and South Africa, corporate governance is inculcated as a culture, most of the aspects are codified but importantly they insist on a value system. In a country such as our voluntary application of the principles may end up not having them applied at all. Corruption is still rife and it is hard to rely on values to guide enforcement of public policy. Moreover, as an executive order the President can do away with the code at will. Mwongozo ought to be enacted as a statute or regulations under a statute.

Executive orders have many challenges. First there is the perception that it amounts to unilateral executive law making that impact the interests of private citizens and encroaches upon the power of parliament. As already indicated in the US case of *Youngstown Sheet & Tube v Sawyer*, the US Supreme Court found the executive order issued by President Harry Truman in 1952 to avert worker's strikes during the Korean Civil war, in the country's steel mills unconstitutional. The president had issued an executive order to the effect that the Secretary of Commerce to take possession of the country's steel mill and ensure continued production. Executive orders lack stability as the President is free to revoke, modify or supersede his own orders or those issued by his predecessor.

5.2.3 Multiplicity of regulations to be avoided

Having two laws or regulations that have conflicting provisions does not assist the enforcement of a public policy. The National Treasury gazetted the Code of Corporate Governance Practices for Issuers of Securities to the Public 2016 on 4th March 2016. The code is issued in accordance with sections 11(3) (v) of the Capital Markets Act Cap 485 A. The new code replaces the Corporate Governance Guidelines 2002 which was based on a 'comply or explain' approach to the 'apply or explain' approach. The code is intended to provide minimum standards required from shareholders, directors, managers of listed and unlisted companies that issue securities to the public

so as to promote high standards of conduct as well as ensure that they exercise their duties and responsibilities with clarity, assurance and effectiveness.

The ‘apply or explain approach recognizes that there is need for flexibility and that no single set of rules are applicable to all types of companies. Accordingly, where a standard applied is lower than the one prescribed in the code, the listed company will have to explain non application of the recommended standards to the shareholders and the authority. The code provides for executive pay provisions, where remuneration of board members is to be fair and responsible. The same are to be disclosed in the annual report. The code also provides for levels of remuneration for directors where an independent committee is to recommend the appropriate remuneration. The code also sets the age limit for board members at 70 years unless retained by a vote by the annual general meeting. There are also provisions of term limits for directors to 9 years and board diversity. This is contrary to Mwongozo which provides that a board member shall not hold office for a term exceeding 6 years.

5.3 Legal reforms

The State Corporations Act Cap 446 ‘ hereinafter the Act’ has to be repealed and a new Act be enacted in accordance with Article 10 and Article 232 of the Constitution to be put in place. The Act is not in consonance with the quoted Articles and Mwongozo. As has already been established, corporate governance principles can only be incorporated and implemented by a competent and independent board. The board is the brain of a corporation because it makes the policy decisions that are cascaded and implemented by the managers. Section 3 gives the President the power to establish a corporation. This provision the President unfettered discretion to decide if and when to establish a state corporation for whichever purpose. The best the provision could do is to provide that the President can establish a state corporation upon recommendations from the body in charge of state corporations, in this case the state corporations advisory committee. This has to be based on the need and the public has to be consulted and have to participate in the process before the recommendation is forwarded to the President. The legislature has to be involved in the establishment of a state corporation because they are representatives of the people. The provision in essence makes the establishment of a SC a one man thing.

Section 4 of the Act provides for the powers delegated to ministers in the management and governance of state corporations. This provision interferes with the ability of the board to make independent decisions because the President through the ministers can give specific or general directions that have to be complied with. The better route would have been to leave the management of the SCs to board members who should be recruited on merit and the oversight role to be provided by the advisory committee who can share the role with parliaments relevant departments because the money to run the SCs is mostly sourced from the ex-chequer.

The exemption under Section 5 A where a SC may be exempted from the provisions of the Act should be provided by Parliament and not the President. This is in a way meant to cut down the powers of the President to influence the decision making and the general direction a SC is taking. Section 6 on the composition of the board is retrogressive to the extent that the appointment of the chairman of the board is done solely by the President. First such a position should be advertised and competitively filled by the advisory committee in conjunction with the Public Service Commission. This is to insulate political considerations in the selection of board members. The composition of the board is to adhere to the structure adhered to by Mwongozo. Representations from the state/or ministry to be limited to about 2 only and the same to be on merit. The other board members are to be recruited competitively based on the skills and qualifications in management and the knowledge in the relevant sector. The term limits of board members should be guided by Mwongozo.

Section 7 of the Act should not find its way in our statute books because it allows one person clothed with the powers of the presidency to be able to determine the direction of a SC. This contradicts and may undermine the role of the board because of the powers of coercion and control exercised by the President. The overall direction to be taken a SC has to be determined by a competent board. This avoids the conflict of interests that may pit political interests against economic interests. Under section 7(3) of the Act, the President may at anytime and by himself or herself revoke the appointment of board member in the national interest. After such a revocation the Act allows the President the power to replace the removed board member. First the term ‘in the national interest’ is ambiguous and secondly such a role should be exercised by the advisory

committee. The removal of a board member has to observe Article 47 and 50 of the Constitution where the said board member has to be given a fair hearing and a fair administrative action.

Section 8 of the Act has to be in accordance with the provisions of Mwongozo on board meetings and the required levels of participation by all board members. The salaries and remuneration of board members is to be determined by the salaries and remuneration commission. All the provisions on the financial management and accountability should be included in the new Act albeit with due consideration to the Constitutional chapter on Public Finance and the Public Finance Management Act.

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