UNIVERSITY OF NAIROBI

School of Law

# The Law on Corporate Governance and Shareholder Protection in Kenya: A Case for Reduction of Corporate Scandals within Private Companies

A Thesis submitted in partial fulfilment of the requirements for the award of the Degree of Master of Laws (LL.M), the University of Nairobi.

by

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NAIROBI

## DECLARATION

I, **NYAKERI BOAZ AMORO** of Registration Number **G62/7713/2017**, do hereby declare that this project paper is my original work. I further declare that this work has never been submitted to any university, college or other institution of learning for any academic credit or other award. Other works cited or referred to are accordingly acknowledged.

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**NYAKERI BOAZ AMORO** **DATE**

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## SUPERVISOR'S DECLARATION

This thesis has been submitted for examination with my knowledge and approval as the university supervisor.

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**DR. AKUNGA MOMANYI** **DATE**

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Finally, I express my profound gratitude to my family for their enduring support and encouragement throughout my years of study, especially during this thesis. This accomplishment would not have been possible without them.

# DEDICATION

To dad and mum, from whom I draw immense inspiration.

## LIST OF CASES

1. *Aron Salomon vs. Salomon & Company Limited* [1897] AC 22
2. *Borland's Trustee vs. Steel Brothers & Co. Ltd* [1901] 1 Ch.279
3. *Foss vs. Harbottle* [1843] 2 Hare 461
4. *Kimani Waweru & 4 Others vs. Central Bank of Kenya & 7 Others* [2018] eKLR
5. *National Hospital Insurance Board of Management vs. Deposit Protection Fund Board (As Liquidator of Euro Bank Limited) (In Liquidation) Euro Bank Limited (In Liquidation) & 3 others* [2014] eKLR
6. *Nyali Ltd vs. A-G of Kenya* [1955] ALL ER 646
7. *Peskin vs. Anderson* [2000] All ER (D) 2278
8. *Primrose Management Limited & 3 Others vs. Nakumatt Holdings Limited & another* [2018] eKLR
9. *Republic vs. Lloyd Masika & Uchumi Supermarkets & 13 others* [Criminal Case No. 900 of 2008]
10. *Winding Up Cause 29 and 30 of 1986: In the Matter of an Application by the Official Receiver and Liquidator of Continental Credit Finance Limited (In Liquidation)* [2012] eKLR
11. *Winding Up Cause No. 1175 of 2002: In the Matter of Eurobank*
12. *Winding Up Cause No. 5 of 1987: In the Matter of Capital Finance Limited*

## LIST OF STATUTES, REGULATIONS AND OTHER LEGAL INSTRUMENTS

Capital Markets (Amendment) Act of 2018

Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations, 2002

Capital Markets (Securities) (Public Offers, Listing and Disclosures) (Amendment) Regulations, 2016

Capital Markets Act, Chapter 485A of the Laws of Kenya.

Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015

Combined Code of Corporate Governance of 2003

Companies (Amendments) Act of 2017

Companies (General) Amendment Regulations of 2017

Companies Act of 1948 (UK)

Companies Act, 2006 (UK)

Companies Act, Chapter 486, Laws of Kenya

Companies Act, No. 17 of 2015

Constitution of Kenya, 2010

Joint Stock Companies Act of 1844 (UK)

Limited Liability Act of 1855 (UK)

Nairobi Securities Exchange (Market Participant) Rules, 2014.

Penal Code, Chapter 63, Laws of Kenya

Sarbanes – Oxley Act, 2002 (US)

## LIST OF ABBREVIATIONS AND ACRONYMS

| | |
|---|---|
| ABIL | African Bank Investments Limited |
| ACTS | African Centre for Technology Studies |
| A-G | Attorney General |
| AGM | Annual General Meeting |
| AIG | American Insurance Group |
| All ER | All England Law Reports |
| ARTS | Applied Research and Training Services |
| BCCI | Bank of Credit and Commerce International |
| BoD | Board of Directors |
| CACG | Commonwealth Association for Corporate Governance |
| CBK | Central Bank of Kenya |
| CCG | Centre for Corporate Governance (K) |
| CEOs | Chief Executive Officers |
| CFO | Chief Finance Officer |
| CMA | Capital Markets Authority |
| CMC | Cooper Motor Corporation (K) Limited |
| CS | Cabinet Secretary |
| CSR | Corporate Social Responsibility |
| EA | East Africa |
| Edn | Edition |
| Eds | Editors |
| eKLR | Electronic Kenya Law Reports |

| | |
|---|---|
| GDP | Gross Domestic Product |
| GoK | Government of Kenya |
| IBLR | Imperial Bank Limited |
| ICDC | Industrial and Commercial Development Corporation |
| IFIs | International Financial Institutions |
| IMF | International Monetary Fund |
| IoDSA | Institute of Directors in Southern Africa |
| JSE | Johannesburg Stock Exchange |
| KCB | Kenya Commercial Bank |
| KDIC | Kenya Deposit Insurance Corporation |
| KENATCO | Kenya National Transport Company |
| KICOMI | Kisumu Cotton Mills |
| KMC | Kenya Meat Commission |
| KNH | Kenyatta National Hospital |
| KNTC | Kenya National Trading Corporation |
| KTDA | Kenya Tea Development Agency Holdings Limited |
| KWAL | Kenya Wine Agencies Limited |
| KWP | Kinangop Wind Park Limited |
| LL.M | Master of Laws |
| NBFI | Non-Bank Financial Institutions |
| NBK | National Bank of Kenya |
| NCPB | Nairobi Cereals and Produce Board |
| NEDs | Non-Executive Directors |

| | |
|---|---|
| NGOs | Non-Governmental Organisations |
| NHIF | National Hospital Insurance Fund |
| NHL | Nakumatt Holdings Limited |
| NMC | Numerical Machining Complex |
| NSE | Nairobi Security Exchange |
| NSSF | National Social Security Fund |
| OECD | Organisation for Economic Co-operation and Development |
| OUP | Oxford University Press |
| SA | South Africa |
| SAPs | Structural Adjustment Programs |
| SCs | State Corporations |
| SLP | Separate Legal Personality |
| SOA | Sarbanes-Oxley Act (2002) |
| SOEs | State Owned Enterprises |
| SSA | Sub-Saharan Africa |
| UCHM | Uchumi Supermarkets |
| UK | United Kingdom |
| US(A) | United States of America |
| WB | World Bank |

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## ABSTRACT

This study is on the law on corporate governance and shareholder protection in Kenya with key emphasis on corporate scandals within private companies. It examines the evolution of corporate governance in Kenya and a number of key scandals and debacles that have been experienced within the private corporate sector from 1900 to present. These scandals are an indication that despite the numerous legal enactments, amendments and regulations within this focus, the corporations in Kenya are still at a risk of collapsing.

History has revealed that in the recent past, Kenya has substantively amended its legal framework on corporate governance. But yet again, the corporate failures have equally been on the rise. Therefore, it suffices to say that there is need to review the legal framework on corporate governance in Kenya so as to ascertain where the problem lies, noting that Kenya has been in the forefront in emulating the international standards on corporate governance.

The legal framework on this study is broad because there are several local statutes (and rules and regulations) and other international instruments. Additionally, a critical look at this concept will demonstrate that the back stops at the interaction between the shareholders and the Board of Directors (BoD). The relationship between these two organs is paramount towards attaining good corporate governance.

The core argument of this study is that countries which have a strong legal system are expected to perform well on matters of corporate governance. Additionally, corporations which embrace good governance have the ability to control failures. Such governance is typically demonstrated by a robust BoD, who in essence are the agents of the company. The shareholders, on the other

hand, are the owners of the company. As such, good corporate governance by a competent BoD guarantees shareholder confidence and this translates to high economic growth.

This study recommends that for Kenya to sufficiently deal with corporate failures within the private corporate sector, it must embrace an environment where there is a strong legal framework and a healthy interplay between the shareholders and the BoDs.

# CHAPTER ONE

## OVERVIEW AND STRUCTURE OF THE STUDY

### 1.0 Background of the Study

In the course of the last decade, the subject of corporate governance has been characterized by numerous scandals globally. This has prompted the growth of the concept of 'corporate governance'.[1] Gakeri for instance observes that corporate governance has been an eminent subject of discussion 'in the recent past' despite its seasonal existence, owing to the various 'developments in the corporate sector' and numerous corporate failures.[2] Equally, Gachoki and Rotich emphasize that 'globally, corporate governance has received increased attention because of high-profile scandals stemming from excessive managerial compensation, various abuse of corporate power, recent events, such as the financial crisis that began in the mid-2007 and other corporate governance failures.'[3]

An attempt to regulate these scandals has always responded to the available regulatory framework.[4] Measures have been taken to ensure that transparency and independency are paramount so as to control the numerous scandals, and as such, increase confidence of the capital markets. It is thus paramount that corporations must refrain from having weak corporate

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[1] Githui, D. M., 'Corporate Governance and Organizational Management: An Ethical Perspective of the Challenges Facing Effective Corporate Management in Kenyan State Owned Enterprises (SOEs)' [2013] XIII(X) *Global Journal of Management and Business Research* (A), 43.

[2] Gakeri, K. J., 'Enhancing Kenya's Securities Markets through Corporate Governance: Challenges and Opportunities' [2013] 3(6) *International Journal of Humanities and Social Science*, 94.

[3] Gachoki, S. and Rotich, G., 'Increase of Corporate Governance on the Performance of Public Organizations in Kenya: A Case of Kenya Ports Authority' [2013] 4(6) *Research Journal of Finance and Accounting*, 205. A similar argument has equally been postulated by Njuguna, L. and Moronge, M., 'Influence of the Managerial Behaviour of Agency Cost on the Performance of Listed firms on NSE' [2013] 1(7) *International Journal of Social Sciences and Entrepreneurship*, 397 who opine that corporate accounting scandals, particularly in the US and Europe, such as Enron, HealthSouth, Parmalat, Tyco, WorldCom and Xerox, were witnessed towards 'the end of the 1990s and the beginning of the 20$^{th}$ Century.'

[4] Iraya, C., *et. al.*, 'The Effect of Corporate Governance Practices on Earnings Management of Companies Listed at the Nairobi Securities Exchange' [2015] 11(1) *European Scientific Journal*, 169-70.

governance structures, for instance those characterized by weak management boards, too powerful Chief Executive Officers (CEOs) and weak internal controls, among others. This is because a governance system of any corporation is key in determining the performance outcome of that entity. In this vein, corporations which are well-governed will perform better (than those which are poorly managed) and this will translate to high economic growth.[5]

From the foregoing, it is correct to observe that corporate governance developed smoothly in its early stages until the development was marred by numerous corporate shortcomings thus necessitating the implementation of various laws. In other words, these numerous corporate setbacks have been centrally attributed to the development of the legal framework in relation to corporate governance. This implementation has continued for a long period of time but it has failed to curb the ongoing dilemmas.

The history of this concept began long during the implementation of the Joint Stock Companies Act of 1844 (UK) where this legislation attempted to separate control from ownership of a corporation. Later in 1855, the Limited Liability Act of 1855 (UK) was passed with an aim of protecting shareholders from a debt beyond their investment. At about 1980s, there were numerous stock market crashes across the world and the then corporate governance framework was insufficient to prevent such failures.

In the 1990s, various corporate governance structures were adopted across the world.[6] In 1999, the Commonwealth Association for Corporate Governance (CACG) came up with the CACG

[5] Miring'u, N. A. and Muoria, T. E., 'An Analysis of the effect of Corporate Governance on Performance of Commercial State Corporations in Kenya' [2011] 1(1) *International Journal of Business and Public Management*, 36.

[6] In that, for civil law jurisdictions like France, Germany, Italy and Netherlands, a framework was developed that focused on stakeholder; and for common law jurisdictions such as USA, UK, Canada Australia and New Zealand developed a framework that focused on shareholders returns or interest.

Guidelines on corporate governance. Additionally, a global forum was developed by the World Bank (WB) and the Organisation for Economic Co-operation and Development (OECD).

In Africa, the King's Committee Report and Code of Practice for Corporate Governance in South Africa (SA) was published in 1964. The WB and the Commonwealth Association equally provided training and technical support to Botswana, Mali, Cameroon, Mauritius, Senegal, Sierra Leone, Tunisia, Zambia, Gambia and Mozambique purposing to establish a national corporate governance mechanism. Within the East Africa (EA) region, major regional conferences were held in Kampala, Uganda in June 1998 and September 1999 that were aimed at creating awareness and promoting regional co-operation on matters of corporate governance.[7]

Several reports have been adopted with an aim of promoting good corporate governance. They include the Cadbury Report (1992),[8] Greenbury Report (1995),[9] Hampel Report (1998),[10] Higgs Report (2003),[11] the combined Code of Corporate Governance (2003),[12] OECD Principles (1999)[13] later revised (2004),[14] and Governance in Africa 'Crisis of Governance' (1988) by WB group.[15]

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[7] In particular, Uganda established the Institute of Corporate Governance of Uganda that was tasked to formulate a national code of best practices; Tanzania organized the East Africa Regional Workshop for corporate governance early in the year 2000; and, in Kenya, the Private Sector Initiative for corporate governance continuously consults with Uganda and Tanzania towards the establishment of a Regional Centre of Excellence in Corporate Governance.

[8] Cadbury, A., 'Report of the Committee on the Financial Aspects of Corporate Governance' [1992] (London: Gee).

[9] Greenbury, R., *Director's Remuneration* (17th July 1995).

[10] Hampel, R., *Committee on Corporate Governance: Final Report* (January 1998).

[11] Higgs, D., *Review of the Role and Effectiveness of Non-Executive Directors* (April 2002).

[12] Combined Code of Corporate Governance of 2003.

[13] Organisation for Economic Co-Operation and Development (OECD) Principles of Corporate Governance, Meeting of the OECD council at Ministerial Level (1999).

[14] Organisation for Economic Co-Operation and Development (OECD) Principles of Corporate Governance (April 2004).

[15] See generally Tricker, B., 'Corporate Governance after Hampel' [1997] *The Accountant*, London. See also, Jordan, C., 'Cadbury Twenty Years On' [2012] 12, *Center for Transnational Legal Studies* 136.

In Kenya, numerous institutions have promoted the growth of corporate governance locally. These includes the Capital Markets Authority (CMA), Nairobi Security Exchange (NSE), the Centre for Corporate Governance (CCG), the Central Bank of Kenya (CBK), among others. Relevant legislations in this subject are the Companies Act,[16] the Companies Act, 2015,[17] the Penal Code,[18] the Capital Markets Act, 2002 and the Code of Corporate Governance (2016).

It is noted that Kenya has borrowed heavily from the UK's corporate legislation. Harney, for instance, emphasizes that Kenya's Companies Act, 2015 has borrowed much from the UK's Companies Act of 2006. Thus, the 2015 Act will therefore 'preserve' the 'English System' heritage because it is based on the 'principles of English company statute law and the common law'.[19] This is perhaps a major challenge that has crippled our corporate governance sector in Kenya.[20] Until the Companies Act and other related legislations are enacted to suit and respond to our local challenges, it is apparent that the same past challenges, such as the corporate scandals, will recur.

### 1.1 Statement of the Problem

The dilemma of poor corporate governance has been analysed extensively and much emphasis has been directed towards dilemmas such as 'corporate fraud, accounting scandals, insider trading, excessive compensation, and other perceived organization failures'.[21] In Kenya, 70% of

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[16] The Companies Act Chapter 486 Laws of Kenya. This Act borrowed heavily from the England's Companies Act of 1948.

[17] This Act borrowed heavily from the UK's Companies Act, 2006.

[18] The Penal Code, Chapter 63, Laws of Kenya.

[19] Harney, R., 'The New Companies Act 2015 has come into operation in Kenya' *Bowman Gilfillan Africa Group's Coulson Harney office* (Nairobi Kenya).

[20] See for instance Lord Denning in the case of *Nyali Ltd vs. A-G of Kenya* [1955] ALL ER 646 whereby the court observed that 'one can take an oak tree from English soil and plant it on Kenyan soil, but one cannot guarantee that it would do equally well as in Kenya as it initially did in England'.

[21] Larcker, D. and Tayan, B., *Corporate Governance Matters: A Closer Look at Organizational Choices and their Consequences* (Pearson Education Inc. 2011) 1.

the failures has been attributed to the question of poor governance, particularly, weak practices, lack of proper internal control mechanisms, conflict of interest, and a weak regulatory and supervisory framework.[22]

Despite the new legal framework,[23] corporate governance scandals continue to happen, the latest examples being the crisis at Nakumatt Holdings Limited and the recent shutdown of Tuskys chain of supermarkets. This latest law review seems not to have been able to deter the mismanagement of Kenya's corporations. This research is aimed at addressing the existing gaps within the law (if any) and come up with necessary recommendations that will reduce such collapses within the private corporate sector.

## 1.2 Justification of the Study

Law is created by society as a tool to resolve the societal problems. This study is justified by the fact that in spite of having reviewed our laws to align them with best practice and globalization, this seems to have made no difference in the governance of the corporations in Kenya. Corporate governance scandals continue to be common-place.

The history of corporate governance emanated from 'developed jurisdictions', especially those with the best codes of practice. The codes aimed at making corporate boards of directors more professional, effective and accountable while they are in the course of executing their duties. The success of these codes would however depend on the legal and regulatory framework of these jurisdictions.[24]

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[22] Gachoki, S. and Rotich, G. (n 3).
[23] The Companies Act, No. 17 of 2015 and the Kenya's Code of Corporate Governance (2016).
[24] Gakeri, K. J. (n 2) 96.

Going by this standard, it is correct to maintain that the continuous collapses of corporations in Kenya can be accounted for by a poor legal system and regulatory framework.[25] Other corporate governance problems in Kenya include weak and unethical practices, lack of proper internal control mechanisms, conflict of interest, lack of transparency and disclosure and lack of accountability. Upon conducting research on this topic, this paper is aimed at informing legal reformists such the CMA, NSE, CBK, CCG among others.

## 1.3 Objectives of the Study

The core objective of this study is to review the law on corporate governance and shareholder protection in Kenya while making a case for corporate scandals within the private companies. The specific objectives to this study are as follows:

i. To review corporate scandals in Kenya from 1990 to-date.

ii. To identify the role of shareholders in minimizing corporate scandals within private companies.

iii. To identify what the law provides in relation to the corporate governance problem in Kenya.

iv. To evaluate whether the legal framework is adequate or whether these collapses are caused by other factors.

v. To make suggestions and recommendations for review if any.

## 1.4 Research Questions

The following research questions will guide this study;

i. Which corporate scandals have occurred in Kenya from 1900 to-date?

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

ii. What is the role of shareholders towards minimizing corporate scandals within private companies?

iii. What is the relevant law that is aimed at solving the corporate governance problems in Kenya?

iv. Is the available legal framework adequate or are these collapses by other factors?

v. What should be done to deter this corporate governance problem from recurring?

## 1.5 Hypotheses of the Study

This research is grounded on the assumptions that:

i. Proper shareholder protection mechanisms is key in achieving best corporate governance practices;

ii. Outline of the current legal framework on corporate governance is not a guarantee to minimizing corporate scandals; and,

iii. Compliance with a robust and relevant legal framework will reduce the level of corporate scandals in Kenya.

## 1.6 Theoretical Framework

This section review three major pertinent theories to this subject of corporate governance, namely, Agency theory, stewardship theory and contractarian.

### 1.6.1 Agency Theory

Arguably, this theory began developing in the 1960s and 1970s, and by 1980s, it was popular in determining 'the optimal-incentive contracting among different individuals and establishing

suitable control mechanisms to monitor the behaviours and actions.'[26] Its main proponents are Jensen and Meckling[27] and they defined it 'as a contract for which one or more people (the principal) urges another person (the agent) to carry out on her behalf an unspecified spot which implies a delegation of some decision-making power to the agent'.[28] Additionally, Bonazzi and Islam hold that, this theory, that was developed by Jensen and Meckling, postulates that 'the principals (the shareholders) can assure themselves that the agent will make the optimal decisions only if appropriate incentives are given and only if the agent is monitored.'[29] Fontrodona explains as follows:

> Agency theory is designed to explain the relationships that obtain in organisations, understood as principal-agent relationships, in which the principal decides on a certain course of action and the agent is responsible for carrying it out. Normally, the agent will never act exactly as the principal would like, because he has different interests and risk perceptions. Consequently, the principal will need to incur certain costs to ensure that the agent acts as required.[30]

The gist of this theory is that it separates 'ownership from management' thus causing conflict of interest known as 'agency problems' between 'managers and shareholders'. Due to these problems, which are costs on the company, the manager is encouraged to perform highly so as 'to protect the company from bankruptcy'. In this sense therefore, the manager assumes the role

[26] Namazi, M., 'Role of Agency Theory in implementing Management's control' [2012] 5(2) *Journal of Accounting and Taxation* 38, 40.
[27] See for instance Daly, H., 'Conflicts of Interest in Agency Theory: A Theoretical Overview' [2015] XV (I) *Global Journal of Human-Social Science* (E) 17, 18.
[28] Jensen, C. M. and Meckling, H. W., 'Theory of the Firm: Managerial behavior, Agency Costs and Ownership Structure' [1976] *Journal of Financial Economics,* 305.
[29] Bonazzi, L. and Islam, N. M. S., 'Agency Theory and Corporate Governance: A Study of the Effectiveness of Board in their Monitoring of the CEO' [2007] 2(1) *Journal of Modelling in Management* 7, 8. Consider an illustration principal (employer)-agent (employee) relationship, whereby the principal is too busy to do a given job and thus he hires an agent to do the work. Further, the principal is too busy to the extent that he cannot monitor the agent perfectly. As a consequence, the principal then invents ways by which he can motivate the agent, say through bonuses and stock options, so that he can execute his duties diligently.
[30] Fontrodona, J., 'Beyond Agency Theory: The Nature of the Firm from a Humanistic Perspective' in Lutz, D. and Mimbi, P. (eds), *Shareholder Value and the Common Good: Essays on the Objectives and Purposes of Business Management* (Strathmore University Press and the Konrad Adenauer Foundation 2004) 47.

of an agent who is acting on behalf of shareholders.[31] Therefore, there is a fundamental conflict of interest between managers and owners whereby managers do not bear full consequences of their actions.

This theory argues that in a company, ownership is, or at least, ought to be different from management. The BoD is required to perform highly so that the company cannot become bankrupt. In essence, this theory seeks to protect shareholders out of the directors' best performance.

Theorists such as Hung have criticized the agency theory and especially with respect to 'its scope, organizational view, assumptions, moral implications and units on analysis'. It is also observed that this theory falls short of informing us why there is a need of an agent for a principal in an organization.[32]

### 1.6.2 Stewardship Theory

This theory originated from a robust definition that was advanced by Davis, Schoorman and Donaldson (1997). The two argued that 'a steward protects and maximises shareholders wealth through firm performance, because by so doing, the steward's utility functions are maximised.'[33] The theory is premised on sociological and psychological approaches that interrogates the conduct of the executives and requires that since managers are stewards of a firms, they should act in the firm's best interest.[34]

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[31] Saltaji, I., 'Corporate Governance and Agency Theory: How to Control Agency Costs' [2013] 4(32) *Internal Auditing and Risk Management,* 47-8.

[32] Hung, H., 'Rethinking Agency Theory as a leading Framework for the Study of Board Performance' [1998] 3(2) *AAM Journal* 1, 15.

[33] Abdullah, H. and Valentine, B., 'Fundamental and Ethics Theories of Corporate Governance' [2009] 4 *Middle Eastern Finance and Economics*, 90 <http://www.eurojournals.com/MEFE.htm> accessed 6th December 2017.

[34] Yusoff, W. F. W. and Alhaji, I. A., 'Insight of Corporate Governance Theories' [2012] 1(1) *Journal of Business and Management* 52, 57.

The theory is an inverse of the agency theory and it presupposes that the central task of a manager in a firm is to maximize the firm value. In other words, a firm which performs better motivates managers since they are stewards of the firm.[35] To this end, the stewardship theory sees 'a strong relationship between managers and the success of the firm, and therefore the stewards protect and maximise shareholder wealth through firm performance'.[36]

Pursuant to the foregoing, this theory presupposes that directors in companies have a key role of protecting and maximizing the shareholders' wealth through firm performance. This can be achieved by avoiding corporate failures. If the company's value is protected and maximized, the shareholders' investment will equally be protected.

### 1.6.3 Contractarian Theory

The origin of this theory has been widely associated with the early writings of Ronald H. Coase, '*The Nature of the Firm*' of 1937,[37] and Oliver Hart, '*An Economist's Perspective on the Theory of the Firm*' of 1989.[38] This theory was founded on the concept that a company is made up of a collection of private contractual obligations negotiated by the shareholders. It therefore perceives a company as a 'contract between private individuals' whereby the 'shareholders and the company are recognized as the only parties to that contract'.[39] This is a private affair between the

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[35] Afza, T. and Nazir, M. S., 'Theoretical Perspective of Corporate Governance: A Review' [2014] *European Journal of Scientific Research* 225, 257 <http://www.europeanjournalofscientificresearch.com> accessed 6th December 2017. For similar argument, see also Donaldson, L. and Davies, H. J., 'Stewardship Theory or Agency Theory: CEO Governance and Stakeholder Returns' [1991] 16(1) *Australian Journal of Management*, 51, whereby the authors opine that *'...managerial motivation is an alternative to agency theory and which may be termed as stewardship theory….stewardship theory hold that there is no inherent, general problem of executive motivation'*.

[36] Yusoff, W. F. W. and Alhaji I. A. (n 34).

[37] O'Kelley, T. R. C., 'Coase, Knight, and the Nexus-of-Contracts Theory of the Firm: A Reflection on Reification, Reality, and the Corporation as Entrepreneur Surrogate' [2012] 35 *Seattle University Law Review*, 1247.

[38] Fisch, E. J., 'Governance by Contract: The Implications for Corporate Bylaws' [2018] 106 *California Law Review* 373, 374.

[39] Koutsias, M., 'Shareholder Supremacy in a Nexus of Contracts: A Nexus of Problems' [2017] 38(4) *BULA* 136.

shareholders alone. The theory perceives managers as being self-interested and opportunistic in the company.[40] The company is a legal fiction, as opposed to an individual, which serves as a link for various contracts of individuals to enhance production.[41]

The proponents of this theory view the shareholder's relationship with the company as being contractual in nature, the contract being the articles of association. To them, corporations are the starting point of all contracts.[42] This contract is ordinarily negotiated by the shareholders with an aim of maximizing their own profits and utility. Therefore, the company is an outcome of a network of contractual agreement. The importance of the shareholders is highly recognized since they are the owners of the company. In broader terms, all other parties to that contract, including the stakeholders, are viewed as external to the corporation. This theory is therefore designed to promote the 'shareholder exclusivity'.[43]

Another distinct feature that this theory postulates is that corporations, having been formed through the agreement of shareholders or what the participants have freely chosen, owe nothing

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[40] Whincop, J. M. and Keyes, E. M., 'Corporation, Contract, Community: An Analysis of Governance in the Privatisation of Public Enterprise and the Publicisation of Private Corporate Law' [1997] 25, *Federal Law Review*, 52. See also Klausner, M., 'Fact and Fiction in Corporate Law and Governance' [2013] 65 *Stanford Law Review*, 1325.

[41] Bratton, W. W., 'Nexus of Contracts: A Critical Appraisal' [989] 74(3) *Cornell Law Review*, 415. This concept is further expounded in Hayden, M. G. and Bodie, T. M., 'The Uncorporation and the Unraveling of 'Nexus of Contracts' Theory' [2011] 109(6), *Michigan Law Review*, 1129, whereby the authors argue that 'The nexus of contracts theory, generally attributed to Jensen and Meck*ling's Theory of the Firm,* holds that the firm-and by extension the corporation-is merely a central hub for a series of contractual relationships. Jensen and Meckling emphasize that the firm is a 'legal fiction;' it is 'not an individual' and has no real independent existence. Their approach seeks to disaggregate our notion of the corporation as an entity and break it down into its component parts. These parts are the contractual relationships between the various parties involved with the firm: executives, directors, creditors, suppliers, customers, and employees. The corporation itself doesn't really exist; it is merely the nexus (or connection or link) amongst these various corresponding relationships." To view the corporation as an entity is to confuse the legal fiction for reality.'

[42] Whincop, J. M. and Keyes, E. M., (n 40) 51.

[43] Koutsias, M., (n 39).

to the state.[44] This argument goes to the extent that the promoters of a corporations ought not to seek permission from the legislator in order for them to form a company.[45] Therefore, this theory also seeks to minimize the role of the state within a corporation.

The central argument of this theory is that corporations are only about shareholders, at the exclusion of all other agents in a company, such as directors. This theory introduces a correct assumption because, in essence, the company belongs to shareholders and they are better suited to protect their investment or wealth. This theory is relevant where a corporate failure has been or is likely to be occasioned by an errant BoD or other agents.

The application of this theory has been criticized on the basis that even though it seeks to promote shareholder exclusivity, it does not embrace the realistic approach. Its limitation has been observed within the legislative framework and even the courts which do not seem to appreciate the concept of shareholder exclusivity.[46]This theory has also been criticized as failing to describe the reality of the basis for policy prescription. Critics have argued that it was 'based largely on perfect market assumptions and lacked empirical support'.[47]

### 1.7 Conceptual Framework

This study focuses on two variables, that is, corporate governance and corporate setbacks. In this vein, key terms such as corporate governance, corporate scandals, corporate debacles and corporate failures, arise. The term '*corporate governance*' has been widely discussed over time.

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[44] Hayden, M. G. and Bodie, T. M., (n 41) 1127.
[45] Pettet, B., *Company Law* (Pearson Education Limited 2001) 52.
[46] Koutsias, M., (n 39). The author further argues that the theory has failed to embrace the new reality in that '…On the one hand, it should certainly protect the rights of shareholders stemming from their shares and it should allow for effective shareholder protection against mismanagement. On the other hand, the theory should adopt a more inclusive definition of the company that will not leave the stakeholders off its context. Especially those stakeholders who clearly have a contractual relationship with the company should be factored into corporate governance.'
[47] Klausner, M., 'The Contractarian Theory of Corporate Law: A Generation Later' [2006] *The Journal of Corporation Law*, 781.

Its phenomenal growth can be attributed to the growth in academic research, following various obstacles within the corporate sector.[48]

An attempt to define this term adopts two broad approaches. On one hand, there is the narrow view which posit that the concept of corporate governance strictly relates to the interplay between the company and its shareholders, an expression commonly seen in 'agency theory'; while on the other hand is the broad view that this concept extends beyond the relationship of the company and its shareholders, to its relationship with other stakeholders such as the employees, customers, suppliers, among others.

This approach adopts the 'stakeholder theory'. The latter approach is arguably more inclusive and it attracts 'greater attention' because the issues of accountability and social responsibility are widely pronounced.[49] From this departure, governance is all about the process of making and implementing the decisions in a company.[50] This definition underscores the 'exercise of power in the management of economic and social resources for sustainable human development.'[51] As such, the Cadbury Report posit that corporate governance is the 'system by which companies are directed and controlled'[52] a definition which was equally adopted by the OECD Principles (2004).

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[48] Solomon, J. and Solomon, A., *Corporate Governance and Accountability* (John Wiley & Sons Ltd 2004) 11. See also Githui, D. M., (n 1), who argues that '…corporate governance is an evolving field which has gained popularity in the last decade after the demise of Enron, WorldCom, Arthur Anderson etc in the United States which have forced academics, legal practitioners, accounting and other professionals, regulatory agencies, government institutions, NGOs and international financial institutions to pay attention to corporate governance reforms…'

[49] Solomon, J. and Solomon, A., (ibid) 12.

[50] Crowther, D. and Seifi, S., *Corporate Governance and International Business* (2011) <http://bookboon.com> accessed 6th December 2017, 10.

[51] Ruparelia, R. and Njuguna, A., 'The Evolution of Corporate Governance and Consequent Domestication in Kenya' [2016] 7(5) *International Journal of Business and Social Science*, 153.

[52] Cadbury, A., (n 8) *Report of the Committee on the Financial Aspects of Corporate Governance* (London: Gee 1992) at section 2.5.

The corporate governance structure specifies the distribution of rights and responsibilities among the different participants in the organisation – such as the board, managers, shareholders and other stakeholders – and lays down the rules and procedures for decision-making.'[53] It is also 'heightened by the important role it plays in a modern economy' and it is 'essential in any industry'.[54]

According to Hassid and Brass, scandals are 'actions or events involving certain kinds transgressions which become known to others and are sufficiently serious to elicit a public response'.[55] Going by this definition, *corporate scandals* are therefore 'widely publicized incidents involving allegations of managerial wrongdoing, disgrace, or moral outrage of one or more members of a company.'[56] These types of scandals may include insider trading, accounting misreporting and frauds, mismanagement, bankruptcy and executive compensation, among others.[57] It is observed that corporate scandals mainly occur as a result of poor regulations.[58]

*Corporate failure* refers to the collapse of a corporation due to its 'inability' to generate enough revenue to cover its expenses or to make profit.[59] Corporate failures occur as a result of poor corporate management[60] which render a corporation incapable of attaining its 'economic and

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[53] See https://stats.oecd.org/glossary/detail.asp?ID=6778; see also European Central Bank, 2004, Annual Report: 2004, ECB, Frankfurt, Glossary.

[54] Imperial Bank Limited, *Annual Report and Financial Statements* (2011) 13.

[55] Hassid, J. and Brass N. J., 'Scandals, Media and Good Governance in China and Kenya' [2014] *Journal of Asian and African Studies*, 2.

[56] Bonini, S. and Boraschi, D., 'Corporate Scandals, Capital Structure and Contagion Effect' [2009] *New York University, Stern School of Business*, 5.

[57] Tiscini, R. and Donato, di F., 'The Relation between Accounting Frauds and Corporate Governance Systems: An Analysis of Recent Scandals' *Luis Guido Carli University, Rome*, 1. Available at <http://ssrn/comsbstract=1086624>

[58] Hail, L., et al., 'Corporate Scandals and Regulation' [2018] 56(2), *Journal of Accounting Research,* 6.

[59] Akpan, F. E. and Femi, J. A., 'Corporate Failure and the Dilemma of Auditors' [2014] 3(6) *Global Advanced Research Journal of Management and Business Studies*, 243.

[60] ibid 242.

financial objectives as well as legal obligations'.[61] *Corporate debacle* is closely related to corporate failure. It is perhaps an entrenchment of the same. A simple definition of debacle is a 'complete failure' which 'causes embarrassment'.[62] These words can sometimes be used interchangeably. This study endeavours to recommend a review of the law affecting corporate governance in Kenya with an aim of minimizing corporate collapses. The central argument advanced is that for good governance to prevail, corporate scandals and debacles must be eliminated or reduced.

## 1.8 Research Methodology

Approaches to research have grown tremendously to the extent that there is no an agreed system of category of research, owing to the different criteria that are used to classify research.[63] Nevertheless, it can be broadly categorized into qualitative and quantitative approaches.[64] Mugenda & Mugenda further postulate that research methodology should include elements such as 'proposed research design, population and sample, data collection procedures, data analysis procedures' among other things.[65] This study shall use the doctrinal and analytical method(s).[66]

This study is on the law on corporate governance and shareholder protection in Kenya while making a case for corporate scandals within private companies. As captured in the background,

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[61] Mbat, O. D. and Eyo, I. E., 'Corporate Failure: Causes and Remedies' [2013] 2(4) *Business and Management Research*, 19.

[62] *Oxford Advanced Learner's Dictionary*, (8th edn. OUP) 375.

[63] Mugenda, A. G., *Social Science Research: Theory and Principles* (Applied Research and Training Services (ARTS) Press 2008) 81.

[64] Creswell, W. J., *Research Design: Qualitative, Quantitative, and Mixed Methods Approaches* (3rd edn, SAGE Publications Limited 2009) 3. The author further notes that 'Qualitative and quantitative approaches should not be viewed as polar opposites or dichotomies; instead, they present different ends on a continuum. A study tends to be more qualitative than quantitative or vice versa…it incorporates both…approaches'.

[65] Mugenda, M. O. & Mugenda, G. A., *Research Methods: Quantitative and Qualitative Approaches* (African Centre for Technology Studies (ACTS) Press, Nairobi 2003)216.

[66] Kothari, R. C. and Garg, G., *Research Methodology: Methods and Techniques* (3rd edn, New Age International (P) Limited Publishers 2014) 2.

this subject is broad in its nature and as such, a trifling understanding of corporate governance from an international perspective is inevitable. Having said that, it is therefore imperative that various international and municipal instruments shall be relied upon throughout this study. These maybe statutory laws, judicial precedents, legal opinions, writings and commentaries from eminent scholars and practitioners in this subject, policy documents and reports, among others.

This study relies mainly on secondary data, this being the most important methods of data collection.[67] A number of statutes and reports will form the gist of the study. They include the Capital Markets Act, the Companies Act, the Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations, 2002 and the Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015. Internationally, various materials such as the Cadbury Report (1992),[68] Greenbury Report (1995),[69] Hampel Report (1998),[70] Higgs Report (2003),[71] the combined Code of Corporate Governance (2003),[72] OECD Principles (1999),[73] later revised (2004),[74] and Governance in Africa 'Crisis of Governance' (1988) by WB group[75] and relevant statutes shall be utilised. Case law and judicial precedents (of both international and municipal jurisdiction(s)) shall be applied in this study.

Law libraries, such as those of the University of Nairobi Law School and Africa Nazarene University Law School, among others, will be accessed to guide this research. The relevance will be to obtain materials such as text books, law reports, journals and books of reference that will

[67] ibid 91.
[68] Cadbury, A. (n 8).
[69] Greenbury, R. (n 9).
[70] Hampel, R. (n 10)
[71] Higgs, D. (n 11).
[72] Combined Code (n 12).
[73] OECD Principles (1999) (n 13).
[74] OECD Principles (2004) (n 14).
[75] See generally Tricker, B. and Jordan, C. (n 15).

assist in shaping this research. Internet sources shall also be used, especially with regards to electronic books, online journals, websites and blogs.

## 1.9 Literature Review

### *1.9.1 Corporate Governance and the relationship between Shareholders and the Board of Directors*

*Nyasae Amota Nyang'era*'s work is titled *Corporate Secretarial Practice in Kenya Today.*[76] The author discusses various concepts that the study intends to rely on. Key observations were made especially in relation to shareholders' and the relationship between the shareholders and the board. The author differentiates between the concepts of management and governance. The author also appreciates the role of the CMA and the NSE, among other institutions, as key bodies which have played a fundamental role towards growth and attainment of good corporate governance in Kenya.

This work will provide insightful academic contribution to this study on various platforms. This study argues that good corporate governance is demonstrated by a healthy relationship between the BoD (who are the agents of the company) and the shareholders (who are the owners of the company), whereupon if this is achieved, there is a guarantee of high economic growth and investment. Additionally, this study, while discussing on the legal framework on corporate governance, will invoke the input of the CMA and the NSE in formulating the relevant rules and regulations.

There are a few shortcomings that were noted from this work. Whereas the author gives a concise discussion of directors, he falls short of discussing two central topics, that is, directors' duties and disqualification of directors in a company. Also, the author gives a superficial

[76] Nyasae, A. N., *Corporate Secretarial Practice in Kenya Today* (Law Africa Publishers 2016).

discussion of shareholders while he is writing on shares in a company, instead of giving an indept discussion of shareholders from the perspective of company membership. Lastly, the work was last authored in 2016 whereby we have had an Amendment Act of 2017 (to the Companies Act of 2015) which obviously has affected the content therein.

*Crowther and Seifi*[77] address various relevant issues that are alluded to in this study. The authors begin by giving a robust definition and various principles of corporate governance. Their work further highlights on the developing framework of corporate governance with a specific bias to the UK. Additionally, theories of corporate governance, for instance agency, are discussed as applied in this study. Towards the end, the authors capture various scandals such as Enron, WorldCom and Parmalat.

Whilst the authors postulate a very candid and relevant arguments to this study, they fall short of analyzing the current legal framework and how it has contributed to or failed to address these issues. Additionally, the authors have based their entire discussion on global corporate governance while this study will be focusing on Kenya.

*Monks and Minow*[78] give a broad discussion on international corporate governance, with an emphasis on shareholders, directors and management. They discuss the history of the US framework and address the Sarbanes – Oxley legislation of 2002 that 'helped to restore confidence in the markets' and its impact thereafter. This discussion, despite its commendable insights, does not draw conclusions on the expectations of a good corporate governance.

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[77] Crowther, D. and Seifi, S., (n 50).

[78] Monks, G. A. R. and Minow, N., *Corporate Governance* (John Wiley & Sons 5th edn 2011).

*Mwaura*[79] advances an in-depth discussion of the directors' duty of skill and care. The author argues that due to the increasing growth of the global economy, much is needed from the directors of companies. So that for any country to benefit from this global economic growth, the country's legal framework and practices must conform to the international standards. This article investigates whether the directors in Kenya meet the global required standards of care skill and diligence.

This article is relevant to this study because the duty of directors in corporate governance is central in this discussion. The BoD is ordinarily entrusted by shareholders on matters of governance. Proper governance translates to shareholder investment thereby promoting economic growth. Such governance can only be achieved if directors observe their duties diligently, especially that of skill and care.

This study will reveal that most of the corporate scandals and debacles in Kenya emanate from the negligence of the directors in companies. The key limitation of this article is that it was authored long before the enactment of the current legal regime. However, the arguments fostered by the author seem to have been taken into consideration by the current regime, especially vide section 145 of the Companies Act of 2015.

### *1.9.2 The Dilemma of Corporate Failures within Private Corporations*

On a recent work by *Larcker and Tayan*,[80] the authors are empathic on the question of international corporate governance. They argue that the subject of corporate governance has been given serious attention in the recent past following numerous 'corporate frauds', 'accounting

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[79] Mwaura, K., 'Company Directors' Duty of Skill and Care: A Need for Reform' [2003] 24(9) *Company Lawyer* 283.

[80] Larcker, D. and Tayan, B. (n 21).

scandals' and 'other organizational failures'. The authors extend their discussion by outlining scenario, such as the HealthSouth case, that have crippled the development of corporate governance especially in the (United Kingdom) UK and (United States of America) USA. This work, despite its relevance to the study, does not offer sufficient solutions on how to control or limit corporate frauds. This study shall therefore recommend possible ways of limiting or minimizing such scandals.

*Jill Solomon and Aris Solomon*[81] formulate a robust definition of the term 'corporate governance' and go further to discuss various theories and application on corporate governance, particularly agency and stakeholder. The key focus of this book is on Enron as a lead case study in discussing the failures of corporate governance. The authors discuss the rise, fall and aftermath of the Enron scandal and the consequences thereof. Towards the end, they capture the development of international legal framework through reports such as Cadbury (1992), Greenbury (1995), Hampel (1998), Turnbull (1999), Higgs (2003), Smith (2003) and the redraft of the combined code of 2003.

Despite the in-depth discussion of the Enron scandal, the authors do not clearly give recommendations on how to avoid such scandals in future. Additionally, even though the authors give a detailed development of various reports that impacted the development of corporate governance in the UK, they fail to address the question as to why the scandals still recur.

*Mulili* and *Wong*'s work[82] is relevant to this study because it discusses corporate governance from a developed jurisdiction perspective. This works captures the history of corporate governance and equally demonstrate the application of agency and stewardship theories. They

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[81] Solomon, J. and Solomon, A., (n 48).

[82] Mulili, M. B. and Wong, P., 'Corporate Governance Practices in Developing Countries: The Case for Kenya' [2011] 2(1) *International Journal of Business Administration* 14.

further subscribe to the cogent argument that corporate governance has developed rapidly since the 1980s, and therefore urge third world countries such as Kenya to develop theirs. The authors however fail to address new developments that have since been put place. Despite that the authors acknowledge that numerous scandals have shaped the development of corporate governance, they shy away from addressing them.

There have been very few studies on this particular subject matter and especially post the enactment of the Companies Act of 2015 and other relevant legislations. Corporate setbacks have been there for a long time and various jurisdictions, including Kenya, have attempted to enact legislations with an aim of curing that problem. However, despite the recent legislations, we are still experiencing similar setbacks which result to a poor economy. In this vein, this study purpose to fill this knowledge gap by providing necessary solutions and recommendations.

### *1.9.3 Best Corporate Governance Practices and a Robust Legal Framework*

While discussing development of corporate governance codes in the UK, *Keasay, Short and Wright*'s work[83] symbolizes a corporate structure of a developed jurisdiction. The relevance of this work is that Kenya has heavily borrowed from the UK's legal framework and such reports highly informed the current UK law. The authors have however done a narrow discussion on these developments in that their emphasis is entirely based on the Cadbury and Hampel reports alone. This study shall briefly highlight on the other reports not captured here.

*Musikali*,[84] in her work, questions the Kenyan legal framework on corporate governance and proposes that a good corporate governance should be 'associated with a strong legal system'. She

[83] Keasay, K., Short, H. and Wright, M., 'The Development of Corporate Governance Codes in the UK' in Keasay, K., Thompson, S. and Wright, M. (eds), *Corporate Governance: Accountability, Enterprise and International Comparison* (John Wiley & Sons 2005).
[84] Musikali, M. L. (n 25) 213.

argues that despite Kenya's attempt to 'train directors' so as to promote good corporate governance, the same cannot be achieved unless there is a new legislation in place, which equally aims at minimizing scandals. The limitation of this work is that it was authored before the Companies Act, 2015. However, despite the current law, we still experience similar scandals such as Uchumi and the recent shut down of Nakumatt Supermarkets. This study shall therefore be seeking to address that problem.

*Gakeri* observes that 'corporate scandals are reshaping the way that corporations are directed and controlled.'[85] In support of this study, he analyses the local legal framework, especially the principles of corporate governance in Kenya and the failure of the CMA to enforce the guidelines. The author however does not critically analyse the practices of developed jurisdictions in this subject of study.

### 1.10 Limitations of the Study

The dilemmas in the subject of corporate governance are social, economic and legal in nature. However, this study will only endeavor to investigate the legal problem. Additionally, most corporate governance problems are global and therefore there are some universal challenges. Nevertheless, the study will only deal with the problem in relation to Kenya.

This study also limits its argument to corporate failures in private companies only with the exclusion of all others such as the public companies. In addition to the foregoing, and while history has revealed that corporate failures began way back in 1844 and onwards, this study only focuses on the failures that occurred between the years of 1990 to 2020.

[85] Gakeri, K. J., (n 2).

## 1.11 Chapter Breakdown

### 1.11.1 Chapter One: Overview and Structure of the Study

This study is on the law on corporate governance and shareholder protection in Kenya while making a case for corporate scandals within private companies. On the first part, this chapter gives a background of the study, from both the legal and theoretical dimensions. The background of this study reveal that despite the various enactments of legislations and amendments of laws relating to corporate governance, corporate scandals are still evident. Further, it states the problem and justification of the study.

Despite the recent amendments of the laws governing corporate governance in Kenya, similar scandals that were experienced over a decade ago are still in the looming. The chapter also outlines the objectives and the research question that will guide this study. On the theoretical framework, the study adopts the agency, stewardship and contractarian theories of study. Towards the end, it highlights the research methodology to be applied, the relevant literature review, the limitations of the study and the hypotheses that will guide the study.

### 1.11.2 Chapter Two: The Evolution of Corporate Governance: Dilemma of Corporate Scandals from 1990 to-date

Chapter two of this study is devoted to investigate the fruition of corporate governance in Kenya and identify the nature of the corporate governance problem. In bid to achieve a robust outcome, the chapter endeavours to revisit various corporate scandals and debacles experienced in Kenya from 1990 to present. These scandals are evidence that corporate failure in Kenya is increasing despite the legal framework and other amendments thereto.

It has been noted that corporate scandals have been recurring, and more rampantly from 1990 to present. The current legal framework and its subsequent amendment and regulations have all

fallen short of addressing these dilemmas within the corporate sector. Therefore, a critical analysis of the past corporate scandals in Kenya is likely to address this problem since this is not a new phenomenon.

### 1.11.3 Chapter Three: The Legal Framework on Corporate Governance: Toward Controlling Corporate Scandals within Private Companies

This is a legal study and therefore the question of the relevant legal framework is inevitable. As a consequence, this chapter will analyse the current legal framework in relation to corporate governance. This shall be done while addressing the legal problems, if any. This study shall delve into local statutes such as the Constitution of Kenya, 2010, the Companies Act of 2015 (together with its amendments), the Capital Markets Act, the Penal code, among others and subsequent rules and regulations thereto.

The chapter shall also investigate other international legislative frameworks, and especially those of which are in operation of those jurisdictions with a robust structure on corporate governance. The sole objective of this chapter shall be to find out and cure the lacunae in our legal framework so that we have a developed corporate governance system with minimal scandals.

### 1.11.4 Chapter Four: Towards Good Corporate Governance in Kenya: A Case for Shareholder Protection

This research is aimed at providing a solution that will address the numerous corporate scandals that have been experienced in the past within private companies despite having enacted new legislations. A keen reading of this subject will reveal that the concept of corporate governance is mainly an interplay between the shareholders and BoD. Therefore, this chapter advocates for a corporate governance that is aimed at protecting shareholders by minimizing corporate scandals within private companies.

The core argument of this chapter is that the corporations which have embraced good governance have the ability to control scandals and debacles. The nature of such governance is normally exhibited by a robust BoD, who in essence are the agents of the company. The shareholders are the owners of the company. In this vein, good corporate governance by a competent BoD guarantees the shareholder confidence and this translates to economic growth.

#### 1.11.5 Chapter Five: Summary of Findings, Conclusions and Recommendations

This chapter shall give an overview of the study, the conclusion and final findings and recommend the way forward. The chapter is aimed at suggesting possible way(s), if put in place, will reduce the scandals within the corporate sector in Kenya.

# CHAPTER TWO

# THE EVOLUTION OF CORPORATE GOVERNANCE: DILEMMA OF CORPORATE SCANDALS FROM 1990 TO-DATE

## 2.0 Introduction

The purpose of this Chapter is to address the first and second research questions of this study. On the first part, the study will focus on the development of the concept of corporate governance in Kenya, while on the second part, it shall examine some of the notable corporate scandals that have occurred in Kenya from 1990s to present with a keen interest on the role of shareholders in an attempt to minimize corporate scandals within private companies. Previous studies have revealed that 'good governance translates to better results; while weak governance is often the root of numerous performance problem'.[86]

Therefore, good corporate governance is encouraged in every corporation especially in the third world countries, such as Kenya. Such governance not only require professional BoD, but also a proper reporting system, audit and control, among other measures. It is therefore correct to observe that good corporate governance ensures integrity, transparency, accountability and market growth. Corporations with such governance structures stand a better place to attract investors.

The practice and development of corporate governance is not constant; it differs from one jurisdiction to another. Kenya has not exemplified good corporate governance despite the enactment of new laws and legislations. It is arguable that Kenya's dilemmas of corporate

[86] Mathenge, D. M. (n 1). See also Ogutu, E., 'Corporate Failure and the Role of Governance: The Parmalat Scandal' [2016] 11(3) *International Journal of Management and Information Technology*, 2747, who postulates that '…Organizations with strong and effective corporate governance structure and processes demonstrate better performance in all areas than those with weak corporate governance processes.'

governance were realised after 1990s onwards. Thus, it is important to examine this period whereby the scandals and collapses experienced will provide an answer to the present problem that Kenya is experiencing.

While addressing the question on corporate scandals and debacles in Kenya, emphasis will be drawn to three key elements which are as follows; firstly is the 'corporate governance philosophy which underpins the goal for which the corporation is governed', secondly, are the 'rules and regulations within the company, its board, shareholders and stakeholders, and thirdly, is the 'firm's domicile regulatory and market mechanisms'.[87] It is noteworthy to state that of all the three elements mentioned, the question on the role of shareholders in private corporations in minimizing scandals is the most fundamental.

### 2.1 The Concept of Corporate Governance: Definition, Scope and Context

This concept is familiar but yet it lacks a strict definition due to the difference in culture, legal system and historical development of each country.[88] According to the Cadbury's Report, corporate governance refers to the '…terms of the system by which firms are directed and controlled'.[89] If this observation is anything to go by, corporate governance would be defined as a structure through which companies are directed and controlled.[90] It is commonly construed to relate to the management of corporations with key reference to the BoDs, shareholders and

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[87] Wagana, M. D. and Nzulwa, D. J., 'Corporate Governance, Board Gender Diversity and Corporate Performance: A Critical Review of Literature' [2016] 12(7) *European Scientific Journal*, 222.

[88] Mulili, B. M. and Wong, P. (n 82).

[89] Cadbury, A. (n 8). *The Final Report of the Committee on the Financial Aspects of Corporate Governance*, otherwise known as the Cadbury's Report, December 1992. The Report further poses that '…The shareholders' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place…' The CMA Guidelines of 2002 have further defined corporate governance as the 'process and structure used to direct and manage business affairs of the company towards enhancing prosperity and corporate accounting with the ultimate objective of realizing shareholders long-term value while taking into account the interest of other stakeholders…' Available at <https://www.nse.co.ke/regulatory-framework/capital-markets-authority.html?download=475:corporate-governance-guidelines-2002> Accessed on 13th June 2019.

[90] Gakeri, K. J. (n 2).

stakeholders.[91] A further interpretation perceives that it refers to the mode by which an organisation, whether private or public, 'sets high level strategic goals and how it implements them through corporate structures such as boards'.[92] For this to be achieved, such an organisation is required to have the 'most skilled and talented' people, be capable of giving incentives to employees who are of good performance and exhibiting good work, and ensuring accountability for result.[93]

From the foregoing discussion, it is correct for one to assume that the concept of corporate governance is a global concept owing to the proliferation of international business. It has also played a fundamental role in the management of corporations within the developed and developing countries.[94] The concept has historically been linked to the negative firm performance as opposed to positive performance.[95] The prevalence of this concept during the 1980s is widely owed to the massive failures and collapses of corporations globally.

These have therefore necessitated to the formulation of various corporate governance codes with an aim to curb the prevalent scandals. Instead, more collapses continued to be experienced globally while experts on this subject continued to seek a remedy for this dilemma. It was first realized that the best way forward would be to guarantee that managers should run the firms and

[91] Gakeri, K. J. (n 2). The OECD Principles of 2004 further articulate that '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.'
[92] Mathenge, D. M. (n 1).
[93] ibid.
[94] Mulili, B. M. and Wong, P. (n 82) 15.
[95] Kamau, G., Machuki, V. and Aosa, E., 'Corporate Governance and Performance of Financial Institutions in Kenya' [2018] 17(1) *Academy of Strategic Management Journal*.

BoD ensure that those firms are run efficiently.[96] This is to say that the directors and managers were therefore required to possess different skills.

Various approaches were also applied as a way to deter these collapses and failures. Historically, we had two approaches whereby the Civil law countries developed a corporate governance framework that focused more on stakeholders, what is otherwise known as the insider model of corporate control, while those of common law focused on the shareholder's interest, what is otherwise known as the outsider model of corporate control.[97] Despite the distinction between these two approaches, it was unanimously agreed that 'the management boards of firms were to be elected by shareholders to set policies and then delegate to management the authority to manage the firms'.[98]

From this period onwards, different countries adopted different legislations with a need to solve the dilemma of corporate scandals. Kenya is among these countries that have attempted to enact new legislations, the latest being the Companies Act 2015 and the subsequent Companies (Amendments) Act of 2017. This legislation has however been marred with various shortcomings, the greatest of them all being that it 'has drawn heavily on the Companies Act, 2006 of the United Kingdom'.[99] This weakness has been a key hindrance to finding some solutions to our problems that we face as third world countries. It would be important for us to formulate our own unique legislation(s) that mirror our legal, financial, political, economic and cultural system.

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[96] Mulili, B. M. and Wong, P. (n 82) 15.

[97] ibid. On the insider model, the role of corporate governance was to balance the interests of a variety of key groups such as employees, managers, creditors, suppliers, customers and the wider community, while on the outsider model, corporate governance was supposed to ensure that corporations achieved the objectives set by their owners.

[98] ibid 16.

[99] Harney, R. (n 19).

## 2.2 Historical Background and Theoretical Foundation and Development of Corporate Governance

### 2.2.1 The concept of corporate governance in emerging economies: A Kenyan experience

Even though the concept of corporate governance was more popular around 1980s, scholars and academics have argued that it began in the 19th Century when incorporation was introduced as a mode of limiting liability. It was during this period that there was need to enact the Joint Stock Companies Act of 1844 (UK) that aimed at promoting the formation and registration of corporations. This legislation also introduced the separate control of corporations from ownership, whereby 'firms no longer controlled the firm's actions because that was the role of professional managers'.[100] For this to be actualized, there was need to have a proper corporate governance structure, in addition to which, the Limited Liability Act of 1855 (UK) was passed 'to protect the shareholders from debt beyond their investment'.[101]

The subject on the foundations and development of corporate governance is traced from the global corporate scandals. Scholars have suggested that this concept 'gained prominence in the 1980s and 90s due to stock market crashes and general corporate failure across the world'.[102] The US and Europe, for instance, experienced numerous corporate accounting scandals.[103] These failures were commonly cited as the main cause of the 1929 stock market crash in the US, the

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[100] Mulili, B. M. and Wong, P. (n 82) 15. Additionally, in Wells, H., 'The Birth of Corporate Governance' [2010] 33(4) *Seattle University Law Review*, 1251, whereby the author holds an opinion that the concept of corporate governance for the entire period that we have experienced a conflict between investors and mangers. He observes that '…Asserting that corporate governance's origins lie early in the twentieth century, before Berle and Means, raises the question: what do we mean by corporate governance? In one form or another, "corporate governance" has always been with us, at least as long as the corporate form has allowed for conflicts between investors and managers. Early in the seventeenth century, for example, conflicts between directors and shareholders marked the Dutch East India Company'.

[101] The Limited Liability Act of 1855 (UK), being an Act for limiting the liability of members for certain joint stock companies.

[102] Ruparelia, R. and Njuguna, A., (n 51) 154.

[103] Njuguna, L. and Moronge, M., (n 3) 397.

1970s banking crisis in the UK, the 1980s savings and loans crisis in the US, and, the mid-1990s East-Asian economic crises.[104] Additionally, Mathenge observes that:

> Corporate governance is an evolving field which has gained popularity in the last decade after the demise of Enron, WorldCom, Arthur Anderson etc in the United States which have forced academics, legal practitioners, accounting and other professionals, regulatory agencies, government institutions, NGOs and international financial institutions to pay attention to corporate governance reforms…Other countries have had similar corporate scandals, for example HIH Insurance in Australia; Marconi in UK, Parmalat in Italy; Regal Bank, Leisure Net and Krion in South Africa. Consequent upon these publicized corporate scandals and the preceding financial crises experienced in Asia in the late 1990s, there was a global impetus to promote good corporate governance, accountability and ethical business practices in many countries…'[105]

In this vein, it is worth to mention that proper corporate governance framework was not only arrived at due to these scandals but also due to the need to embrace a robust and developed economy. On the basis of this backdrop, there was need to come up with the 'guiding principles in countries and supranational organisations'.[106] Besides many others, we have had the OECD principles (1999 and revised in 2004), the US' Sarbanes – Oxley Act (SOA) (2002) and the South Africa's King's Committee of Corporate Governance. These guidelines argue that 'even though corporate governance is based on individual legal, historical and cultural systems, certain universal principles governance do exist.'[107]

Developing countries began to embrace the reality of good corporate governance because it promotes sustainable economic growth.[108] It is arguable that at around 1970s most African states, including Kenya, were aware that performance in many corporations, especially the State Owned Corporations, had dwindled.[109] This was mainly associated with 'labour rigidities in the market

[104] Ruparelia, R. and Njuguna, A., (n 51) 154.
[105] Mathenge, D. M., (n 1) 43-44.
[106] Otieno, Y. A., 'Corporate Governance Problems facing Kenyan Parastatals: A Case study of the sugar industry' (2009) *Master of Law and Business Thesis submitted at Bucerius/WHU*, 14.
[107] ibid.
[108] Miring'u, A. and Muoria, E., (n 5).
[109] See Kiarie, M., 'The Failure of 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*, 34.

increased fiscal and foreign debt and inflation problems. State corporations provided poor and unreliable services, failed to meet demand and were lagging behind in technology areas like telecommunications'.[110] Therefore, there was need to promote good corporate governance.

Following Kenya's independence up to around 1982, the banking and the entire financial sector in Kenya operated within very stringent terms that were put in place by the government of the day. These control measures by the Government however dwindled over time due to the introduction of the licenses to operate the Non-Bank Financial Institutions (NBFI). On one end, the NBFI eased the operation of such business in Kenya, and on the other, it paved way for promoting poor corporate governance within corporations.[111]

The poor corporate governance structure that was experienced then led to a massive failure of banks within Kenya, beginning with the Rural Urban Credit Finance Company Limited. The Government of Kenya (GoK), having been awakened by this collapse, went forward to amend the Banking Act and the Central Bank Act so as to curb future corporate failures within the financial sector in Kenya. These amendments did not however offer any solution within the corporate sector. More than 33 banks and numerous parastatals collapsed in Kenya.[112] These

[110] Miring'u, A. and Muoria, E., (n 5) 37. The authors argue further that 'The poor performance of SCs in Kenya by 1990 led to outflow from central government to parastatals equivalent to 1 percent of the GDP in 1991. Further, in 1990 – 1992, the direct subsidies to parastatals amounted to Ksh 7.2 billion and as additional indirect subsidies amounted to Ksh. 14.2 billion. By 1994, the subsidies paid to parastatals or organizations were taking 5.5 % of the GDP. The levels of inflation in the country then reflected deficits financed by the Central Bank. Some ways were devised to solve these problems, such as negotiations between SC and government in a bid to clarify the former's objectives and set targets, introduction of competition and better accountability to customers, provision of incentives in form of higher salaries and benefits to employees based on performance and increased training of employees. All these measures were not 100% successful. Failure of the above measures made many governments embark on privatization…'
[111] See remarks by the Centre for Corporate Governance, 2004, 5.
[112] Otieno, Y. A. (n 106).

included the Continental Bank of Kenya and the Continental Credit Finance Ltd (1986),[113] the Capital Finance Ltd (1987)[114] and the Eurobank (2002).[115]

Around 1990s, corporate failures in Kenya were very common especially in state owned corporations until some of them were privatized. This was due to lack of proper corporate governance framework and lack of accountability in both the private and public sector. Some of the problems which bedeviled these corporations included improper allocation of shares of the few public owned companies to senior government officials, the BoD consisted of friends or people of close relation, the NSE was not an independent regulator, among others. These failures were associated with to weak internal controls and bad governance and management practices,[116] as it will be seen later in this Chapter. These problems were so rampant that even the enactment of the Capital Markets Act in 1990 was not sufficient.

This then led to the implementation of the Guidelines on Principles of Corporate Governance for Public Listed Companies in 31st May 2002 by the CMA. These Guidelines were not motivated by any corporate scandal. They adopted the model of 'explain or comply'.[117] In an attempt to explain this, Lekaram postulates that:

> In 2002, the Capital Markets Authority introduced corporate governance guidelines for all public listed companies in the Nairobi Stock Exchange. These guidelines derive their legal basis from the Capital Markets Authority Act under Section 12 which mandates the Capital Markets Authority to formulate rules guidelines and regulations as may be required for the purpose of carrying out its objective to regulate activities in the stock market. These principles were further strengthened by Kenya's adoption of Organization of Economic Co-operation and Development's (OECD) principles of corporate governance. In Kenya, the corporate governance principles in the capital markets are enforced through the "comply or explain" principle. In essence this principle is to the

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[113] See for instance the *Winding Up Cause 29 and 30 of 1986: In the Matter of an Application by the Official Receiver and Liquidator of Continental Credit Finance Limited (In Liquidation) [2012] eKLR.*

[114] See the *Winding Up Cause No. 5 of 1987: In the Matter of Capital Finance Limited.*

[115] See the *Winding Up Cause No. 1175 of 2002: In the Matter of Eurobank*.

[116] Gathaiya, R. N., 'Analysis of issues Affecting Collapsed Banks in Kenya from year 2015 to 2016' [2017] 7(3) *International Journal of Management and Business Studies*, 10.

[117] Gakeri, K. J., (n 2) 97.

> effect that listed companies are required to comply with the rules, regulations and laws laid down by parliament or the CMA, it being the regulatory body. Failure to comply, the company, through its directors must explain the reasons for non-compliance or risk facing serious sanctions. For instance the capital markets authority requires that all listed companies and brokering firms so authorized to act as agents to file annual returns on their financial base. Where a company fails to do so, the company through its directors is required by law to give sound reasons as to the failure to file the returns and in the event it fails to do so then the company or the agent may be suspended from activities at the stock market until it complies with this requirement.[118]

Those in the private sector would later adopt a national code of best practice for corporate governance. Despite the positive economic progress and an enlightened labour force that Kenya has demonstrated from 2002, it still faces major challenges that require to be addressed.[119]

### 2.2.2 The Evolution of Corporate Governance in Kenya and Elsewhere: The need for change

The UK has been in the forefront on matters relating to development of corporate governance. This has been evidenced by numerous reports that have been aiming to improve the practice of corporate governance, such as, the Cadbury Report (1992),[120] the Greenbury Report (1995),[121] the Hampel Report (1998),[122] the Higgs Report (2003)[123] and the Combined Code of Corporate Governance (2003).[124]

Far and beyond these reports, was the brooding omnipresence of the OECD Principles that were first implemented in 1999, and later amended in 2004. These principles sought to provide a framework that governments should adopt to improve the legal, institutional and regulatory framework for corporate governance.[125] These principles were not only limited to governments

[118] Lekaram, V., 'The Relationship of Corporate Governance and Financial Performance of Manufacturing Firms Listed in the Nairobi Securities Exchange' [2014] 3(12) *International Journal of Business and Commerce*, 33.
[119] Muthuri, N. J. and Gilbert, V., 'An Institutional Analysis of Corporate Social Responsibility in Kenya' [2011] *Journal of Business Ethics*, 468.
[120] Cadbury, A., (n 8).
[121] Greenbury, R. (n 9).
[122] Hampel, R. (n 10).
[123] Higgs, D. (n 11).
[124] Combined Code (n 12).
[125] OECD Principles (n 13).

but also to other bodies and agencies such as the stock exchanges, companies and investors. It suffices to note that the OECD Principles are purely voluntary, thus not legally binding, as they only seek to guide institutions as they develop their own corporate governance codes.[126]

The OECD Principles have played a profound role on matters relating to corporate governance internationally, having been adopted by different states, regulatory bodies corporations, investors in OECD and non-OECD countries. They were revised in 2004 to 'cover the foundation of an effective corporate governance framework, shareholder rights, roles of shareholders, and guidelines for ensuring that disclosures are done in an accountable and transparent manner'.[127] According to the WB, poor economic performance in most developing countries such as the Sub-Saharan Africa (SSA) has been prevalent due to poor governance.[128]

Therefore, it is correct to assume that countries with a good governance structure, both at the national level and corporate level, have a good economic growth. That is to mean, corporations with such a structure are well placed to attract investors.[129] From the foregoing discussion, it is arguable that some SSA countries such as Kenya, Nigeria and Ghana, have adopted corporate governance codes similar to those of developed countries.[130] In this vein, Koech, Namusonge and Mugambi opine that:

> The corporate sector in Kenya at a seminar organized by the Private Sector Initiative for Corporate Governance formally adopted in 1999 a national code of best practice for Corporate Governance. In Ghana, The Ghana Institute of Directors (IoD-Ghana), in collaboration with the Commonwealth

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[126] Corporate Governance Codes are documents which state the principles, rules and procedures for making strategic decision and prescribe the frameworks for governing corporations and achieving corporation objectives.

[127] Ruparelia, R. and Njuguna, A., (n 51) 157.

[128] World Bank Report of 1988. See further the World Bank Report of 1989 on SSA on 'Crisis of Governance'. The International Financial Institutions (IFIs) and the International Monetary Fund (IMF) (2002) have also emphasised continuously on the question of Good Governance, especially to the SSAs 'places great emphasis on good governance when providing policy advice, financial support, and technical assistance to its 184 member countries.'

[129] Ruparelia, R. and Njuguna, A., (n 51) 158. See also the OECD Principles of 2004 that company's adherence to good corporate governance practices is thought to be an important factor in investment decisions.

[130] Ruparelia, R. and Njuguna, A. (ibid).

> Association of Corporate Governance, conducted a survey on the state of Corporate Governance in Ghana over the period 1999-2000. Upon the results of the survey that revealed an increasing acceptance of good Corporate Governance practices by business in Ghana, the Manual on Corporate Governance in Ghana was launched in 2001... The Code of Corporate Governance in Nigeria was adopted in 2003 based on the Report of the Committee on Corporate Governance of Public Companies in Nigeria... Whilst The Egyptian Institute of Directors was established in 2004 to create proper awareness among Egyptian corporations and to emphasize the roles and functions of the directors in overseeing corporate activities and attaining corporate goals.[131]

Prior to the privatization of State Owned Corporations in Kenya in 1990s, these corporations were marred with corruption, nepotism, poor accountability, among other vices. This was due to poor or lack of a good corporate governance framework. The efforts by the CMA to improve these challenges in 1990 remained futile until the introduction of the principles of Corporate Governance for public listed companies in 2002. These guidelines were effected through the Gazette Notice No. 3362 and the Capital Markets Act.[132] These guidelines were developed out of a comparative analysis done in the UK, Malaysia, SA, OECD and the Commonwealth Association for Corporate Governance.

The CMA also played a key role to the development of the Code of Best Practice for Corporate Governance in Kenya. These guidelines were developed so as to respond to the economic challenges that Kenya is facing in the corporate sector.[133] Other than the CMA, other institutions

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[131] Koech, P., Namusonge, G. and Mugambi, F., 'Board Characteristics as a Determinant of Effectives of Corporate Governance in State Corporation in Kenya' [2018] 5(4) *International Journal of Business and Commerce*, 39.

[132] Chapter 485A. This legislation aimed at promoting, regulating and facilitating the development of an orderly, fair and efficient Capital Markets in Kenya. Koech, P., Namusonge, G. and Mugambi, F., (ibid) further argues that 'CMA created a major impact in the development of Corporate Governance guidelines in Kenya when it issued the Capital Market Guidelines on Corporate Governance Practice by public listed companies in 2002. These guidelines were published under a gazette notice No. 369 of 25th January 2002… certain guidelines have subsequently been incorporated into legal notice No.60 of 3rd May 2002 as part of the Capital Markets guidelines and are enforceable in law. The stated objective of the CMA guidelines on Corporate Governance is to strengthen and promote the standards of self-regulation and bring the level of governance practices in line with international trends.'

[133] Ruparelia, R. and Njuguna, A., (n 51) 159.

such as the NSE, CCG and CBK have also played a key role in promoting good corporate governance in Kenya.[134]

## 2.3 Corporate Scandals in Kenya: From 1990s to Present

### 2.3.1 A synopsis of corporate scandals

Scandals are 'actions or events involving certain kinds of transgressions which become known to others and are sufficiently serious to elicit a public response'.[135] These scandals have been experienced globally, and especially in the corporate sector. It has been observed that 'the increasing number of corporate failures and financial scandals has been caused by incompetence, fraud and abuse of office by the agents running the corporations'.[136]

Historical references have been made over time, from the developed states to the developing states. For instance in the UK, we have experienced corporation failures and collapses such as the Marconi, Coloroll, the Bank of Credit and Commerce International (BCCI), Maxwell Corporation, Polly Peck and Barrings Bank, among others. In the US, similar scandals and collapses have occurred, the notable ones being Enron, WorldCom, Tyco International and Arthur Andersen.[137] Elsewhere in SSA, SA is a definitive illustration on matters of corporate governance. The country has witnessed corporate failures, scandals and collapses such as the Steinhoff International Holdings N.V., African Bank Investments Limited (ABIL), the Masterbond Group of Companies, the Fidentia Group of Companies and the Leisurenet Corporation.[138]

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[134] Koech, P., Namusonge, G. and Mugambi, F., (n 131).
[135] Hassid, J. and Brass, J., (n 55).
[136] Iraya, C., Mwangi, M. and Muchoki, G., (n 4) 172.
[137] Ongogo, E. B., 'Corporate Scandals: An Analysis of the Legal Framework of Corporate Governance in Kenya' [2013] *Unpublished Master of Laws (LL.M) Thesis*, University of Nairobi.
[138] See generally Mlambo, C., 'The Influence of Corporate Failures and Foreign Law of South African Corporate Governance' *Unpublished Master of Laws Thesis (LL.M)*, University of Pretoria.

Kenya is arguably another key reference on matters of corporate scandals and debacles. Scholars have concluded that most scandals in Kenya have resulted from the poor corporate governance exhibited by the managers and directors. It has for instance been observed that directors put their personal interest before those of the corporation and the shareholders. Ngunjiri further observes that 'Kenya has been fraught with a number of scandals.'[139] This argument has been evidenced by recent scandals, debacles and corporate failures and collapses such as the collapse of the [140]

### 2.3.2 Key corporate scandals: Analysis and lessons learned

When scandals occur in any corporation, everyone expects a change to occur in response to that scandal. This response is often through the implementation on new legislation. However, despite these regulations, scandals continue to happen, to the extent that corporations run out of solution to curb them.[141] The following selected corporate scandals will demonstrate how corporate scandals have been prevalent in Kenya over past years to present, despite having a new and strong legal framework and regulatory institutions.

### 2.3.3 Corporate scandals from 1990s to 1999

#### 2.3.3.1 Kisumu Cotton Mills

KICOMI was unveiled in 1964 having been incorporated by the Khatau group (India) and the Development Finance Company of Kisumu. The incorporation was necessitated by the influence of the Belgium, Portuguese, Germany and Great Britain on matters of cotton within the African continent. KICOMI was aimed at cultivating 'locally grown cotton and process it into textiles

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[139] Ngunjiri, I., 'Corruption and Entrepreneurship in Kenya' [2010] 2(1) *The Journal of Language, Technology and Entrepreneurship in Africa*, 93.

[140] See Iraya, C., Mwangi, M. and Muchoki, G., (n 4) 172.

[141] Abdi, Y. N. and Minja, M. D., 'Influence of Corporate Governance Compliance Programs and Performance of State Corporations in Kenya: The Case of National Social Security Fund (NSSF)' [2018] 3(2) *International Academic Journal of Human Resource and Business Administration*, 363.

that could then be sold on markets locally and even globally', this making it a great economic pillar in the region.[142] It is arguable that KICOMI had a great economic impact in the region such that as at 1970, the number of employees had risen from 300 to 2,000.[143]

KICOMI's challenges began in the early 1980s. Authors and commentators have cited that these problems included 'insufficient amount of water in the factory, frequent power outages, unskilled labor, cheap competitions from fabrics imported from the near East [and] second-hand clothes flooding the Kenyan market' among others.[144] Additionally, the African textile industry became liberalized through the IMF and WB's Structural Adjustment Programs (SAPs), thereby forcing the Khatau group (India) to surrender the running of the company in 1982.

The GoK stepped in to run it as a parastatal from 1983 until it also surrendered in 1993. This was due to the stringent demands by the IMF and WB's SAPs, leading to the privatization of KICOMI. It was put under receivership in 1993 whereby it was privatized until 1999. Its problems continued leading to its collapse. Attempts by the locals and internationals to revive it have remained futile.[145]

From the above study, it is evident that KICOMI was a well doing private company that was a hub for economic growth until its challenges began. Looking at the challenges mentioned above, it is obvious that they originated from poor management of the company. Management is a

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[142] Pavlik, J., Wawira, C. M. and Mwabali, D., 'Kisumu Cotton Mills (KICOMI): The Rise and Fall of an Important Industry in Kenya' [2019] available at <https://macleki.org/stories/kisumu-cotton-mills-kicomi/> accessed on 17th June 2019.

[143] ibid.

[144] ibid.

[145] ibid. See also Odhiambo, M., 'Cotton Factory unlikely to roar back to life soon' [2014] available at < https://www.nation.co.ke/counties/Cotton-factory-unlikely-to-roar-back-to-life-soon/1107872-2436676-iwv6lqz/index.html> accessed on 17th June 2019. The author argues that 'Chances of reviving the collapsed Kisumu Cotton Mills any time soon are slim…Efforts to revive the cotton industry in Kisumu have hit a snag due to wrangles over the ownership of the only ginnery in the region…'

concern for the BoD. The shareholders have a right to vote out an errant BoD and put in place that which can execute its duties diligently. The shareholders therefore have a key role to play in relation to the question of management of private corporations.

### 2.3.4 Corporate scandals from 2000 to 2009

#### 2.3.4.1 Euro Bank Scandal

Euro Bank was established in May 1996 under the stewardship of Dr. Leon Baranski, who was endorsed by the WB. He was later succeeded by Philip Ndegwa and later Nahashon Nyagah. The Euro Bank scandal of 2003 has been cited as one of Kenya's 'disaster in Kenya's history of banking'.[146] This happened under the tenure of Nyagah, as the CBK governor, who is arguably Kenya's shortest serving CBK governor. Nyagah stepped down as CBK governor 'for failing to prevent loss of Sh. 1.4bn, which state organisations had deposited in Euro Bank'.[147]

The lost cash included the pension savings for workers and State-Owned health institutions such as the Kenyatta National Hospital (KNH). Statistics reveal that the parastatals had deposited up to 67% of the total bank deposits. The Euro Bank scandal exhibited high level of fraud and embezzlement. Upon the fall of the Euro Bank, there were no meaningful investigations that followed thereafter. Most charges were dropped following the demise of key names in the scandal, and others directors were set free.[148]

The aftermath of the Euro Bank scandal has revealed that minimal progress has been made in an attempt to recover the lost funds. These are some of the challenges that bedeviled the past regime

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[146] Kamau, J., 'Forget the Eurobond, there once was a Euro Bank too' [2015] available at < https://www.nation.co.ke/oped/opinion/Eurobond-Euro-Bank-/440808-3010944-w5png1z/index.html> accessed on 17th June 2019.

[147] ibid.

[148] *National Hospital Insurance Board of Management vs. Deposit Protection Fund Board (As Liquidator of Euro Bank Limited) (In Liquidation) Euro Bank Limited (In Liquidation) & 3 others [2014] eKLR.*

of the Companies Act. It will be captured in Chapter three of this study that the current Companies Act has made tremendous improvement in requiring that all companies must have a natural face. This is a win for the shareholders and at the same time a caution for scrupulous directors.

### 2.3.5 Corporate scandals from 2010 to 2019

#### 2.3.5.1 Imperial Bank Limited

The banking sector in Kenya has in the recent past undergone a serious economic turmoil. This is due to the corporate failures that were evidenced in the Dubai Bank, Imperial Bank and Chase Bank. These failures led to a huge financial loss thereby resulting to prejudicing the interests of the shareholders, creditors and depositors. According to Gathaiya, these collapses were witnessed as a result of 'insider lending, weak corporate governance practices, weaknesses in regulatory and supervisory systems, poor risk management strategies, lack of internal controls, and conflict of interest.'[149] Kenya's banking sector is arguably the largest and most sophisticated in East Africa. However, there are still major challenges especially in relation to '…financial distress…non-performing loans and weaknesses in corporate governance.'[150] These weaknesses have contributed to corporate failure in Kenya, and especially in the banking sector.

IBLR was established in 1992 and commenced business in 1996 after being licensed by CBK. The impressive growth of this bank saw it reach an asset base of Kshs. 43 billion with a shareholder equity of about Kshs. 5.719 Billion as at December 2013. It is through these statistics that IBLR was ranked '19th largest Kenyan commercial bank, by assets, out of forty-three licensed banks in the country' by CBK.[151]

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[149] Gathaiya, R. N., (n 116) 9.
[150] ibid.
[151] ibid.

In October 2015, IBLR was placed under receivership[152] by Kenya Tea Development Agency Holdings Limited (KTDA).[153] Plans to buy out IBLR by KCB Limited began with the aid of CBK and Kenya Deposit Insurance Corporation (KDIC).[154] The reasons cited for putting IBLR under receivership were 'unsafe and unsound business conditions and practices of transacting business in the bank'.[155]

From this departure, it is arguable that corporate failures and debacles in the banking sector have been caused by 'weak corporate governance practices, poor risk management strategies, lack of internal controls, and weaknesses in regulatory and supervisory systems, insider lending,

[152] See *Kimani Waweru & 4 Others vs. Central Bank of Kenya & 7 Others [2018] eKLR* especially paragraph 17 that 'It was pleaded that on or about 13th October 2015, after the death of the Bank's Chairman and the appointment of a new CBK Governor, the Bank was placed under receivership by a decision made and communicated by the CBK's Governor on 13th October 2015 and contained in the *Kenya Gazette Special Issue Volume CXVII- Number 111 being Gazette Notice number 7715* dated 13th October 2015 and made without any notice to the Petitioners. By the same *Kenya Gazette Special Issue*, the CBK suspended the banking business of the Bank the result of which was that neither of the Petitioners could deposit money, access or demand monies held on their behalf at the Bank nor carry out the business they had been permitted to so carry out with the licensing of the Bank by the CBK since the Gazette Notice informed the public that; *"no deposits on any types of accounts operated by Imperial Bank Limited (in Receivership) shall be paid nor shall any claims by any other creditors be met."* See also CBK, 'Imperial Bank Limited (In Receivership): Receipt of Binding Offer From KCB Bank Kenya Limited' 3rd October 2018, Press Release.

[153] KTDA Press Release of 18th April 2016, available at < https://www.ktdateas.com/index.php/our-press-releases.html> Accessed on 26th June 2019, that '…In October 2015, Imperial Bank Limited was also placed under receivership with our Group deposits of KES 2.93 billion. In spite of this, we were able to successfully process farmers' second payment and meet our other financial obligations.'

[154] Juma, V., 'KCB to complete Imperial Bank buyout in June' [2019] Business Daily. Available at < https://www.businessdailyafrica.com/corporate/companies/KCB-to-complete-Imperial-Bank-buyout-in-June/4003102-5111644-4cqugnz/index.html> Accessed on 26th June 2019, that 'KCB Bank Kenya, a subsidiary, received approval from the Central Bank of Kenya and Kenya Deposit Insurance Corporation (KDIC) to enter into a part transfer of assets and liabilities of Imperial Bank Limited (in receivership) –IBLR'. See also CBK, 'Imperial Bank Limited (In Receivership): Receipt of Binding Offer From KCB Bank Kenya Limited' 3rd October 2018, Press Release, that '…in the High Court Civil Case No. 303 of 2018, on September 26, 2018, CBK, KDIC, and Kenya Tea Development Agency Limited (KTDA) consented in an Order adopted by the High Court to maintain the status quo (i.e., continuation of IBLR's receivership) until the matter is determined by the Court…CBK and KDIC expect that this Order provides sufficient time to conclude the matter of KCB's binding offer.'

[155] Gathaiya, R. N., (n 116) 9.

ineffective laws, poor financial sector oversight, a base sector culture and overbearing political and executive corruption and conflict of interest among others'.[156]

Similar to other corporations, a good corporate governance structure in banks contribute to their growth while those with a weak structure result to their failure. A bank should therefore be capable of identifying, monitoring and controlling its risks. To this end, the CBK, apart from being the regulator, should also be able to adequately advise the banks in case of any looming problem in the sector.

From the ongoing concern, it will be difficult for CBK to expunge its interests or contribution towards the collapse of IBLR. On one hand, the shareholders at IBLR blame the CBK officials of the conspiracy to defraud them while on the other, the CBK blames the said shareholders of the failure to inject cash into the bank. Following this, the Directors moved to Court and filed a suit against the said officials of CBK thereby linking the former to the collapse of the bank. It was argued that fraud that led to the collapse of the bank was a collusion between some CBK officials and the senior management of the bank. The case has been quiet without any notable convictions.

Assuming the foregoing scenario is anything to go by, it would therefore be unfair for the regulator to involve itself in such matters which are clearly a conflict of interest at the detriment of the shareholders. Regulators ought to act in a manner that promote the shareholder interests and protection as opposed to their self-interests. CBK, having been simultaneously cited in this case for conflict of interest, could not therefore purport to execute its duties properly as a regulator.

[156] ibid, 14.

#### 2.3.5.2 Nakumatt Holdings Limited

NHL was at its zenith up to around 2016 when the company 'started experiencing serious cash-flow difficulties' making it 'unable to meet its financial obligations to Landlords, Suppliers, and the employees'.[157] This meant that the company could no longer pay its suppliers, remunerate employees or even pay rent, as and when it was due. Due to these problems, among others, a petition was filed by some of its creditors to liquidate it.[158]

Other factors that led to the collapse of NHL include gross mismanagement, poor strategic decisions, tax issues and massive internal losses arising out of rogue employees.[159] It was reported that the company's debt rose from Kshs. 4.2 Billion in 2011 to about Kshs. 18 Billion in 2017. This led to a closure plan of several non-performing outlets so as to ease pressure and control the growing debt. The closure of NHL had a great impact on the economy of Kenya, whereby more than 3,000 employees lost their employment.[160]

NHL was a victim of litigation on matters relating to tax. Its fall would also be associated with internal weaknesses and poor strategic decisions, among other reasons. It is therefore correct to conclude that the fall of NHL was due to a poor corporate governance structure that as a consequence, gave room to its turmoil.[161]

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[157] *Primrose Management Limited & 3 Others vs. Nakumatt Holdings Limited & another [2018] eKLR.*

[158] ibid.

[159] Some, K., 'Reasons behind slow death of Supermarket chain Nakumatt' (2017) Available at < https://www.nation.co.ke/news/Why-Nakumatt-is-on-its-knees-/1056-3986128-157dhxe/index.html> Accessed on 26th June 2019.

[160] See Mulunda, L., 'The Trouble with Nakumatt' (2017) Business Today < https://businesstoday.co.ke/the-trouble-with-nakumatt/> Accessed on 26th June 2019.

[161] Muchiri, N., 'Internal Weaknesses, debts expose Nakumatt underbelly' (2017) The East African Newspaper. Available at <https://www.theeastafrican.co.ke/business/Debts-expose-Nakumatt/2560-4131440-w3jbh3z/index.html> Accessed on 26th June 2019.

The cries that led to the fall of NHL revolved around its inability to meet its credit. However, of utmost importance was the auditor's concern over the details given by the directors to facilitate the auditing exercise. The auditors argued that the annual and financial statements for the company proved multiple inconsistencies despite the directors maintaining that they were the true reports. Auditors are or ought to be independent professionals in a company who should be acting in favour of the shareholders. The directors should therefore be transparent while disseminating information to them.

### 2.4 Corporate Governance in Emerging Economies: Toward Robust Practices

Corporate governance is the yardstick by which a corporation's stability is measured.[162] Therefore, countries with a strong corporate governance system often demonstrate good results as opposed to those with a weak system. A plethora of reasons can be attributed to this assumption, for instance, the nature of the legal system, the extent of political stability, the level of ethical practices, corruption, procedure of appointment, weak institutions,[163] among others.

Good corporate governance varies from one jurisdiction to another[164] and numerous researchers have concurred that good corporate governance leads to high organizational performance.[165] However, various legislations, report and codes on this subject have been essential in underpinning what these practices ought to be. Some of these instruments are the Australian Stock Exchange Corporate Governance Council (2003),[166] Cadbury Report (1992),[167] Sarbanes-Oxley Act (2002)[168] and the OECD Principles (1999), revised (2004).[169]

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[162] Ogutu, E., (n 86) 2752.

[163] Ireri, E. N., 'Assessment of Problems Facing State Owned Enterprises in Kenya' [2016] 6(4) *International Journal of Business, Humanities and Technology*, 45.

[164] Mulili, B. M. and Wong, P., (n 82) 17.

[165] Kamau, G., Machuki, V. and Aosa, E., (n 95).

[166] The Australian Stock Exchange Corporate Governance Council (2003) lists ten principles of good corporate governance: Lay solid foundations for management oversight; Structure a board to add value; Promote ethical and

A review of these instruments has revealed that there are six primary principles of good governance that are agreed globally. These are a fair distribution of the roles and responsibilities of the directors; a proper division of the responsibilities of the chair of the board and the CEO; the ability to provide timely, accurate and complete information to the board; a formal, transparent, and competitive appointment of directors and accountability to shareholders; a proper financial reporting system; and an effective internal control system.[170]

It is therefore correct to assume that these principles revolve around the control of directors, CEOs, shareholders, audit and accountability, and general practices. The question of establishing a board is fundamental. Issues that need to be put into consideration include director's remuneration, supply and disclosure of information, board balance, fair appointments to the board and re-election, and resignation of directors.

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responsible decision-making; Safeguard integrity in financial reporting; Make timely and balanced disclosure; Respect the rights of shareholders; Recognise and manage risks; Encourage enhanced performance; Remunerate fairly and responsibly; and, Recognise the legitimate interests of stakeholders.

[167] The Cadbury Report (1992) outlines four key aspects, that is: Establishing a board of directors that has clear responsibilities and whose role of directing or governing is different from that of the firm's managers; Establishing checks and balances in governance structures with no one person having unfettered power; Having a well-balanced board team composed of executive and non-executive directors; and, Ensuring transparency of a board in directing and controlling an organisation.

[168] The Sarbanes-Oxley Act (2002) (passed by the US Congress as a response to the collapse of Enron and WorldCom) fundamentally provides as follows: The need for an independent audit committee (section 301): A firm's principal executive and financial officers signing a statement that they have sufficient internal controls in place to ensure that financial statements do not contain any material misstatements (section 302); and, Independence of external auditors (sections 201-209).

[169] The OECD Principles (1999, revised 2004) provides five key principles of Corporate Governance as follows: Protection of shareholders' rights; Equitable treatment of all shareholders, including effective redress; Recognition of the rights of stakeholders; Timely and accurate disclosure of all matters that are regarded by a firm as being material. These may include financial, performance, ownership and governance matters; and, Effective monitoring of management and accountability of a board.

[170] Ogutu, E., (n 86) 2748.

## 2.5 Conclusion

This Chapter focused on the evolution of corporate governance in Kenya while addressing key scandals and corporate failures that have occurred in Kenya between 1990s to present. It further crystallizes on the historical development of the concept of corporate governance. The study observed that this concept was more popular around 1980s but it began in the 19th Century. In Kenya, it began around 1990s and reached its zenith in 2002, owing to the implementation of the CMA guidelines.

It was observed that this concept, despite being a current global concern, began at different times depending on each jurisdiction. An observation was also made this concept has grown in the recent past due to the major corporate scandals and debacles that have been witnessed globally. These scandals have seen it necessary to implement new legislations.[171] The implementation of these legislations and regulations have not been sufficient to address these shortcomings.

Developed jurisdictions such as the UK, the US, Malaysia and SA have a robust system of corporate governance. Developing countries such as Kenya have equally attempted to mirror these practices. A recent example is the Companies Act of 2015 which almost an entire replica of the UK's Act of 2006 and other international instruments such as the OECD principles. It is therefore correct to conclude that countries with a stronger legal system, if well implemented, have been exemplary in handling corporate scandals and debacles.

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[171] Lekaram, V., (n 118) 31, whereby the author observes that 'Corporate failures and regulatory initiatives have placed corporate governance systems under closer scrutiny than ever for instance, CMC Motors and NHIF, in Kenya Management and policies of companies during the recent financial crisis were put into the radar of the analysts. JP Morgan, Bear Steers (both mortgage lenders), Fannie Mae and Freddie Mac (investment banks), and American Insurance Group (AIG) served to prove that corporate governance was by and large the cause of the crisis; some decisions were not made right when it mattered the most…In Kenya the Capital Markets Authority as well as regulatory authorities like The Central Bank of Kenya and the Insurance Regulatory Authority enhanced their corporate governance policies to avert such a crisis in Kenya.'

Kenya, like many other states, has experienced numerous corporate collapses that cannot all be discussed in this Chapter. However, notable examples have been highlighted so as to shed light on what transpired and the lessons learnt. It was concluded that these scandals have always occurred despite the change in the legal regime. In fact, most scandals have occurred and more are likely to occur post the Companies Act of 2015.

For instance, corporations such as Webuye's Pan Paper Mills (2009), Karuturi (2014), Kinangop Wind Park Limited (KWP) (2016), Spencon (2017), ARM (2018), Deacons East Africa (2019), and Midland Energy have been placed under management in the years indicated. This Chapter therefore concludes that corporate scandals are not mainly promoted by poor legal framework but by other factors, such as unethical behaviour.

Finally, it is concluded that corporate governance plays a vital role in the failure and/ or collapse of corporations in Kenya. In this vein, a robust and advanced corporate governance structure guarantees prosperity of a corporation. It is worth to note that factors that lead to arriving at a robust system of corporate governance differs from one corporation to another. Apart from having a commendable legal framework, the government, regulators and professionals have a key role to play towards promoting good corporate governance. Therefore through education and training, corporations are 'encouraged to embrace good corporate governance strategies'.[172]

The next chapter will address the legal framework on corporate governance in Kenya. From the onset, this study postulated that Kenya has made tremendous attempts to review and amend its legal framework. This has been done with hope that the laws would deter corporate scandals from occurring more often. However, the country continues to experience more scandals and

[172] Kemei, F. K. and Mwaberi, E., 'Effect of Corporate Governance Practices on Financial Management in Non-Governmental Organisation, Kenya' [2017] V(4) *International Journal of Economics, Commerce and Management, UK,* 613.

debacles despite the amendments. Chapter three seeks to analyse these laws with an aim of making a proper conclusion as to whether the current legal framework on corporate governance is sufficient in controlling and deterring corporate scandals and debacles in Kenya.

# CHAPTER THREE

# THE LEGAL FRAMEWORK ON CORPORATE GOVERNANCE: TOWARD CONROLLING CORPORATE SCANDALS IN PRIVATE COMPANIES

## 3.0 Introduction

This Chapter seeks to address the third and fourth research questions of this study. A key observation was made in the previous Chapter that Kenya has made tremendous attempts to improve its legal framework on corporate governance. It is therefore from this departure that we question the adequacy or otherwise of this legal framework. Towards the end of this Chapter, a conclusion will be made as to whether or not, the law relating to corporate governance in Kenya is sufficient to deter corporate scandals and debacles in Kenya.

The legal system of a country is a fundamental concept in determining the governance system. This means that countries with a robust legal system are expected to exhibit a good governance structure. Developing countries such as Kenya have not exhibited an exemplary structure of governance, although Kenya must be applauded for attempting to emulate corporate governance practices of developed countries such as the UK and South Africa (SA). The country's efforts to attain a good corporate governance structure are evident following a series of the legal and regulatory frameworks that have been implemented so far.

The major predicament is that despite all these legislations, the country has increasingly continued to succumb to corporate scandals and debacles. Kenya implemented its Companies Act in 2015 (together with the Amendment Act and the Regulations of 2017) with an aim of responding to various challenges that the country was facing on matters of corporate governance. Despite this legislation, a considerable number of corporations have collapsed without any substantial remedies to the affected companies. Corporations such as the Imperial Bank Limited,

Nakumatt Holdings Limited, Karuturi, KWP, Spencon, ARM and Deacons East Africa, among others, have faced corporate governance challenges post the Companies Act, 2015 and the Amendment Act of 2017.

It is against this backdrop that we shall examine the relevant legal framework on corporate governance with an objective of making a conclusion as to whether or not, the legal framework is sufficient to deter or control these scandals. This Chapter proceeds with an assumption that despite these tremendous implementations in Kenya's legal framework, good corporate governance has not yet been attained.

### 3.1 The Legal Framework on Corporate Governance

The legal framework on corporate governance plays a very significant role towards providing for the necessary safeguards in the Kenyan economy. As already observed above, a country with a proper legal framework on corporate governance is expected to thrive economically. An argument has been postulated that Kenya's legal framework has been a key hindrance, among other reasons, towards attaining a good corporate governance system. Accordingly, Pettet argues that 'corporate governance is about alignment; that is, it is about the system of legal or other mechanisms which ensure that the interests of the managers of the company are aligned with those of the shareholders.'[173]

According to Githui, the concept of corporate governance in Kenya has not only been hindered by the socio-political, economic and cultural factors but also by corruption and weak and inefficient legal framework.[174] Gachoki and Rotich additionally argue that a considerable number of these scandals are 'attributed to weak corporate governance practices, lack of internal

[173] Pettet, B., (n 45) 157.
[174] Mathenge, D. M., (n 1) 44.

controls, and weaknesses in regulatory and supervisory systems as well as conflict of interest'.[175] From these sentiments, it is evident that there is need to review our legal framework on corporate governance, as a starting point, towards attaining the best corporate governance practices.

There is a broad legal framework on corporate governance in Kenya. Previously, the country has relied mainly on the UK's Companies Act of 1948[176] and the repealed Companies Act.[177] It has also embraced corporate lessons learnt from the commonwealth arena such as the Cadbury Report (1992),[178] the Greenbury Report (1995),[179] the Hampel Report (1998),[180] Higgs Report (2003),[181] the Combined Code of Corporate Governance (2003),[182] the OECD Principles of 1999[183] (revised in 2004),[184] the South African Kings Report on Corporate Governance[185] and the UK's Companies Act of 2006,[186] among others.

Pursuant to the foregoing legislations, Kenya has gone a step further to codify some of the international practices on corporate governance in the local legislation. This study will focus on a number of those legislations which include the following; the Constitution of Kenya,[187] the Companies Act,[188] the Companies (Amendments) Act,[189] the Capital Markets Act,[190] the Code of

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[175] Gachoki, S. and Rotich, G. (n 3).
[176] Companies Act of 1948 (UK).
[177] Companies Act (n 16).
[178] Cadbury, A. (n 8).
[179] Greenbury, R. (n 9).
[180] Hampel, R. (n 10).
[181] Higgs, D. (n 11).
[182] Combined Code (n 12).
[183] OECD Principles (1999) (n 13).
[184] OECD Principles (2004) (n 14).
[185] Institute of Directors in Southern Africa (IoDSA), *King IV: Report on Corporate Governance for South Africa* (The King Committee on Corporate Governance in South Africa 2016).
[186] Companies Act (UK) (n 17)
[187] Constitution of Kenya, 2010.
[188] Companies Act (n 23).
[189] Companies (Amendments) Act of 2017.
[190] Capital Markets Act, Chapter 485A of the Laws of Kenya.

Corporate Governance Practices for Issuers of Securities to the Public of 2015,[191] the Nairobi Securities Exchange (Market Participant) Rules[192] and the Penal Code.[193]

### 3.2 The Constitution of Kenya, 2010

The Constitution of Kenya, 2010, declares its supremacy under Article 2 thereof. It is observed that the '… Constitution is the supreme law of the Republic and binds all the persons and all State organs at both levels of government.'[194] A key connotation from this Article of the Constitution is that all persons are bound by the Constitution. Corporations are artificial persons because they are creatures of the law and as a consequence they are bound by the Constitution. In addition to this, the Constitution is the supreme law to the extent that all laws must conform to the Constitution.[195] The Constitution of Kenya is profound on matters of corporate governance. The concept of rule of law is paramount in matters of corporate governance. Further, there are other various constitutional underpinnings in relation to the key pillars on corporate governance.

The BoD, while acting as a fiduciary, should have clear roles and functions. These function include directing the corporation, oversight and accountability. This is complemented by *article 232(1) (e)* of the Constitution of Kenya.[196] Good corporate governance further requires that a BoD should be independent, and this includes, division of responsibility between the Chairman and the CEO, among others. The relevant provisions here are *articles 232(1) (a)*, *232 (1) (i)* and *27*.[197] In relation to the board systems and procedures, leadership and strategic management, the

[191] Code of Corporate Governance Practices for Issuers of Securities to the Public of 2015.
[192] Nairobi Securities Exchange (Market Participant) Rules, 2014.
[193] Penal Code (n 18).
[194] Constitution of Kenya (n 187), Article 2(1).
[195] ibid, Article 4.
[196] ibid, Article 232(1) (e) on accountability for administrative acts.
[197] ibid, Article 232 (1) (a) (*high standards of professional ethics), Article 232 (1) (i)* (*adequate and equal opportunities for appointment, training and advancement) and Article 27* (*freedom from discrimination).*

relevant constitutional underpinning is *article 232 (1) (a)* which provides for high standards of professional ethics.

Another key element is transparency and disclosure, beginning from board evaluation, search and appointment of new board to whistle blowing. The applicable constitutional provisions are *article 232 (1) (f)* on transparency and provision to the public of timely and accurate information and *article 232 (1) (g)* on fair competition and merit as the basis of appointment and promotions. Additionally, there is the requirement on adherence to the laws and regulations and compliance. This is provided for in *article 232 (1) (a)* (high standards of professional ethics) and article 41 (right to fair labour practices/reasonable working conditions) of the Constitution. This should be reflected in both public and private companies.

The question on diligence also arises as an important pillar of corporate governance and this is captured under *article 232 (1) (c)* (responsive, prompt, effective, impartial, and equitable provision of services) of the constitution. On the issue of human resource and its tenets, the Constitution is profound in *article 27* (freedom from discrimination), *article 54* (persons with disabilities), *article 56* (rights of minorities and marginalized groups) and *article 57* (rights of older persons). Quality of financial reporting and efficiency in the financial operation is another core pillar. This is dealt with under *article 232 (1) (b)* of the Constitution, on efficient, effective, and economic use of resources.

Additionally, is the issue on Communication and Public Education under *articles 232 (1) (f)* and *232 (1) (d)* of the Constitution on transparency and provision to the public of timely and accurate information and involvement of the people in the process of policy making respectively. Lastly is on the question of social responsibility, and this is particularly in relation to respect for human rights and the environment. The relevant provisions are *articles 20* (bill of rights applies to all

persons (including corporations)), *article 42* (right to a clean environment), *article 43* (economic and social rights) and *article 46* on consumer rights.

The above constitutional underpinnings tend to revolve around public companies. However, reference needs to be drawn to Article 2 which points out that this Constitution is the Supreme law of the Republic and it binds all persons. A company, be it public or private, it is a person. As such, these provisions directly and simultaneously apply to the private corporations as contemplated in this study.

### 3.3 The Companies Act No. 17 of 2015

The Companies Act was amended in 2015 with an aim of simplifying and at the same time improving the concept of formation and management of companies in Kenya.[198] Borrowing heavily from the UK's Companies Act, the 2015 Act has attempted to embrace a number of the core principle of corporate governance. This Act is the most voluminous piece of legislation in the history of Kenya's legal framework which endeavours to address various gaps that were evident in the repealed regime.

There are various notable sections in the 2015 Act that are aimed towards promoting good corporate governance in Kenya. In *sections 9* and *10*, the 2015 Act draws a line between private and public companies.[199] The 2015 Act also provides a section that deals with the question of appointment and removal of directors. *Sections 128* and *129* of the 2015 Act provides that a

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[198] Ager, P. and Muchiri, G., 'The Companies Act, 2015' [2018] available at <https://www.oraro.co.ke/2018/09/12/the-companies-act-2015/> accessed on 8th August 2019.

[199] For purposes of Sections 9 and 10 of the Companies Act of 2015, the former defines a private company as such if its articles restrict member's right to transfer shares, limit the number of members to fifty, prohibit invitations to the public to subscribe for shares or debentures of the company; it is not a company limited by guarantee, and, if its certificate of incorporation state that it is a private company; while the latter defines a public company within the context that, if its articles allow its members the right to transfer their shares in the company, its articles do not prohibit invitations to the public to subscribe for shares or debentures of the company, and, its certificate of incorporation states that it is a public company.

private company can now have one director in so far as that director is a natural person. This section is important because a now a company must have a natural face.

This means that in the event of any scandal, at least someone will be accountable, and if found culpable, penal sanctions will be issued upon them. In further terms, this is a win for the shareholders and a caution to scrupulous directors. In addition to this, *section 131* provides that a director must have a minimum age of eighteen years. Further in *section 133*, the 2015 Act postulates that the actions of a director are valid even if it is later discovered that his/her appointment was defective, s/he was disqualified from holding office or had ceased from holding office, or, s/he was not entitled to vote on the relevant matter.

Another key observation postulated by the 2015 Act, and perhaps among the greatest improvement from the 1984 Act, is the codification of the director's duties, and that is between *sections 142* to *147*. These duties are common law in nature and they pose as safeguards to control the abuse of power by the directors in a company.[200] This means that 'these duties are based on certain common law rules and equitable principles and are to be interpreted and applied in the same way as common law rules or equitable principles.'[201] On the basis of these rules, the directors can now be held personally liable in the event of any breach, they can also be disqualified to act as such in case they are found culpable of an offence, or if they are found to be unfit to act as such. *Section 140(2)* presents another interesting feature in that even once a person

[200] The Companies Act (n 23), section 140(1) for instance provides that the general duties that are specified in this division are owed by a director of the company to the company. Further, section 148(1) states that the consequences of breach of these duties of the directors are the same as would apply if the corresponding common law rule or equitable principle applied. Section 140(3) and (4) also affirms that the general duties of directors are based on common law rules and equitable principles that apply in relation to directors and have effect in place of those rules and principles with respect to the duties owed to a company by directors. The general duties of directors are to be interpreted and applied in the same way as common law rules or equitable principles, and those interpreting and applying those rules and principles are required to have regard to the corresponding common law rules and equitable principles.

[201] Hicks, A. and Goo, H. S., *Cases and Materials on Company Law* (6th edn, OUP 2008) 379.

has ceased to be a director in a company, s/he continues to observe the duties in *sections 146* and *147*, that is, to avoid conflict of interest and not to accept benefits from third parties.

The current regime does not make it mandatory for private companies to hold an Annual General Meeting (AGM) unless the articles of association provide so. The private companies can also hold meetings on short notice if the shareholders consent. The 2015 Act further provide for take overs, mergers and amalgamations. Additionally, companies can now buy back their own shares. Foreign companies are governed by regulations published by the Cabinet Secretary (CS). The 2015 Act, in bid to promote good corporate governance practices, makes it compulsory for public companies and some private companies to have a company secretary.[202] The Act also recognizes the role of auditors in a company.[203] The Act also protects the shareholders' rights by availing them an opportunity to participate in decisions making. These provisions are aimed at promoting good corporate governance practices.

As stated above, the 2015 Act provides for various duties of directors in a company. These duties are owed to the company.[204] *Section 142* of the Act upholds the principle of rule of law whereby directors are required to act within their powers. Also in *section 143* of the Act, the directors are mandated to act in manner that is aimed at promoting the success of the company. In addition to these, the directors, through *section 144* of the Act, are required to exercise independent judgment. Accordingly, *section 145* contemplates that directors should exercise reasonable care,

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[202] The Companies Act (n 23), section 243 & 244.

[203] ibid, sections 727 to 738, on 'Functions of Auditors'.

[204] Davies, L. P. and Worthington, S., *Gower: Principles of Modern Company Law* (10th edn, Sweet & Maxwell Publishers 2016) 465.This position was further illuminated by Mummery LJ in *Peskin vs. Anderson* [2000] All ER (D) 2278 whereby it was held that '…The fiduciary duties owed to the company arise from the legal relationship between the directors and the company directed and controlled by them. The fiduciary duties owed to the shareholders do not arise from that relationship. They are dependent on establishing a special factual relationship between the directors and the shareholders in the particular case. Events may take place which bring the directors of the company into direct and close contact with the shareholders in a manner capable of generating fiduciary obligations, such as a duty of disclosure of material facts to the shareholders…'

skill and diligence. Other duties of directors that are aimed at promoting transparency are in *section 146* and *147* whereby directors should avoid conflict of interest and that they should not accept benefits from third parties.

To this end, the 2015 Act has attempted to put in some safeguards towards protecting the shareholders' interests and promoting good corporate governance practices. For instance, companies now have a duty to file with the Registrar of Companies the annual financial report for every financial year.[205] Additionally, all the documents filed at the said Registry are public documents, in that, any person can access them. This is aimed at promoting accountability in companies. Despite the fact that this Act made attempts to solve numerous lacunas that were evident in the 1984 regime, it has not been sufficient to address all the corporate governance problems. These gaps will be address at later chapter. These problems have however necessitated for the amendment of the 2015 Act that resulted to the Companies (Amendment) Act of 2017 and the Companies (General) Amendment Regulations of 2017, about two years after its enactment.

### 3.3.1 The Companies (Amendment) Act of 2017

These amendments were brought into force vide a Gazette Supplement No. 121 of 2017. They were aiming at promoting proper corporate governance practices. These amendments perhaps pose an evidence that Kenya is moving towards embracing international standards on corporate governance. For instance, the Amendment Act of 2017 amplifies the question of disclosure in relation to directors. This is a robust move towards protection of minority shareholders in a company.

[205] See the Companies Act (n 23), section 635.

Another key amendment is in relation to *section 146* of the 2015 Act which requires that directors must avoid conflict of interest. *Section 12* of the Amendment Act of 2017 amends this section by providing that directors will be held liable if they, by themselves or through their families, have an interest in the company's transaction. It also prohibits directors from receiving any form of gifts or benefits due to their position as directors. In amending this, it imposes a fine or conviction as a penalty for non-compliance. It is noteworthy that in the 2015 Act, receiving of such gifts was not an offence so long as they did not result to conflict of interest.[206]

For these amendments to be effected, the directors are required to disclose their extended families. These include in-laws, brothers, sisters, spouses, e.t.c.[207] They must also disclose the nature of directorship they hold. *Section 14* of the Amendment Act of 2017 amends *section 151* of the 2015 Act. It inserts a time frame that is required for disclosure. The Act now contemplates that disclosure of interest in public companies must be done within seventy two hours. The Companies (General) Amendment Regulations, 2017, were brought into force by virtue of *section 1022* of the Companies Act of 2015. They do not deal much with the substance of the matters of corporate governance and therefore they will not be discussed in this forum.

### 3.3.2 The Companies Act of 2015 and the Companies (Amendment) Act of 2017: strengths and weaknesses

The 2015 Act came at a time when the issues on corporate governance were at their zenith. It also aims to encourage both the local and international investors to register and transact

[206] See ibid, section 147(3) and the Companies Amendment Act (n 189), section 13.

[207] The Companies Act, ibid, section 123, family members of a director are specified as the director's spouse, a child or step-child of the director, a child or step-child of the director's spouse who lives with the director and has not reached eighteen years of age or a parent of the director.

businesses in Kenya smoothly.[208] The shareholders are arguably the greatest beneficiaries of this regulation. For instance the 2015 Act makes it possible to form a limited company to the extent of having a single shareholder. It also facilitates a fast decision making by admitting written resolutions of members through electronic communication.

With this regime, a proprietor of a company is not required to draft a memorandum of association of the company. The current position is that one will only need to state the imposed restrictions. This legislation has been successful in providing the grounds and procedure of instituting legal proceedings against a director(s) and former director(s) or company officer(s) in relation to their duty of care while discharging their duties.

Another strength of this legislation is that it introduces the use of electronic communication in issuing notices, prospectus and passing of resolution. It further gives a guideline on when a company may buy back its shares. The 2015 Act also makes it compulsory for a foreign company to have a 30% of their shareholding to be Kenyan citizens by birth. The Act also seeks to disclose the faces behind a company, marking the end of error of faceless companies in Kenya. In this vein, the level of accountability will be evident.[209]

The amendment of *section 344* of the 2015 Act is also in favour of the shareholders of a company. The Amendment Act of 2017 amends this section to allow a private company through its articles of association, to offer shares to its existing shareholders before allotting them to other persons. The 2017 Amendment Act, in amending *section 155* of the 2015 Act, seeks to provide

[208] Kinyanjui, H., 'Key Highlights on the Amendments to the Companies Act, 2015' Robson Harris Advocates [2017]. Available at <http://robsonharrisadvocates.com/key-highlights-on-the-amendments-to-the-companies-act-2015/> Accessed on 5th August 2019.

[209] Maema, I. W., 'New Law Sounds Death Knell for Faceless Company Owners' [2017] IKM Advocates. Available at <http://www.ikm.co.ke/news/articles/2017/NEW-LAW-SOUNDS-DEATH-KNELL-FOR-FACELESS-COMPANY-.html> accessed on 5th August 2019.

for disclosure of information on directorship held by a director in another company. In reality this is an attempt to make the company aware of any potential conflict of interest.

The 2015 Act and the 2017 Amendment Act have fallen short of addressing some other grey arears within the context of corporate governance. For example, in as much as the two legislations enforce the question of directors disclosing any existing conflict of interest to the extent of his/her relatives within seventy two hours, they fail to embrace the reality of that provision. The practical implementation is difficult since the director of a company may not be reasonably aware that one of his relatives is involved in the contemplated transaction.[210]

The 2015 Act also makes an observation in relation to the director's duty of conflict of interest. It requires that if there is such conflict, the director ought to disclose it within seventy two hours. This move was adopted to minimize conflict of interest with an aim of protecting the shareholders' rights in a company and also to draw a distinction between a company as a Separate Legal Person (SLP) and a director as a person. Directors are required to have an ethical approach and judgment towards making choices which are or ought to be in the best interests of the company. This should be put in consideration from the onset of every decision to be made, thus justifying the 72 hour period of disclosure.

It however falls short of compelling the director to account for any proceeds made out of an existing conflict that was knowingly not disclosed, leaving room for scrupulous directors who would make secret profits. *Sections 635, 636, 638* and *115* of the 2015 Act relate to the issue of Financial Reporting Standards. *Sections 635* and *636* provide that directors are under a duty to prepare the company's financial statements, devoid of which they are liable for an offence, and,

[210] ibid.

that they may further approve financial statements if they give a true account of the company's accounts, respectively.

In addition to this, *section 638* provides for the contents of a financial statement while *section 115* provide that the financial statement for each financial year are required to be lodged with the Registrar. The 2015 Act falls short of appreciating the role of financial accounting in corporate governance. In essence, financial reporting requires summarizing and recording of transactions of financial records, preparation of financial statements and auditing of the reports. If an organisation has poor financial reporting standards then it becomes a recipe for corporate scandals.

### 3.4 The Capital Markets Act, Chapter 485A of the Laws of Kenya, (and Regulations, Rules and Guidelines)

The CMA is an autonomous body established by virtue of *section 5* of the Capital Markets Act Cap. 485A, Laws of Kenya[211] under the Ministry of Finance. The key responsibility includes 'supervising, licensing and monitoring the activities of market intermediaries' thereby being a core player in the economy.[212] This agency consists of a board that is expected to mirror the tenets of good corporate governance for purposes of offering direction and leadership. In addition to this, there is a legislative framework that is aimed at promoting, supervising and regulating the market intermediaries.[213]

[211] The Capital Markets Act (n 190), section 5 provides for the establishment and membership of the CMA. Section 5 (1) particularly notes that '…There is hereby established an authority to be known as the Capital Markets Authority…'
[212] The Capital Markets Authority, 'Who We Are' available at <https://www.cma.or.ke/index.php?option=com_content&view=article&id=9&Itemid=146> accessed on 5th August 2019.
[213] ibid.

*Section 11* of the Act provides for the objectives of the CMA, among them being to protect the interests of the investors.[214] *Section 18* of the Capital Markets Act establishes the Investor Compensation Fund that is aimed at granting compensation to the investors who suffer pecuniary loss. Another central feature of the CMA is to implement policies and guidelines for the purposes of promoting the capital markets.[215] This is also in line with *section 12* of the Act whereby the Minister has power to issue rules and regulations. In this vein, the CMA implemented the Code of Corporate Governance Practices for Issuers of Securities to the Public (2015) being an update of the Code of Corporate Governance Practices for Public Listed Companies (2002).[216]

### 3.4.1 Code of Corporate Governance Practices for Issuers of Securities to the Public (2015)

The 2015 Code is applicable to both the listed and unlisted public companies due to the increased concern over emerging issues of corporate governance and the steps that various countries have undertaken in regulating governance issues in the corporation. The purpose of the 2015 Code is to '…establish the minimum threshold of standards expected of the various stakeholders such as directors, shareholders, chief executive officers and top tier management of listed or unlisted companies, as long as such companies issue securities to members of the public, or a section of the public…'[217] In broader terms, the 2015 Code fosters an argument that corporations should 'adopt standards of governance' that go beyond the available minimum standards set out in the

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[214] The Capital Markets Act (n 190), Section 11 (1) (d).

[215] ibid, Section 11 (3).

[216] See for instance Kamami, C. M. M., 'Kenya's Corporate Governance Practices Code, 2015' [2016] available at <http://www.bowmanslaw.com/wp-content/uploads/2016/08/Kenyas-Corporate-Governance-Practices-Code-2015.pdf> accessed on 5th August 2019.

[217] Ager, P., 'Defining Boundaries: A Closer look at the Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015' [2018] available at <https://www.oraro.co.ke/2018/08/13/defining-boundaries-a-closer-look-at-the-code-of-corporate-governance-practices-for-issuers-of-securities-to-the-public-2015/> accessed on 5th August 2019. The author further opines that the 2015 Code is aimed at ensuring that all stakeholders will 'exercise their responsibilities with clarity, assurance and effectiveness'.

legislations such as the Companies Act of 2015. In other words, it attempts to achieve maximum compliance with the best practices of corporate governance.[218]

From the foregoing, it is correct to observe that the Board of Issuers have an additional duty to formulate internal policies and strategies. These are not only aimed at promoting the growth of the company but also towards protecting 'the interests of shareholder, stakeholders and the community at large'.[219] In the 2015 Code, the seven chapters discussed are; Introduction, Board Operations and Control, Rights of Shareholders, Stakeholder Relations, Ethics and Social Responsibility, Accountability, Risk Management and Internal Controls, and lastly, Transparency and Disclosures.

Chapter 2 of the 2015 Code gives highlights on matters of board operations and control. It emphasizes on matters such as appointment, composition, size and qualifications of Board members. Others under this chapter are structure, functions and independence of the board. It also provides for the age limit of the board, induction, annual evaluation, remuneration and legal compliance. The other relevant chapters are three, four and six, which mainly deal with the rights of shareholders, stakeholder relations and accountability, risk management and internal control.

Lastly, chapter 7 addresses the issue of disclosure, especially the question of timely and balanced disclosure. It is observed that '…disclosure is a powerful tool for influencing companies and protecting investors… Weak disclosure can contribute to the practice of unethical behaviour, weakening of market integrity and loss of investor confidence.'[220] As already stated above, the 2015 Code replaced the 2002 Code due to the increased concern over the emerging corporate

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[218] See for instance paragraph 1.1.5 of the 2015 Code which states that '…The Code sets out the principles and specific recommendations on structures and processes, which companies shall adopt in making Corporate Governance an integral part of their business dealings and culture.'
[219] Kamami, C. M. M. (n 216).
[220] Code of Corporate Governance Practices for Issuers of Securities to the Public (n 191) Chapter 7.

governance issues. In other words, the implementation of the 2015 Code is an admission that the legislative framework on corporate governance is not sufficient in addressing all the problems that are available within the sector.

From this departure, it is important to note that there are various differences between the 2015 Code and the 2002 Code. For instance, while the 2002 Code mainly focused on matters of self-regulation mechanisms in corporations, the 2015 Code now focuses on the minimum set standards to embrace the full compliance with the best practices. The 2002 Code further adopted the 'comply or explain' principle while the 2015 Code adopts the 'apply or explain' approach. The latter approach is profound because it makes it compulsory for the board to apply this Code, that is, there is minimal excuse on issues of non-compliance.

Good corporate governance is key in promoting the growth of corporations in Kenya. An implementation and application of the 2015 Code is an improvement of the concept of corporate governance in Kenya, perhaps a step closer to the international standards. This can be cited as an attempt to achieve full compliance with best practices.[221] The 2015 Code, when compared to the 2002 Code, introduces a better approach to corporate governance issues.

For instance, it defines terms which were not defined in the 2002 Code such as conflict of interest and stakeholders. It also captures important terms such as 'stakeholder engagement and governance, legal compliance and ethical compliance audits' as opposed to the ambiguity that was evident in the older regime. The 2015 Code is equally more detailed on the issue of 'efficiency and effectiveness of Boards' because it introduces mandatory professional training and development for directors.[222]

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[221] Kamami, C. M. M. (n 229).
[222] ibid.

The 2015 Code also distinguishes the functions of the Chairperson and the CEO in a corporation with a rationale that the functions of those offices are distinct and therefore they cannot be performed by the same individual.[223] On the question of issuing securities to the public, the older regime required the board to only report the requirements on the activities of the board within a financial year. However with the 2015 Code it is now a requirement that performance appraisal must be conducted.

Formerly, the listed companies were expected to have periodic legal and compliance audits, but with the current code, those companies have annual governance audits in addition to the legal and compliance audits. Another key improvement is that the salaries of managers is based on the performance of the company. Lastly, the reporting mechanisms of listed companies has now been enhanced to include independent reporting.[224]

To this end, the 2015 Code has on an equal measure been marred with some dilemmas. For example, it has failed to sufficiently address some key questions such as its enforceability. It has also fallen short of specifying the institutions through which the board training will be done. The CMA also needs to outline and implement sanctions or penalties for non-compliance. Finally, there is an urgent need to harmonise the current codes on corporate governance in Kenya so as to avoid conflict.[225]

The Capital Markets Act (having been informed by the Cadbury Report) appreciates the role of the Non-Executive Directors (NEDs) in view of promoting good corporate governance through

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[223] Ager, P. (n 217).
[224] ibid.
[225] See for instance the Central bank of Kenya Prudential Guidelines for Institutions Licensed under the Banking Act, 2013 prohibits directors of such institutions from holding more than two (2) concurrent directorships while the 2015 Code allows them to hold three (3) concurrent directorships.

the 2015 Code. The 2015 Code defines a NED as 'a member of the board of a company who does not form part of the management team and who is not an employee of the company or affiliated with it in any other way but can own shares in the company'. It further proposes a review of the NED's skills and expertise annually, putting into consideration the fact that the number of the NEDs should outweigh that of the executives on matters of board composition. The Code however fails to provide for NEDs in corporations that have a high profit turnover or are community based.

### 3.5 The Nairobi Securities Exchange (Market Participants) Rules, 2014

Founded in 1954, and formerly known as Nairobi Stock Exchange, the NSE, offers trading facility to both local and international investors. It operates under the auspices of the CMA, in that, it has the mandate to control the activities arising while carrying out its functions. The NSE is central in the country's economy, especially in relation to national finances and other corporate enterprises. It is mainly focused on providing markets for stocks and bonds, thereby facilitating sale of securities to potential investors.[226] It also has a board which is largely entrusted with the day to day running of its institutional affairs.[227] For this to be achieved, the NSE has regulations that govern its operations.

The Nairobi Securities Exchange (Market Participant) Rules, 2014, are key in this study. The core aim of these Rules is to promote transparency and fairness in the market. Their foundation is equally based on the principles of integrity in companies with a view of promoting fair market practices. Fair market practices support the notion of disclosure so as to avoid conflict of interest.

[226] Okumu, J. G., 'The Effect of Regulatory Framework on the Growth of Nairobi Securities Exchange: A Traders Perspective' [2012] *Master of Business Administration, University of Nairobi*, 3 & 4.

[227] Nairobi Securities Exchange, 'About NSE' available at <https://www.nse.co.ke/nse/about-nse.html> accessed on 8th August 2019.

The general acceptable approach is that market participants owe a duty of care to their customers at all times. The NSE Rules are also complementary to the CMA guidelines and also binding upon the listed companies, in that listed corporations are required to enforce them of their employees.[228] From the foregoing discussions, it is correct to observe that strict adherence to these rules promotes best practices of corporate governance.

The NSE Rules of 2014 are profound in terms of attempting to protect the interests of the Companies and shareholders. Part II, paragraph 5 of the Rules provides for the requirements and procedure for one to be admitted and to cease as a market participant. Part III further provides for continuous obligations for market participants. These provisions are essentially aimed at improving and controlling the corporate market practices. The Rules also have an additional six Chapters that must be adopted by the listed companies. Chapter 2 provides advocates for business conduct principles that are expected. These include integrity, due care and diligence, disclosure, best interests of the client, enhancement of relevant knowledge and skills, free and fair market competition, proper communication to stakeholders, among others.

Chapter Three delves into the issue of the Board and Disciplinary Committee. The Chapter establishes the Board and then endows it with powers to enforce these rules. In actualizing this enforcement, paragraph 3.3.1 and 3.3.2 notes that '…a decision of the Disciplinary Committee made pursuant to these Rules will be final and binding on the Market Participants…' This approach is therefore important because it makes it compulsory for the Market Participants to embrace the Rules.

[228] Mukoma, W. J., 'A Comprehensive Review of the Corporate Governance Legislative Framework Encompassed in the Companies Act 2015 in Kenya' [2017] *Master of Laws (LL.M) Thesis, University of Nairobi*, 30.

Chapter Four provides for a general code of conduct which requires market participants to be professional, act in good faith, not engage in insider trading, embrace confidentiality on clients' details, and generally embrace other proper practices. Chapter 5 is on Enforcement, whereby it provides important aspects that are tailored towards promoting proper corporate practices in the market. Paragraphs 5.1 and 5.2 lays down a procedure for lodging complaints at the NSE and how these complaints should be handled. Paragraph 5.5 further gives the Disciplinary Committee an avenue of calling for a Disciplinary Action and sanctions they may apply in the event they find that there is breach of these Rules.

### 3.6 The Penal Code, Chapter 63 of the Laws of Kenya

The Penal Code concerns itself with the crimes and offences committed and the punishment that should be administered if one is found guilty of the charges brought against him/her. *Sections 327*, *328* and *329* of the Penal Code are applicable to the subject of corporate governance and therefore they are worth to mention. Under *section 327*, on directors are trustees of the company, the Act imposes a penal sanction on trustees who fraudulently dispose of trust property. The dilemma with this section is that it falls short of defining directors in companies within the context of the term "trustees". However in strict sense, directors of companies are or act as trustees of a company.[229]

For *sections 328* and *329*, the Act also imposes criminal sanctions on directors for fraudulent accounting or appropriation and for giving false information to deceive or defraud the company. This reveals that the Penal Code lacks sufficient mechanisms for holding directors and majority shareholders accountable in the event of any breach. In light of the provisions of these sections,

[229] See for instance Nyasae, A. N. (n 76) 221, who observes that 'A director is, to some extent, a trustee for the company; that is, of its money and property, and of the powers entrusted to him'.

prosecution is almost impossible because the legal rights of the company belongs to the company and not its members.[230] In broader terms, these penal consequences are porous to the extent that they would exonerate a director from liability by requiring shareholders to prove the directors' dishonest intention.

### 3.7 Conclusion

This chapter dealt with the legal framework on corporate governance with a view of minimizing corporate scandals within the private companies in Kenya. It also appreciated the concept that the current legal framework has tremendously developed with an aim of ensuring that Kenya has attained a good corporate governance framework. This is evident through the various amendments and change of regimes recently.

For example, we have recently had the amendment of the Capital Markets Act through the Capital Markets (Amendment) Act of 2018, the Code of Corporate Governance Practices for Issuers of Securities to the Public of 2015, that succeeded the Guidelines on Corporate Governance Practices by Public Listed Companies in Kenya, 2002, the amendment of the Companies Act of 2017 vide the Companies (General) (Amendment) Regulations of 2017 (arising out of *section 1022* of the Companies Act of 2015) and the Companies (Amendment) Act of 2017. The other recent framework is the Nairobi Securities Exchange Market Participants Rules of 2014 that were brought into force by the NSE to regulate the market.

A keen study of the foregoing legal framework on corporate governance revealed that these developments are tailored towards adopting the international standards on corporate governance. This has also been reflected in a number of our local statutes such as the Companies Act of 2015

[230] See Musikali, L. M. (n 25) 4.

which is arguably a replica of the UK's Companies Act of 2006, the Capital Markets Act, through the 2015 Code, which extensively adopts the UK approach on matters of the board composition, such as introduction of the NEDs, and, the sample Code of Best Practice for Corporate Governance of Kenya.

This study further observed that despite all these legislations and the developments thereof, corporate scandals and debacles are increasingly evident. This can be attributed to not only a weak legal framework but also numerous unethical practices and lack of transparency within the corporate sector. The study appreciated the concept that an implementation and amendment of the legal framework has always been aimed at responding to and curbing corporate scandals in Kenya. The study observes that although these legislations are still insufficient, they constitute a commendable starting point to making a realistic driver of economic development in Kenya.

To this end, the study finds it important that the corporate sector and legal framework should focus in adopting a broader approach by engaging relevant professionals such as the accountants, public secretaries, lawyers, among others. This would contribute towards reducing corporate scandals in Kenya. The question of shareholder protection should also be emphasised in all legislations dealing with matters of corporate governance.

The next chapter of this study will address the need of having a good corporate governance system in Kenya. It is evident that a good corporate governance system will reduce and deter corporate scandals from occurring, thereby improving the level of shareholder investment. The chapter will foster an argument that good corporate governance controls and deters corporate scandals thereby guaranteeing shareholders trust in their investment.

## CHAPTER FOUR

## TOWARDS GOOD CORPORATE GOVERNANCE IN KENYA: A CASE FOR SHAREHOLDER PROTECTION

### 4.1 Introduction

The purpose of this Chapter is to discuss the tenets of a good corporate governance practices in Kenya with an aim of providing a solution on how to minimize corporate scandals from occurring within the private corporate sector. It seeks to address the fifth research question of this study. Previous Chapters have concluded that corporate scandals are increasingly experienced in Kenya despite the country having a robust legal framework.

This chapter therefore argues that the corporations which have embraced good corporate governance practices have the ability to curb corporate scandals and this is to the advantage of shareholders who are the owners of the company. As earlier stated, corporate governance is the manner through which companies are directed and controlled.[231] The question of directing and controlling presumably deals with leadership and management of corporations. This problem is normally placed upon the BoD. In realization of these responsibilities, the BoD then acts as an agent of the corporation.

Good corporate governance contemplates that a corporation should have a robust corporate governance structure. In such a governance structure, the BoD ought to embrace good practices such as fairness, transparency and accountability.[232] Out of such direction, it is expected that the company shall perform well, and perhaps yield good returns to the owners. Shareholders are the

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[231] Cadbury, A. (n 8).

[232] Osei, E., 'A Winning Governance Structure: Basic Components of a Corporate Governance Structure that Supports a Winning Corporate Strategy and Enterprise value enhancement' [2014] 3(8) *International Journal of Advancements in Research and Technology*, 100.

owners of the company. The BoD acts as agents of the corporations, and most importantly, they should act in the best interests of the company. Also, the powers of the company are essentially exercised by two main organs, the shareholders (in general meetings) or the BoDs.[233]

Therefore, the relationship between shareholders and the BoD is very important. The shareholders elect a BoD who acts as their agent and thus can be held accountable. By virtue of this accountability, the BoD then reports to the shareholders on any issues ensuing in relation to the company. The shareholders can then proceed to 'appoint external auditors to provide an independent check on the company's financial statements.'[234]

## 4.2 The Corporate Governance Structure and the Board of Directors in Private Companies: Toward Controlling Corporate Scandals

The concept of corporate governance is a current concern within all spheres of development. However, the important issue of discussion has been 'corporate fraud, managerial misconduct, and negligence and massive loss of shareholder wealth'.[235] These shortcomings have further been attributed to weak corporate structures of governance within the corporate sector. This has spurred a debate as to whether or not corporations are effectively governed. As a result of the foregoing concerns, investors have lost confidence in corporations thereby leading to stringent economic dilemmas.[236]

The concept of 'corporate governance structure' relates to the mode of monitoring the conduct, strategies and decisions of corporations. In more precise terms it is defined as 'the allocation of rights and responsibilities among different participants in the corporation (such as board of

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[233] Hicks, A. and Goo, H. S. (n 201).
[234] Nyasae, A. N. (n 76) 105.
[235] Dzingai, I. and Fakoya, M. B., 'Effect of Corporate Governance Structure on the Financial Performance of Johannesburg Stock Exchange (JSE) – Listed Mining Firms' [2017] *Africa Centre for Sustainability Accounting and Management (ACSAM)*, University of Limpopo, South Africa, 2.
[236] ibid, 1 & 2.

directors, managers, shareholders, creditors, auditors, regulators, customers, and other stakeholders) and specifies the rules and procedures of engagement in corporate affairs'.[237] From the foregoing observation, it is correct to assume that it deals with the rights and responsibilities of key agents in a company and the rules and procedures that govern the corporate affairs.

In this vein, it is arguable that for a corporation to exhibit good governance, factors such as size, characteristics, composition and interactions of the relevant players must be put into consideration.[238] A good governance structure is fully determined by an effective composition and interaction of the corporate actors. The BoD is ordinarily entrusted by the owners of the company on matters of governance. It is perhaps the central player on matters of decision-making within the company.[239] It therefore has the 'overall responsibility of determining the vision and direction of the corporation', among other things.[240] Key considerations that are ordinarily taken into account on matters of the BoD are the role of the board, appointment of directors, remuneration of directors, removal of directors and structure and composition of the board.[241]

For a corporation to achieve such responsibilities, the BoD is required to 'act in good faith and with due diligence and care and in the best interest of the company; applying high ethical standards; exercising independent objective judgement; defining clearly all working procedures

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[237] Osei, E. (n 232). See also Ruparelia, R. and Njuguna, A., (n 51) 159, 160 who argue that 'the principles of good corporate governance revolve around guidelines governing directors, Chairman and Chief Executive, shareholders, audit and accountability and general practices…The board of directors has the primary responsibility of fostering long-term business of the corporation and ensuring that it achieves its fiduciary responsibility to shareholders.'

[238] Osei, E. (n 232).

[239] Davies, L. P. and Worthington, S., (n 204) 355. See also the Financial Reporting Council, '*UK Corporate Governance Code*' 2014, 'Every company should be headed by an effective board, which is collectively responsible for the success of the company'.

[240] Mwaura, K., 'Constitutional Restructuring of Corporate Governance in State Owned Enterprises: Dynamism or Distraction?' [2011] 1 *Journal of Mount Kenya University Law School*, 4.

[241] See generally Kershaw, D., *Company Law in Context: Text and Materials* (2nd edn, OUP 2012) and Pettet, B., *Pettet's Company Law: Company and Capital Markets Law* (3rd edn, Pearson Education Publishers 2009).

of the board; ensuring there is a formal and transparent board nomination and election process'.[242] The BoD should not only concern itself with profit making but also 'ethically responsible individuals who seek to improve' performance within the corporations. In essence, 'effective corporate governance through a small effective board and monitoring by an independent board' would result to positive performance.[243]

Kenya has adopted a good approach on matters of corporate governance structure. Corporate governance bodies should arguably be comprised of an appropriate balance of knowledge, diversity, and independence for discharging their duties objectively and more efficiently.[244] According to the Principles for Corporate Governance in Kenya, good corporate governance dictates that the BoD governs the corporation in a way that maximizes shareholder value and in the best interest of society.[245]

Under *section 139* of the Companies Act of 2015, a company can pass a resolution to remove a director from office. With an attempt to curb down corporate scandals, *section 151* of the Companies Act of 2015 and the Amendment Act of 2017 further provides that a director should declare interest in a proposed or existing transaction or arrangement within 72 hours. The Amendment Act of 2017 also provides that rights of shareholders can only be altered by their consent. Additionally, shareholders are now entitled to vote as a group on the variation of any rights relating to their shares, an approach which has highly favored the minority shareholders in a company.

[242] Mwaura, K. (n 240).
[243] Dzingai, I. and Fakoya, M. B. (n 235), 1, 2.
[244] See generally the Institute of Directors in Southern Africa (IoDSA) (n 185).
[245] Private Sector Initiative for Corporate Governance, 'Principles for Corporate Governance in Kenya and a Sample Code of Best Practices for Corporate Governance' *Private Sector Corporate Governance Trust.* Available at <https://www.ics.ke/wpcontent/uploads/bskpdfmanager/Principles_of_good_corporate_Governance_Private_Sector CS_Gabriel_Kimani_110.pdf> Accessed on 3rd October 2019.

The Capital Markets (Securities) (Public Offers, Listing and Disclosures) (Amendment) Regulations, 2016, otherwise known as 'the Principal Regulations', have attempted to amplify the concept of good corporate governance in Kenya. The Principal Regulations provides that every issuer shall comply with the corporate governance requirements as contemplated in the regulations. Additionally, every issuer shall disclose in its annual report, a statement of the directors as to whether the issuer is applying the recommended corporate governance practices stipulated in the Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015 issued by the Authority. Provided that where the issuer has not fully applied the recommended corporate governance practices, the directors shall indicate the steps being taken to ensure the application of such practices.[246]

In addition to the foregoing, the Principal Regulations provide that every company shall be headed by a board which shall offer strategic guidance, leadership and control of the company. The said board shall have an appropriate balance of skills, experience, independence and knowledge of the company to enable the board to operate effectively, have transparent and documented procedures for the appointment of successive boards to ensure smooth transition, establish separate functions for itself and the management, establish policies to ensure that directors of the board are independent, develop a Code of Ethics and Conduct and ensure that the Code is complied with, establish and periodically review and publicize the board charter on the company's website, ensure the company complies with all applicable laws and standards, and, be accountable to the company's shareholders.[247]

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[246] The Capital Markets (Securities) (Public Offers, Listing and Disclosures) (Amendment) Regulations, 2016, *section F.01.*
[247] ibid *section F.02, (1) and (2).*

Lastly, a person offering himself for appointment as a director of the board shall disclose any real, potential or perceived conflict of interest that may undermine the office of director. The board of an issuer shall on an annual basis, evaluate its performance, the performance of its chairperson, the chief executive officer and the company secretary.[248]

### 4.3 Good Corporate Governance Practices: The Need for Shareholder Protection

This study has endeavoured to discuss a number of case studies in relation to the governance problem in Kenya *vis-a-vis* the role of shareholders in private corporations. Research has revealed that there are various governance issues which have dominated in private companies in Kenya thus causing these scandals.

Corporate scandals are attributed to the questions of poor governance such as weak and unethical practices, lack of proper internal control mechanisms, conflict of interest, lack of transparency and disclosure and lack of accountability. It is worth noting that private companies, and BoDs by extension, must embrace the above practices so as to guarantee the shareholder value, devoid of which, the corporate scandals will continue to be a common place.

As previously observed in this study, corporate governance relates to the 'structures and processes for the direction and control of businesses and the relationships among the management, board of directors, controlling shareholders, minority shareholders and stakeholders.'[249] Other studies have also revealed that the concept of corporate governance involves the methods, structures and processes of managing and directing a corporation.[250]

[248] ibid *section F.02, (3) and (4).*

[249] Sarbah, A. and Xiao, W., 'Good Corporate Governance Structures: A Must for Family Businesses' [2015] (3) *Open Journal of Business and Management*, 40-57. The question of Majority and Minority Shareholders was elaborated in the case of *Foss vs. Harbottle* (1843) 2 Hare 461, whereby two core principles were developed, first, that a company is a legal entity distinct from its shareholders; and, second, that, a company cannot function effectively unless the will of the majority generally prevails. Under this rule, the minority shareholder is often at

Therefore, the general view on corporate governance is to 'enhance the long term shareholder value by the process of accountability of managers'. In other words, good corporate governance supports a BoD that leads company 'in a way that maximizes shareholder value in the best interest of society'.[251] Shareholders play a key role in the governance of companies but this can only be well attained if the shareholders have the ability to review the performance of the BoD and take the necessary steps.[252]

Section 3.3 (iv) of the Guidelines provides for the best practices relating to the rights of shareholders and more so, with regard to election of the directors once nomination and appointment of the directors has been done by the Nominations Committee of said listed company as per the provisions of section 3.1.3 of the Guidelines.[253] Additionally, section 132(1) as read together with section 256(3) of the Companies Act 2015 provides that a single resolution for nomination and election of directors ought to be made by simple majority of shareholders. That is to mean that more than two-thirds of the shareholders for ordinary resolutions and at least 75 per cent for passing special resolutions.[254]

Shareholders have a right to convene general meetings by their own motion or through court order and the said request must be put to the directors if the said members constitute at least 10 per cent of total shareholders having voting rights or owning share capital. The shareholders are further required to put a written statement of the resolution where assenting or dissenting to the

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risk, whereby an exception to this rule is given at the position where the decision of the majority is said to be a 'fraud on the minority'.

[250] Khan, H., 'A Literature Review of Corporate Governance' [2011] 25 *International Conference on E-business, Management and Economics,* IACSIT Press, Singapore 1.

[251] Koech, P., Namusonge, G. and Mugambi, F., (n 131) 41.

[252] Davies, L. P. and Worthington, S., (n 204) 401.

[253] See for instance the Capital Markets Authority, 'Guidelines on Corporate Governance Practices by Public Listed Companies in Kenya', [2012]

[254] The Companies Act (n 23).

board of directors who then must convene the meeting within 21 days. Also, shareholders are responsible for electing directors during meetings and have the ability to change directors based on performance and in accordance with the mandate of the company.[255]

From the foregoing observations, it can be observed that shareholders play a key role in the running of a corporation, such that, they are the long-term owners of the business and as such they act as stewards of the company.[256] Additionally, good corporate governance contributes to sustainable economic development and thus it is important that corporations adopt good corporate governance structures to enable them to grow.[257] Khan argues that good corporate governance is 'fundamental to the economies with extensive business background and also facilitates the success for entrepreneurship'.[258]

Mallin provides a cogent argument on the rights and obligations of shareholders. He observes that a good corporate governance framework should be aimed at protecting the shareholders, and especially the minority shareholder. This should be done through ensuring that there is fairness and transparency within the company.[259] Protection of (minority) shareholders ought to be exercised through ensuring that the existing shareholders are given priority to invest in their company so that their interest can be felt. Additionally, 'no shares should be issued at undervalue; minorities should be treated equally in takeovers; and, where the audit has failed to

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[255] See generally Nyasae, A. N., *Meetings: Law and Procedure in Kenya Today* (Law Africa Publishers 2019).

[256] Lee, P., 'The Need for and Value of Good governance: An Institutional Investor's View' in United Nations Conference on Trade and Development, *Selected Issues in Corporate Governance: Regional and Country Experiences* (United Nations, New York & Geneva 2003) 12. Additionally, Section 30(2) of the Companies Act, 2015, contemplates that a shareholder's key responsibility is to subscribe for shares and inject capital into the company. See also Farwell J. in *Borland's Trustee vs. Steel Brothers & Co. Ltd* (1901) 1 Ch.279, whereby it was held that in a company, the share is an interest measured in money.

[257] Sarbah, A. and Xiao, W. (n 249).

[258] Khan, H. (n 250).

[259] Mallin, C., 'The Relationship between Corporate Governance, Transparency and Financial Disclosure' in United Nations Conference on Trade and Development, *Selected Issues in Corporate Governance: Regional and Country Experiences* (United Nations, New York & Geneva 2003) 4.

ensure full information to shareholders, the auditor should be potentially liable for damages to those who have suffered loss as a result'.[260]

Corporations are generally expected to perform well whereby those that portray poor performance may result to replacing directors and further ensure that the company complies with the best practices in corporate governance. To this extent, it is correct to hold that good corporate governance should be used as a tool of restoring 'investor confidence' especially in markets that have previously fallen into crisis.[261] Despite the fact that sometimes the legislation might not be enough to inspire shareholder confidence, the companies should be able to do so. Honesty and transparency in a corporation inspire confidence and this promotes investment. Additionally, the issue of audit is also fundamental in assuring investor confidence and it has traditionally been attributed to various corporate failures. The auditors should be independent and active.[262]

The previous chapter of this study dealt with the legal framework on corporate governance in Kenya. From this departure, it is important to observe that a robust legal framework guarantees shareholders of good returns on their investments.[263] Protection of shareholder investment in a corporation promote economic growth. Devoid of good corporate governance, the corporation stand to lose both in its performance and the shareholder(s)' investments. It has been postulated that 'shareholder activism is the key to ensuring good corporate governance and without this there is less accountability and transparency, and hence more opportunity for management to engage in activities that may negatively affect the bottom line.'[264] Further, there is need to have

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[260] Lee, P. (n 256) 22.
[261] Mallin, C. (n 259) 6.
[262] Lee, P. (n 256) 13.
[263] Amitava, R. and Ananda, M. P., 'Corporate Governance Compliance, Governance Structures, and Firm Performance' [2017] 21(1) *Indian Accounting Review*, 31.
[264] Mallin, C. (n 259) 7.

'checks and balances' as a foundational pillar in corporate governance, so as to ensure that the interests of shareholders are protected.[265]

On matters of corporate governance and shareholder protection, the OECD Principles provides that corporate governance framework should protect shareholders and facilitate their rights in the company. Additionally, all shareholders, including minority and foreign, should be treated equally and should have a remedy in the event their rights are infringed. The board of directors should set the direction of the company and monitor management in order that the company will achieve its objectives. The corporate governance framework should underpin the board's accountability to the company and its members. Lastly, the Principles argue that 'shareholders should have the right to remove the board members and to participate in nominating them' and also that they 'should be able to ask questions of the board at the general meeting and to place items on the agenda'.[266]

### 4.4 Conclusion

This Chapter examined how good corporate governance practices in Kenya can assist in controlling corporate scandals from occurring within the private companies. The Chapter further found that if these scandals are controlled, the shareholder confidence will be guaranteed and this would promote investment. This Chapter also made a finding that serious debates on the concept of good corporate governance emanate from the past corporate scandals and debacles within the corporate sector. These scandals are increasingly being motivated by weak or poor governance structures in companies. This dilemma falls on the leadership and management of corporations.

[265] Lee, P. (n 256).
[266] OECD Principles 2004 (n 14).

From the above mentioned, this Chapter arrived at a finding that poor corporate governance structure result to corporate scandals and these scandals have led to tremendous loss of shareholders' investments and wealth. Additionally, that leadership and management of a corporations have various key players but the central role rests on the BoD and the shareholders who are the agent and owners of the company respectively. The BoD is expected to execute all its duties to with an aim of maximizing the shareholder value because the shareholders not only play a key role in the running of the company but are eventually the owners of the company.

Lastly, a finding was made that the law on governance structure and shareholder protection in Kenya is profound. It requires that all corporate players comply with the required set of standards towards achieving a proper management of the company. The problem however lies on the issue of enforcement. The enforcement mechanism appears to be ineffective thereby making it difficult to achieve the objective of controlling of corporate scandals. To this end, corporate scandals can be controlled and deterred by effectively applying the law to the extent that the BoD are capable to manage and control the company. The next Chapter will deal with the conclusion and recommendations of this study.

# CHAPTER FIVE

# SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

## 5.1 Summary of Findings

This study made a case for the law on corporate governance in Kenya and shareholder protection with a case for corporate scandals within private companies. The argument was motivated by an observation that numerous scandals within the corporate sector in Kenya result from poor and/or weak corporate governance practices, as the major reason.

For this research to be successfully undertaken, five research questions were formulated and answered. These questions were as follows: Which corporate scandals have occurred in Kenya from 1900 to date; what is the role of shareholders towards minimizing corporate scandals within the private companies; what is the relevant law that is aimed at solving the corporate governance problems in Kenya; whether or not, the available legal framework is adequate at solving the corporate governance problem or are these collapses necessitated by other non-legal factors; and, what ought to be done to control and deter these corporate governance problems from recurring.

In answering the above questions, the study took three broad approaches. Firstly, it interrogated the evolution of the concept of corporate governance in Kenya and the dilemma of corporate scandals and debacles from 1900 to date. In this limb, various case studies on corporate failures were applied. These included KICOMI, Euro Bank scandal, IBLR and NHL. Secondly, this study investigated the legal framework on corporate governance in Kenya, with an objective of making a finding on whether or not, these laws are sufficient in controlling and deterring corporate scandals and debacles in Kenya.

Among the laws prominently featured were the following: the Constitution of Kenya, 2010; the Companies Act no. 17 of 2015; the Companies (Amendment) Act of 2017; the Capital Markets

Act, Chapter 485A of the Laws of Kenya (and the Regulations, Rules and Guidelines); the Code of Corporate Governance Practices for Issuers of Securities to the Public (2015); the Nairobi Securities Exchange regulations; and, the Penal Code, Chapter 63, Laws of Kenya.

Thirdly, the study postulated an argument that there is need to embrace good corporate governance in Kenya with an aim of controlling corporate scandals and debacles from occurring. This approach made a case for shareholder protection in the wisdom that shareholders are the owners of the company and the BoD act as the agents of the company. In broad terms, BoD's role is to manage and control the company. This role should therefore be undertaken in accordance with good corporate governance practices, thereby increasing the shareholder confidence.

From the foregoing observations, it suffices to note that this study formulated three hypotheses, as follows: good corporate governance promotes economic growth; a review of the current legal framework on corporate governance is not a guarantee to minimizing corporate scandals; and, compliance with a robust and relevant legal framework will reduce the level of corporate scandals in Kenya. Various conclusions were made from this study.

## 5.2 Conclusions

This study arrived at a conclusion that the concept of corporate governance is not a new phenomenon since it began at about 1844 and has since been linked to negative firm performances. For instance in the 1980s, there were massive corporate collapses and failures globally which called for the formulation of new laws and codes with an aim of curbing the scandals. Currently, it is arguably an international subject of discussion and it has played a major

role both developed and developing countries. In Kenya, this concept was widely felt from the early 1990s to present.

The study further concluded that despite the numerous legislations being enacted in Kenya, the country has been unable to control corporate scandals from occurring. Kenya has had a series of legislations from time to time but yet the scandals have equally been increasingly felt. For instance, there has been the Companies Act of 2015 and subsequent Amendments of 2017, the Constitution of Kenya, 2010, the Capital Markets Act and Regulations, and the 2015 Code, the NSE Regulations of 2014, the Penal Code, among others, all aimed towards promoting good corporate governance in Kenya.

Despite these numerous legislations within a short interval, the country has been experiencing corporate scandals such as the collapse of Tuskys and NHL chain of supermarkets, the IBLR scandal, and now the looming collapse of Webuye's Pan Paper Mills (2009), Karuturi (2014), KWP (2016), Spencon (2017), ARM (2018), Deacons East Africa (2019) and Midland Energy, among others. From this observation, this study concluded that numerous corporate scandals in Kenya have been attributed to the question of poor and/ or weak corporate governance mechanisms and practices, lack of internal controls and weaknesses in regulatory and supervisory systems as well as conflict of interest.

A further observation made was that corporate governance varies from one jurisdiction to another, in the sense that those countries with a strong legal system are expected to exhibit good corporate practices. In this vein, Kenya, despite being a developing country, has borrowed heavily from various developed countries such as the UK, Malaysia, SA and other OECD countries. For instance, the Constitution of Kenya 2010 is very profound on matters of director's duties, among other issues. Also, the Companies Act of 2015 has codified more duties of

directors and subsequent penalties, in the event a director is found culpable of an offence. The Companies (Amendments) Act of 2017 further dealt with the question of conflict of interest of a director in a broader view.

Beyond these primary legislations, there is also the CMA's Code of 2015 which essentially sets out the principles and specific recommendations on the structures and processes that ought to be adopted by a company to make good corporate governance an integral part of their business dealings and culture, and, also the NSE Rules of 2014 which mainly focus on providing markets for stocks and bonds, thereby facilitating sale of securities to potential investors.

Following these observations, this study made two conclusions, firstly, that Kenya's legal framework on corporate governance is a clear evidence that the country is capable of dealing with corporate scandals, and secondly, that corporate governance in Kenya is also hindered by other non-legal factors such as socio-political, economic and cultural factors.

Towards the end, the 2016 Code adopts the "Apply or Explain" as opposed to the "Comply or Explain" approach. The former mandates the shareholders to call for enforcement of the Code while the latter call for the government to enforce the law. Thus in the "Apply or Explain" approach, BoDs not only comply because the law dictates so but also because they must develop their own policies to the benefit of the shareholders.

The BoD is therefore required to fully disclose any form of non-compliance with the Code to relevant stakeholder including the CMA with a commitment towards full compliance. This study therefore concluded that the 2016 Code has immensely contributed to the question of shareholder protection in the corporate governance sector. Finally, shareholder value can be enhanced

through various ways such as proper board composition and diversity, proper remuneration of directors, focus on the issue of sustainability and good governance and regular legal audits.

## 5.3 Recommendations

### *5.3.1 Best practices of good corporate governance*

The Companies Act, 2015, provides for takeovers and it requires shareholders to accumulate at least 90 per cent shareholding for a takeover to be successful. This was however amended by the Companies (Amendment) Act of 2017 lowering it to 50 per cent. This amendment is set back from the required best practices of good corporate governance because the minority shareholders are now exposed to manipulation by the majority shareholders.

The essence of the initial holding of the 90 per cent was a good practice of protecting the minorities in a company so that the majority can take sufficient measures to convince the minority to sell. This study recommends that the current law should adopt the 90 per cent threshold so as to mirror the best standards on good corporate governance.

If this recommendation is actualized, shareholders' protection will be guaranteed. This will translate to proper decision making thereby solving corporate governance problems cited such as weak and unethical practices. In essence, the shareholders can play their role independently without any manipulation or influence and this will translate to best results.

### *5.3.2 Shareholders' role towards the appointment of directors*

The Companies Act, 2015, also provides for the issue of appointment of directors. The 2015 Act requires a private company to have 1 director while a public company to have 2 directors, at a minimum. Other than the question of appointment of these directors, the 2015 Act falls short of amplifying the shareholder's role towards appointment directors. Thus, this study recommends

that shareholders should have the right to legally review the board members and also have a role to play in nominating them. Further, that the shareholders should be able ask questions about the board at the general meeting and to place items on the agenda.

Directors form the basis of any operations of the company since no company can run without a director. They should therefore act in a manner that is aimed at protecting the shareholders. Of all the corporate governance problems identified in this study, the question of directors took centre stage. This means that unless the directorship of a company is robust, then that company risks collapsing. A robust BoD can only be achieved through a broad shareholder participation in the said exercise.

#### *5.3.3 The need for a qualified and professional board in all companies*

This study has demonstrated that the BoD play a central role in a company. The law contemplates that corporations should have a BoD that is both qualified and professional. Despite this contemplation, most corporations in Kenya have failed to adhere to this. This is common in both the private and public companies. From the discussion of this study, this is part of the reasons as to why there are continuous corporate scandals.

A good board should consist of members who show dedication and commitment to the objectives of the company, have the ability to lead others, who are honest and transparent, qualified in all spheres and who embrace confidentiality. This study therefore recommends that all members of the board must be qualified and professional.

Qualified professionals are important especially in dealing with the problem weak and unethical practices and accountability. Case studies such as NHL revealed that corporations cannot

exclude themselves from professional scrutiny, such as accountants and auditors if they want to successfully control corporate scandals.

### *5.3.4 The effectiveness of the legal framework and the question of enforcement*

The legal framework on corporate governance in Kenya has fallen short of addressing the question in relation to controlling and non-controlling shareholders. The correct position is that that the controlling shareholders owe a fiduciary duty to the non-controlling shareholders. The law has however not placed any enforcement mechanism for non-compliance. Of the numerous corporate scandals and debacles that were discussed in this study, it was revealed that no specific individuals were found culpable of any offence.

This is profound demonstration that the law needs to take into account the question of enforcement. A number of the case studies in this subject that have gone to court have been frustrated by poor enforcement mechanisms. This study recommends that the law should be amended to incorporate the sufficient enforcement mechanism so that the perpetrators of these scandals can be successfully convicted. It was revealed that numerous corporate scandals such as that of IBLR was presented before Court for trial but nothing as so far come out of the said proceedings.

### *5.3.5 Multiplicity of the legal framework on corporate governance*

Following an analysis of the legal framework on corporate governance, it was evident that there are a number of legislations, codes, rules and regulations in relation to this concept. Despite the fact that these legislations are aimed towards improving the concept of corporate governance, there appears to be multiplicity which in the end is likely to cause confusion and poor compliance.

This study recommends that while parliament takes into account the issues legislations (and the amendments thereto), an independent body such as the CMA or the CCG should on the other hand consolidate the codes or regulations one document. The legal framework should be minimized as much as possible to ease compliance.

### *5.3.6 The role of professionals in promoting good corporate governance practices in companies*

Professionals play a central role on matters of corporate governance. A deep observation of the legal framework on corporate governance reveal that the law does not directly involve these professionals on matters relating to corporate governance. This study recommends that these laws, and especially the Codes should seek to appreciate the role of professionals such as the accountants, auditors, public secretaries and advocates, among others, towards the attainment of good corporate governance.

They will advise the board on significant risks and any potential exposures that may prejudice the company. This would assist companies to adhere to corporate governance requirements. The collapse of NHL was mainly not prevented due to non-disclosure and lack of accountability to the professionals. Failure to involve them would expose the company to great risks.

### *5.3.7 Need to create more awareness on corporate governance and ethics*

Finally, this study appreciates the fact that the concept of corporate governance has been widely publicized and commented about. However, the numerous scandals and debacles have suggested that perhaps a lot need to be done in relation to training of this subject. This study recommends that there is need to create more awareness on the importance of corporate governance and ethics.

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