

**A CRITIQUE OF THE APPLICATION AND EFFECTIVENESS OF THE  
MWONGOZO CODE OF GOVERNANCE AMONG STATE CORPORATIONS IN  
KENYA**

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OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF MASTER OF  
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UNIVERSITY OF NAIROBI**

## **DECLARATION**

I Githiri Christine Njeri hereby declare that this is my original work and has not been presented for the award of a degree or any other award in any other University. Where works by other people have been used, references have been provided.

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## **APPROVAL**

This thesis has been done under my supervision and has been submitted to The University of Nairobi, School of Law for examination with my approval as the candidate's supervisor.

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Signed: \_\_\_\_\_  \_\_\_\_\_ Date: 11/25/2020

## **DEDICATION**

This thesis is dedicated to my family Chris, Zane, Micah and Charlotte.

## **ACKNOWLEDGEMENTS**

My sincere gratitude to my Supervisor Mr. Kelvin Asige for guiding me through the whole process so as to come up with a cohesive piece of work. His input is greatly appreciated. To my reader Dr. Njaramba Gichuki, thank you for assisting through the correction stage and streamlining my work. To my loving husband Chris, thank you for the immense amount of support he has given me towards completion of this project. I also want to thank my entire family, friends and colleagues for their support throughout the whole journey and lastly but most importantly God who gave me strength to push through all those sleepless nights

## **LIST OF ABBREVIATIONS**

CCG - Center for Corporate Governance

CEO – Chief Executive Officer

CIC – Commission for the Implementation of the Constitution

CMP – Capital Master Plan

CSR – Corporate Social Responsibility

EACC – Ethics and Anti-Corruption Commission

FPLC - Federation of Public Listed Companies

FSMP – Financial Sector Master Plan

GOE – Government Owned Entity

ICT – Information and Communications Technology

ICPSK – Institute of Certified Public Secretaries of Kenya

ISC - Inspectorate of State Corporations

KEMSA – Kenya Medical Supplies Agency

MAICSA - Malaysian Institute of Chartered Secretaries and Administrators

MIA - Malaysian Institute of Accountants

MICG - Malaysian Institute of Corporate Governance

MICPA - Malaysian Institute of Certified Public Accountants

MSWG - Minority Shareholders Watchdog Group

ODPP – Office of Director of Public Prosecution

OECD - Organization for Economic Co-operation and Development

PTPR – Presidential Taskforce on Parastatal Reforms

SCAC - State Corporations Advisory Committee

SOE – State Owned Entities

## **LIST OF STATUTES**

Anti-Corruption and Economic Crimes Act, 2003

Ethics and Anti-Corruption Commission Act No. 22 of 2011

Kenya Agricultural and Livestock Research Act 2013

Kenya Information and Communications Act (CAP 411A)

Kenya Medical Supplies Authority Act 2013

Leadership and Integrity Act, 2012 (No. 19 of 2012)

National Hospital Insurance Fund Act (CAP 255)

Penal Code CAP 63

Public Officer Ethics Act, 2003

State Corporations Act (CAP 446)

The Constitution of Kenya 2010

Universities Act (CAP 210B)

## **TABLE OF CASES**

*A.P. Smith Manufacturing Company v. Barlow* (1953)

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*Doctors for Life International vs. Speaker of the National Assembly and Others* (CCT12/05)  
[2006] ZACC 11; 2006 (12) BCLR 1399 (CC); 2006 (6) SA 416 (CC).

*Republic v Grace Sarapay Wakhungu, John Koyi Waluke and Erad Supplies & General Contracts Limited* ACC No 31 of 2018.

*Robert N. Gakuru & Others vs. Governor Kiambu County & 3 others* [2014] eKLR

## TABLE OF CONTENTS

DECLARATION .....	ii
DEDICATION .....	iii
ACKNOWLEDGEMENTS .....	iv
LIST OF ABBREVIATIONS .....	v
LIST OF STATUTES .....	vi
TABLE OF CASES .....	vi
TABLE OF CONTENTS.....	vii
CHAPTER ONE .....	1
INTRODUCTION .....	1
1.1 Introduction.....	1
1.2 Statement of the Problem.....	6
1.3 Research Objectives.....	8
1.4 Research Questions .....	8
1.5 Hypothesis.....	9
1.6 Justification of the Study .....	9
1.7 Literature Review.....	10
1.8 Theoretical Framework.....	12
1.8.1 The Agency Theory .....	12
1.8.2 Stakeholder theory .....	13
1.9 Research Methodology .....	15
1.10 Chapter Break Down.....	16
CHAPTER TWO .....	18
EXTENT OF THE APPLICATION OF MWONGOZO CODE OF GOVERNANCE FOR STATE CORPORATIONS IN KENYA .....	18

2.1	Introduction.....	18
2.2	Understanding the Concept of Corporate Governance .....	18
2.3	State Corporations in Kenya .....	20
2.4	Application of the Mwongozo Code of Conduct in Kenya’s State Corporations.....	22
2.5	Agency Theory.....	24
2.6	Stakeholder Theory .....	25
2.7	Performance of State Corporations in Kenya .....	27
2.8	Implications of COVID-19 on Corporate Governance in State Corporations .....	31
2.9	Conclusion .....	33
CHAPTER THREE .....		34
CRITIQUE ON THE ADEQUACY OF THE MWONGOZO CODE IN ADDRESSING THE CORPORATE GOVERNANCE NEEDS OF STATE CORPORATIONS IN KENYA .....		34
3.1	Introduction.....	34
3.2	A Critique of the Mwongozo Code as a Policy Document.....	34
3.3	Public Participation in Policy Making Process .....	36
3.4	Multiple Regulations Governing State Corporations.....	38
3.5	Appointment of Board of Directors .....	39
3.6	The Office of the President .....	41
3.7	Weak Oversight Authorities .....	41
3.8	Implanting of Foreign Codes without Adapting them to our unique Kenyan System..	43
3.9	Weaknesses in our Institutional Framework for Governance in Kenya .....	45
3.10	Conclusion .....	48
CHAPTER FOUR.....		50
COMPARATIVE ANALYSIS .....		50
4.1	Introduction.....	50



4.2	Corporate Governance in Malaysia .....	50
4.2.1	Institutional Reforms .....	51
4.2.2	Malaysian Code on Corporate Governance .....	52
4.2.3	Lessons for Kenya from Malaysia .....	55
4.3	Corporate Governance in South Africa.....	56
4.3.1	Institutional Reforms .....	57
4.3.2	King IV .....	57
4.3.3	Lessons for Kenya from South Africa .....	61
4.4	Corporate Governance in the United Kingdom .....	62
4.4.1	Institutional reforms.....	63
4.4.2	UK Corporate Governance Code (2018) .....	63
4.4.3	Lessons for Kenya from the United Kingdom.....	65
4.5	Corporate Governance in Kenya.....	65
4.5.1	The Mwongozo Code.....	66
4.5.2	Lessons for Kenya from Other Jurisdictions .....	69
4.6	Conclusion .....	69
	CHAPTER FIVE .....	71
	CONCLUSION AND RECOMMENDATIONS .....	71
5.1	Conclusion .....	71
5.2	Recommendations.....	72
5.2.1	The Judiciary.....	72
5.2.2	Strengthening of Institutions.....	73
5.2.3	Public Participation.....	73
5.2.4	Enactment of Mwongozo as a law .....	74
	Bibliography .....	77

## CHAPTER ONE

### INTRODUCTION

#### 1.1 Introduction

Corporate governance is a vital topic when it comes to the constitution and management of corporations all around world. Corporate governance as an emergent discipline has various definitions but we will rely on the definition as provided by the Organisation for Economic Co-operation and Development (OECD) which states 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.<sup>1</sup>

It is mainly concerned with trying to strike a balance between the corporations different competing interests. These are the social goals, economic goals, individual and the community goals through motivating the corporation to use their assets efficiently, creation of accountability in the use of power and stewardship, while aligning the interests of the corporation, society and the individuals.<sup>2</sup>

Accountability and transparency are critical elements of public governance. Accountability goes into the management of public finances which accountability was lacking in the Kenyan public sector.<sup>3</sup> Kenyan citizens demand that the government, officials and the state institutions should grant access to information concerning any actions or decisions. The

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<sup>1</sup>G20/OECD, 'Principles of Corporate Governance', <<https://www.oecd.org/daf/ca/Corporate-Governance-Principles-ENG.pdf>> accessed 24 September 2020.

<sup>2</sup> Guidelines on Corporate Governance Practices by Public Listed Companies in Kenya. Gazette Notice No. 3362, Section 1.2.

<sup>3</sup> Rita Ruparelia and Amos Njuguna, 'The Evolution of Corporate Governance and Consequent Domestication in Kenya', (2016) International Journal of Business and Social Science Vol. 7, No. 5 <[https://ijbssnet.com/journals/Vol\\_7\\_No\\_5\\_May\\_2016/14.pdf](https://ijbssnet.com/journals/Vol_7_No_5_May_2016/14.pdf)> accessed 7 September 2020.

levels of corruption among public and private agents throughout the world are normally observed by international transparency organizations.<sup>4</sup>

Corporate governance in the private sector model tends to attach any rights and responsibilities to the shareholder. The main focus is thus on shareholder rights even though they still apply good corporate governance principles. However, the public sector is different in that a greater importance is placed among the stakeholders due to the fact that they are directly responsible for the community from which public resources are ultimately derived. The key similarities in both the government sector and private enterprises is that the governing board is placed with the responsibility of guaranteeing issues of transparency and accountability.

State Corporations in Kenya are governed by the Mwangozo Code which is based on the values as enshrined under Article 10.<sup>5</sup> The Mwangozo Code came to be through a taskforce that was appointed by His Excellency the President of the Republic of Kenya, Uhuru Muigai Kenyatta on 23rd July 2013 with its mandate being the review of parastatal reforms in Kenya.<sup>6</sup> His Excellency the President noted that State Corporations play an important role in national development and hence a need to increase their productivity and enhance answerability in how public funds are utilized that were scarce. By implementing the Mwangozo Code, Kenya would also adopt the key principles as set out by the OECD.<sup>7</sup> The

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<sup>4</sup> Corruption Perceptions Index 2019, Transparency International, [https://www.transparency.org/files/content/pages/2019\\_CPI\\_Report\\_EN.pdf](https://www.transparency.org/files/content/pages/2019_CPI_Report_EN.pdf) accessed 7 September 2020.

<sup>5</sup> The Constitution of Kenya 2010.

<sup>6</sup> Presidential Task Force on Parastatal Reforms, <http://www.scac.go.ke/2015-02-16-09-34-58/presidential-taskforce> accessed 18 October 2019.

<sup>7</sup> G20/OECD, 'Principles of Corporate Governance' <https://www.oecd.org/daf/ca/Corporate-Governance-Principles-ENG.pdf> accessed 19 October 2019.

Mwongozo Code borrows from other policies and guidelines from other jurisdictions such as the United Kingdom, South Africa, Malaysia, Singapore and India.<sup>8</sup>

In Kenya, State Corporations have been in existence since the colonial period and Boards such as Cotton Lint, Seed Marketing Board and Kenya Tea Development Authority were created by the colonial government to cater for the expansion of a group of liberal farmers who were of African descent.<sup>9</sup> From the year 1963 when Kenya attained its independence up to the year 1979 there was a growth in the number of State Corporations. During this period there was a comprehensive review of the corporations and the government's intervention had increased in most of the commercial activities.<sup>10</sup>

The state dominance that was experienced in mainly commercial activities led to high growth of the economy which stood at 6.8% per annum between 1963 and 1970.<sup>11</sup> However, the impressive growth of the economy declined to 5% between 1970 and 1980. Following the decline in performance, there was a thorough examination of the performance of public enterprises in the year 1979. It was noted that many of the public enterprises had moved away from their key roles at inception. The deviation from their regulatory function resulted in wastage and confusion among parastatals as there was a danger in the production process being over-politicized and distribution through the establishment of too many parastatals.<sup>12</sup>

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<sup>8</sup> Mwongozo The Code of Corporate Governance for State Corporations.

<sup>9</sup> Kiarie Mwaura, 'The Failure of Corporate Governance in State Owned Enterprises and the Need for Restructured Governance in Fully and Partially Privatized Enterprises: The Case of Kenya' (2007) 31 *Fordham International Law Journal*, 34.

<sup>10</sup> John M. Cohen, 'Importance of Public Service Reform: The Case of Kenya' (1993), *Journal of Modern African Studies*, 31 (3): 449–76.

<sup>11</sup> *Comprehensive Review of the Public Sector Performance in Kenya (1979)*.

<sup>12</sup> Kenya Committee on Review of Statutory Boards. (1979), 'Review of Statutory Boards: Report and recommendations of the committee appointed by His excellent the President'. Government Printers. Nairobi Kenya <<https://www.pc.go.ke/privatization-programme>> accessed 7 September 2020.

It was also noted in the report that some of the assets that had been used to fund the activities of State Corporations could have made a major contribution in the development of the nation if these State Corporations had been left in the private sphere.<sup>13</sup> Following the report, several measures were put in place. One of the measures was the enactment of the State Corporations Act.<sup>14</sup> However, most of the corporations deteriorated as they were still relying on financing from the public sector. The financing that was availed to State Corporations was not adequate to meet all its needs.

The purpose of establishment of parastatals soon after independence by the government of Kenya was a critical element due to the assumption that it would aid in the government's goal for development. The appointment of the Civil Service Committee on the 2<sup>nd</sup> of October 1979 by former president His Excellency Daniel Toroitich Arap Moi reviewed the performance of State Corporations and from the report it was clear that State Corporations were not performing as had been envisioned at their inception.<sup>15</sup> Successive governments after independence contributed a great deal to the poor performance. The Report on Review of Statutory Boards highlighted that most of the State Corporations were failing due to lack of efficient systems to support their management, evidence of financial mismanagement, improper dealings, some State Corporations had shifted from their original roles and the establishment of far too many State Corporations.<sup>16</sup> It was due to these governance challenges that prompted His Excellency the President Uhuru Kenyatta to appoint a task force on 23rd

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<sup>13</sup> Comprehensive Review of the Public Enterprise's Performance in Kenya (1979),

<sup>14</sup> CAP 446.

<sup>15</sup> Report of the Civil Service Review Committee 1979-80 <<http://kenyalaw.org/kl/fileadmin/CommissionReports/Report-of-the-Civil-Service-Review-Committee-1979-1980.pdf>> accessed 16 October 2019.

<sup>16</sup> Draft Sessional Paper No. .... Of 2005 On Privatization Of State Corporations And Investments <[http://siteresources.worldbank.org/INTKENYA/Resources/sp\\_Privatization.pdf](http://siteresources.worldbank.org/INTKENYA/Resources/sp_Privatization.pdf)> accessed 12 October 2019.

July, 2013 with a mandate to conclude the current policy review on the sector with the aim of addressing the sectorial challenges while achieving government policy.

The report of the task force led to development of the Mwongozo Code<sup>17</sup> to serve as a critical building block in entrenching principles and values of public service and best practice in corporate governance. The Mwongozo Code was developed in response to the principles of leadership, governance and management of public resources contained in the Constitution.<sup>18</sup> It aims at entrenching the principles and values of public service and best corporate governance practices.<sup>19</sup> All State Corporations are required to implement the Mwongozo Code to be more efficient and improve on their service delivery.

However, despite enactment of the State Corporations Act<sup>20</sup>, the establishment of the Center for Corporate Governance (CCG) and subsequent drafting and implementation of the Mwongozo Code, there has been deterioration in the how State Corporations perform.<sup>21</sup> The creation of State Corporations right after independence was driven with the need to assist in the growth of economic activities in the country and aid in developmental goals hence there was need for government to participate, but objectives for and the circumstances under which most were created has since changed. There is therefore need to critically evaluate the problems affecting the management of State Corporations to enhance return on investments

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<sup>17</sup> Mwongozo Code of Governance for Kenya's State Corporations; a policy guide on the management of state corporations in Kenya.

<sup>18</sup> Chapter Six, Articles 10, 73, 75, 77 and 232.

<sup>19</sup> Mwongozo Code of Governance for Kenya's State Corporations; A policy guide on the management of state corporations in Kenya.

<sup>20</sup> CAP 446.

<sup>21</sup> 'A Decade of Parastatal Waste: A Study of the Audited Accounts of State Corporations over the Period from 1993 to 2002. A Publication of the Centre for Governance and Development (CGD) and US Agency for International Development (USAID)'.

for the government and to critically analyze the legislative gaps contributing to weak implementation of corporate governance practices in Kenya's State Corporations to ensure improved performance and efficient utilization of public resources.

## **1.2 Statement of the Problem**

Notwithstanding the enactment of the State Corporations Act<sup>22</sup>, the establishment of governance bodies such as the Center for Corporate Governance (CCG) and subsequently drafting and implementation of the Mwongozo Code, State Corporations in Kenya are still faced with problems associated with poor implementation of corporate governance practices which have in turn resulted in their poor performance. The recent upsurge in scandals relating to public entities in Kenya and their collapse has brought to the forefront issues of poor corporate governance practices in Kenya and the need for its regulation. We have seen the downward trend impacting critical state agencies such as the national carrier Kenya Airways, Uchumi supermarket, Mumias Sugar, East African Portland Cement among many others. Recent reported cases of corruption can be seen in the National Youth Services (NYS), Kenya Revenue Authority (KRA), Kenya Power & Lighting Company (KPLC), National Hospital Insurance Fund (NHIF) and National Cereals and Produce Board (NCPB) where millions and billions have been lost and the cases are still under investigations and cases on-going.<sup>23</sup>

The failure to achieve accountability, responsibility, fairness, transparency yet there is the existence of the Mwongozo Code is an indication of inadequacy of the guiding code of

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<sup>22</sup> CAP 446.

<sup>23</sup> It didn't start with the dams: A Journey Through Jubilee Scandals <<https://www.standardmedia.co.ke/kenya/article/2001315620/damning-scandals-it-didnt-start-with-the-dams>> accessed 24 August 2019.

ethical conduct. We are still experiencing challenges in the implementation of the Mwongozo Code. Key positions in State Corporations remain vacant for long periods of time which cripples operations<sup>24</sup> due to a lack of fully constituted boards.<sup>25</sup> The arbitrary manner in which directors are appointed and dismissed, inefficient investment and accountability, lack of clear operational guidelines, unqualified personnel, inadequate budgetary control as well as confusion when it comes to their functions due to confusion, duplicity and overlap of their roles are clear indicators of poor governance practices.<sup>26</sup>

There have also been cases where senior executives have allocated to themselves allowances that were beyond what the corporation policy allows for, inability to account for heavy borrowings which were not used for their intended purpose, lack of suitable financing and poor policies when it comes to resources.<sup>27</sup> As such State Corporations faced problems on liquidity which is attributable to loan allocations that were imprudent and the interference from politicians who used their positions in government to put their associates on the boards without due process being followed for in the appointment. Other State Corporations collapsed due to issues of corruption, political appointees and misdirection on policies.<sup>28</sup>

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<sup>24</sup> Watchdog committee alarmed by lack of full boards for parastatals <<https://www.standardmedia.co.ke/article/2001275168/watchdog-committee-alarmed-by-lack-of-full-boards-for-parastatals>> accessed 21 October 2019.

<sup>25</sup> 69 State Agencies have no Boards <<https://www.standardmedia.co.ke/article/2001280617/69-state-agencies-have-no-boards>> accessed 21 October 2019.

<sup>26</sup>Peris Koech, Gregory Namusonge and Fred Mugambi, 'Board Characteristics as a Determinant of Effectiveness of Corporate Governance in State Corporation in Kenya' (2017).

<sup>27</sup> Benson Wambugu, 'Permanent Secretary lists reasons for Uchumi collapse before Nairobi court' (2011, March 14) Daily Nation,p. 6.

<sup>28</sup> Muthumbi, M. 'After reviving KMC and KCC Kenya Government goes after Rivatex' Daily Nation July 29, 2007 21 Standard Reporter (2006).



Despite all this intervention with the enactment of legislation and policy, there has been continued deterioration in the performance of State Corporations.<sup>29</sup> There is therefore need to critically evaluate the problems the State Corporations face to enhance return on investments by establishing the legislative gaps hindering effective implementation of corporate governance principles in Kenya's State Corporations. This therefore brings forth the knowledge gap that this study seeks to fill.

### **1.3 Research Objectives**

**This study will be guided by three specific objectives which aims: -**

- i. To establish the extent of application of corporate governance principles in Kenya's State Corporations;
- ii. To critique the adequacy of the State Corporations Act and the Mwongozo Code in addressing the corporate governance needs of State Corporations in Kenya; and
- iii. To document the legislative gaps hindering effective implementation of corporate governance principles in Kenya's State Corporations

### **1.4 Research Questions**

- i. To what extent have State Corporations in Kenya implemented corporate governance principles?
- ii. Does the State Corporations Act and the Mwongozo Code adequately address the corporate governance needs in Kenya's state corporations in Kenya?

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<sup>29</sup> A Decade of Parastatal Waste: A Study of the Audited Accounts of State Corporations over the Period from 1993 to 2002. A Publication Of The Centre For Governance And Development (CGD) and US Agency for International Development (USAID)

- iii. Are there any legislative gaps hindering effective implementation of corporate governance principles in Kenya's state corporations?

## **1.5 Hypothesis**

In undertaking this study, my hypothesis is that the Mwongozo Code in its current state is weak and insufficient as it fails to address the challenges that had been identified at its inception. The Code was simply a transplant of other codes/principles from other jurisdictions without adapting it to our unique Kenyan context. The concept behind its implementation was good but it failed miserably to take cognizance of our system having in mind the various reforms undertaken throughout history. The Mwongozo Code is an important policy document but is inadequate if it is not reviewed.

## **1.6 Justification of the Study**

The study will greatly contribute towards establishing effective policies in Kenya since it will create a better understanding of the challenges hindering effective implementation of corporate governance principles in Kenya's State Corporations. The documentation of the legislative gaps will lead to better formulation of the laws and regulations to better address the governance challenges in Kenya's State Corporations. A complete understanding of the challenges will lead to better strategy formulation and implementation that will subsequently lead to reduction in cases of mismanagement in Kenyan State Corporations and their collapse.

## 1.7 Literature Review

State Corporations play a crucial role in aiding in the development of a country but it cannot function without having proper governance structures in place. According to Kiratu<sup>30</sup> the level of poor development in developing countries can be directly attributed to lack of proper corporate governance practices. If a country does not have legislation that supports implementation of corporate governance principles in place, the organizations are bound to perform poorly.<sup>31</sup> He goes on to state that poor corporate governance can be seen through fraudulent acts such as appointment of boards not based on merit, failure to account for funds utilized and failure to comply with the law. Kiratu further attributes the corporate failures of State Corporations to the limited understanding of corporate governance issues and a weak judicial system. This would mean that though we have the Code for guidance how do we ensure implementation of the principles? There are no repercussions for failure to apply the corporate governance principles.

According to Mulili and Wong<sup>32</sup>, we should not view corporate governance practices as a one size fits all rather each country should adapt to their circumstances and needs. The corporate governance principles employed in developed countries should be different to those in developing countries. Developing countries should therefore take into account their surroundings such as cultural, political and technological environment which will affect the

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<sup>30</sup> Anthony Mukangu Kiratu, 'Influence of Corporate Governance on Organizational Performance In Kenya: A Case of Agricultural State Corporations' <<https://strategicjournals.com/index.php/journal/article/view/266>> accessed 8 September 2020.

<sup>31</sup> Stijn Claessens & Burcin Yurtoglu, 'Corporate governance in emerging markets: A survey' *Emerging markets review*, 15, 1-33 (2013).

<sup>32</sup> Benjamin Mwanzia Mulili, & Peter Wong, 'Corporate governance practices in developing countries: The case for Kenya', (201) *International Journal of Business Administration*, 2(1) <<http://www.sciedu.ca/journal/index.php/ijba/article/view/37>> accessed 8 September 2020.

implementation of corporate governance practices which will enable them achieve their desired result and also have the ability to adapt to the ever changing environment.<sup>33</sup>

Kiarie Mwaura<sup>34</sup> identifies the problems that arise in implementing corporate governance principles as lack of a measure of profitability for the corporations. They have no set targets and they do not base their performance on profitability nor are there any incentives. Another issue is on conflict of interest due to boards being appointed by the Cabinet Secretary and the President. The board of directors therefore tend to serve the interests of the appointing authority.

Miring'u & Muoria<sup>35</sup> in their study which was an analysis of the public sector deduced that the poor performance of State Corporations is attributable to lack of a qualified board, poor governance practices, no legal framework, rampant corruption and interference from politicians. Miring'u & Muoria observed that the governance structure in place influence how the State Corporation is able to respond to any issues that arise which is also determined by ability of the board.<sup>36</sup>

According to Ireri, one of the major challenges in State Corporations is in the appointment process as the boards are appointed by Cabinet Secretaries and the President which converts the appointment into a political process. The Directors are thereafter left with no choice that to serve the interests of the appointing authority as failure to do so will lead to them being removed from the boards. The interests of the organization are put at the back due to the

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<sup>33</sup> Benjamin Mwanzia Mulili, & Peter Wong, 'Corporate governance practices in developing countries: The case for Kenya', (201) International Journal of Business Administration, 2(1) <<http://www.sciedu.ca/journal/index.php/ijba/article/view/37>> accessed 8 September 2020

<sup>34</sup> Kiarie Mwaura, 'The Failure of Corporate Governance in State Owned Enterprises and the Need for Restructured Governance in Fully and Partially Privatized Enterprises: The Case of Kenya' 34 at.p.43-74 <<https://ir.lawnet.fordham.edu/cgi/viewcontent.cgi?article=2080&context=ilj>> accessed 7 September 2020.

<sup>35</sup> Alice N. Miring'u & Esther T. Muoria, 'An analysis of the effect of Corporate Governance on Performance of Commercial State Corporations in Kenya' (2012) International Journal of Business and Public Management, 1(1): 36-41.

<sup>36</sup> Alice N. Miring'u & Esther T. Muoria, 'An analysis of the effect of Corporate Governance on Performance of Commercial State Corporations in Kenya' (2012) International Journal of Business and Public Management, 1(1): 36-41.

conflicting interests of the appointing authority, stakeholders and the organization at large.<sup>37</sup>

He proposes the various legislation to be streamlined and the government abstain from involvement in the management of the State Corporation.

## **1.8 Theoretical Framework**

This study will be based on the well-known agency theory which is the widely recognized and applicable to corporate governance. It will also look at the stakeholder theory which departs from the concept of agency theory.

### **1.8.1 The Agency Theory**

Agency theory is based on the assumption that there is a contract between the holders of the resources and the individuals known as agent who ought to act in the interest of the resource holder who is the principal. Jensen and Meckling<sup>38</sup> that the only way agents can act on behalf of the principal is through incentives being put in place so as to ensure the decisions made are beneficial to the principal and checks put in place for the agent.

This relationship is however not necessarily in consonance as it raises an impediment in the principal-agent model.<sup>39</sup> According to Eisenhardt, the aim of agency theory is to solve two issues that normally arise with the first being agency problems that arise when the goals of the principal are in conflict with those of the agent and where the principal cannot verify the actions of the agent and whereby the principal and agent have dissimilar aversions to risk.<sup>40</sup>

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<sup>37</sup> Elijah Njagi Ileri, 'Kenya's Legal and Regulatory Framework on the Appointment of Board of Directors (BOD) for State Owned Enterprises (SOE) and Its Effectiveness' (2016), *International Journal of Humanities and Social Science* Vol. 6, No. 12 <[https://www.ijhssnet.com/journals/Vol\\_6\\_No\\_12\\_December\\_2016/6.pdf](https://www.ijhssnet.com/journals/Vol_6_No_12_December_2016/6.pdf)> accessed 8<sup>th</sup> September 2020.

<sup>38</sup> Ibid.

<sup>39</sup> Eugene F. Fama and Michael C. Jensen, 'Agency Problems and Residual Claims' (1983). *Journal of Law and Economics* 26, 327-349 36.

<sup>40</sup> Kathleen Eisenhardt, 'Agency Theory: An Assessment and Review' (1989), *The Academy of Management Review*, 14(1), 57-74. <<http://www.jstor.org/stable/258191>> accessed 9 September 2020.

The theory seeks to determine the contract terms that will efficiently reduce the problems associated between the principal and the agent relationship given the assumption that people are driven by selfish interests, bound by their logic and are reluctant to take any risks that would be to their detriment. Under the agency theory it is assumed that if the remuneration of the agent is fixed it will not motivate them but variable remuneration based on the performance of the corporation or profits would be an influencing factor in their performance.

The agent therefore does not take any risk with the view of adding any benefit to the principal rather as Simon Herbert was quoted in Bassinger and Hoskisson<sup>41</sup> stated that the managers are merely satisfiers rather than maximizers as they are more concerned with perpetuating their continuity as opposed to focusing on increasing the value of the organization for the benefit of the shareholder. The agent therefore does the bare minimum as they tend to play it safe.

### **1.8.2 Stakeholder theory**

This theory was originally detailed by R. Edward Freeman.<sup>42</sup> The underpinnings of this theory are derived from the significance a corporation plays through identification and recognition of the different stakeholders groups in the society as opposed to being focused solely on the investors. That is, the duty of the organization to serve the community at large besides a focus on the maximization of shareholders' wealth. The theory opines that the corporations' actions have the capacity to affect the different stakeholders in the community and that their success is dependent on whether they have impacted the stakeholders through value addition to them.

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<sup>41</sup> Barry Baysinger & Robert Hoskisson, 'The Composition of Boards of Directors and Strategic Control: Effects on Corporate Strategy' (1990), *The Academy of Management Review*, 15(1), 72-87. <<http://www.jstor.org/stable/258106>> accessed 9 September 2020.

<sup>42</sup> Robert E. Freeman, *Strategic Management: A Stakeholder Approach*. (Pitman, Boston, MA 1984).

The Mwongozo Code in chapter 6 has also identified the need for stakeholders as they have provided for the board to undertake stakeholder mapping, development of policies to manage them, open channels of communication with the stakeholders, recording of stakeholder's interests and ensuring the reputation of the organization is protected. This shows that stakeholders have an impact on the organization and the organization cannot operate in oblivion limiting its duties and responsibilities to only the shareholders as can be seen in the famous Berle Dodd debate.<sup>43</sup> Berle was of the view that managers owe their duty solely to shareholders<sup>44</sup> while Dodd was of the opposite view that corporations should be responsible to the society as well, as they need each other in order to coexist.<sup>45</sup> Dodd's arguments are based on the assumption that a corporation cannot function on its own, but there is the existence of external factors that may influence how a corporation is managed and this should not be ignored as was seen in the case of *AP Smith Manufacturing*<sup>46</sup> whereby the New Jersey Supreme Court held that a corporation could make charitable donations. A corporation should therefore be alive to the fact that there are other external factors which influence its management as it cannot exist in a vacuum to serve the sole needs of shareholders.

When a corporation promotes the stakeholder relationships and manages their interests which in turn leads to their satisfaction, the stakeholders feel obligated to support the corporation. As a result, corporations should take into consideration the rights of various stakeholders and make appropriate considerations when making any decisions that will impact on the stakeholders. The proponents of stakeholder theory are of the view that in order for the rights of stakeholders to be protected they should be represented in the board of directors. Stakeholder involvement in the board will ensure a reduction in the conflicts that may arise

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<sup>43</sup> Lynn A. Stout, Bad and Not-so-Bad Arguments for Shareholder Primacy <<https://scholarship.law.cornell.edu/cgi/viewcontent.cgi?article=1833&context=facpub>> accessed 10 September 2020.

<sup>44</sup> Adolph A. Berle, 'Corporate Powers as Powers in Trust', 44 HARV. L. REV. 1049, 1049(1931).

<sup>45</sup> E. Merrick Dodd, 'For Whom Are Corporate Managers Trustees?', 45 HARV. L. REV. 1145,1148 (1932).

<sup>46</sup> *A.P. Smith Manufacturing Company v. Barlow* (1953).

and propagate good corporate governance. This appears to be the theory advising the Constitution when it calls for the representation by the youth, marginalized communities, advocates for gender equality, regional representation in all public activities including those of State Corporations.

Article 73 of the Constitution of Kenya, echoes this provisions which enshrines affirmative action. State Corporations should therefore be governed in a manner that allows for representation and diversity as can be seen in our country and promotes adequate and equal opportunities when it comes to the appointment, training and advancement at all levels of the public service for both men and women. It should also take into account issues on ethnicity, youth representation and representation on persons with disabilities.<sup>47</sup>

The actions of management may therefore have conflicting effects on the various stakeholders in existence. It is the duty of managers to identify the various stakeholders and try to balance the competing interests that arise. The approach taken by the corporation should be more proactive than reactive thus the managers should take into account the interests of the various stakeholder when making any decisions.

## **1.9 Research Methodology**

The research will take an analytical approach by critically analyzing the Mwongozo code and other codes that were used as a point of reference in formulating it and see why it has failed.

The collection of the data in support of the paper will be through primary and secondary sources. The primary sources will include various acts, laws and policies in place governing corporate governance among State Corporations in Kenya and whether the same is efficient or whether there is need for formulation of new laws and policies.

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<sup>47</sup> Brooke Manville & Josiah Ober, 'Beyond Empowerment: Building a Company Of Citizens' (2003), Harvard Business Review, 81(1), 48-53. 46. 26 pp.245- 57. 15.



The secondary sources that will be relied on will be from research studies, books journals reports, theses, academic journals, textbooks, newspapers, internet websites and dictionaries to obtain the relevant information for its data collection and analysis.

## **1.10 Chapter Break Down**

This thesis will be divided into five chapters as follows:-.

### **Chapter One: Introduction**

This chapter will act as an introduction to the study by providing a brief background of the study, identify the problem statement, research objectives, research questions, literature review, theoretical framework, research methodology and finally the chapter outline of the study.

### **Chapter Two: Extent of the Application of Mwongozo Code of Governance for State Corporations in Kenya**

This chapter will provide a detailed discussion on the application of corporate governance principles in Kenya's State Corporations and expound the extent to which they are implementing the principles.

### **Chapter Three: Critique on the adequacy of the Mwongozo Code in addressing the corporate governance needs of State Corporations in Kenya**

This chapter will identify the legislative gaps hindering effective implementation of corporate governance principles in Kenyan State Corporations with a view to highlighting the best practices that Kenya can adopt for purposes of improving performance of State Corporations.

### **Chapter Four: Comparative Analysis**

This chapter will be a comparative analysis of the Mwongozo Code vis-a-vis other established codes of different countries such as Malaysia, South Africa and the United Kingdom which were used as a basis for developing the Mwongozo Code in Kenya.

## **Chapter Five: Conclusion and Recommendations**

It will be a presentation of the conclusions and recommendations of the study. It will build on the previous chapters and summarize the entire study, its findings and broadly make recommendations on key policy, legal and institutional reforms to ensure effective performance of State Corporations in Kenya.

## CHAPTER TWO

### EXTENT OF THE APPLICATION OF MWONGOZO CODE OF GOVERNANCE FOR STATE CORPORATIONS IN KENYA

#### 2.1 Introduction

This chapter will be focused on the meaning and understanding of the concept of corporate governance and how it came to be in Kenya. It is a review of how the Mwongozo Code was drafted, the purpose and whether there is legislation currently in place that allows for implementation of the principles in State Corporations as envisioned in the Mwongozo Code. This chapter also looks at the State Corporations in Kenya and try to understand the relationship that currently exists between the State Corporations and the Mwongozo Code.

#### 2.2 Understanding the Concept of Corporate Governance

Corporate governance that gained momentum due to the various corporate scandals that were experienced between the late 1900s and the early 2000s.<sup>48</sup> One such scandal that rocked the world was the Enron scandal<sup>49</sup> whereby the world saw the collapse of Enron Corporation which filed for bankruptcy in the end. The managers that were entrusted with protecting the interests of shareholders proved to be more detrimental by pursuing their own selfish interests which in the end resulted in diminished share value of a corporation.

There is no one definition of corporate governance as it varies in each country as different authors have defined it according to their own understanding. According to the 1992 Cadbury Report it defined corporate governance as a *system by which companies are directed and controlled*.<sup>50</sup> The Cadbury Report's influence cannot be ignored as it set out the basic

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<sup>48</sup> Introduction to Corporate Governance, <<https://www.businessballs.com/organisational-culture/corporate-governance/>> accessed 17 September 2020.

<sup>49</sup> William W. Bratton, 'Enron and the Dark Side of Shareholder Value' (2002), Tulane Law Review 76: 1275-1361.

<sup>50</sup> Report of the Committee on the Financial Aspects of Corporate Governance (1992) <<http://www.ecgi.org/codes/documents/cadbury.pdf>> accessed 17 September 2020.

corporate standards of governance that other Codes were based on and introduced the concept of ‘comply or explain’. It is also important to note that in preparing the Cadbury Report, the Chairman of the committee Adrian Cadbury explicitly stated that in setting out the recommendations of the committee they would have to be reviewed over time taking into account the changing circumstances and other developments in governance.<sup>51</sup> This means that corporate governance codes ought to be reviewed periodically to suit the circumstances and ever developing changes in the economy.

Another definition on corporate governance is whereby there is a system of structures and processes that are in place that ensure a corporation is being run effectively while trying to balance the different interests of the various stakeholders. Simply put corporate governance according to Ching et al, is that it constitutes a set of rules that govern the relationship between management, shareholders and stakeholders.<sup>52</sup> It is an essential element that influences the growth and development of a country due to its impact on the economy and should therefore be regulated by the government as failure to do so has adverse effects.<sup>53</sup> A good example of this can be seen in the Asian Financial Crisis of 1997<sup>54</sup> which affected several Asian countries, such as Malaysia, Thailand, South Korea and Indonesia whereby the governance standards were poor in both private firms and government owned entities.<sup>55</sup>

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<sup>51</sup> Ibid

<sup>52</sup>Ching, K. W., Tan, J. S., & Ching, C. R. G, ‘Corporate governance in East Asia: The road ahead : analysis and case studies in China, Hong Kong, Taiwan, Korea, and Japan’ (2006), Singapore New York: Pearson Prentice Hall.

<sup>53</sup> Leng, , ‘The Impact of Corporate Governance Practices on Firms' Financial Performance: Evidence from Malaysian Companies’ (2004), ASEAN Economic Bulletin, 21(3), 308-318 <[www.jstor.org/stable/25773828](http://www.jstor.org/stable/25773828)> accessed 29 November 2019.

<sup>54</sup> Yilmaz Akyuz, ‘Causes and Sources of The Asian Financial Crisis’ <[https://unctad.org/en/Docs/ux\\_hi\\_akyuz.en.pdf](https://unctad.org/en/Docs/ux_hi_akyuz.en.pdf)> accessed 29 November 2019.

<sup>55</sup> Allan Chang Aik Leng, ‘The Impact of Corporate Governance Practices on Firms' Financial Performance: Evidence from Malaysian Companies’ (2004), ASEAN Economic Bulletin, 21(3), 308-318 <[www.jstor.org/stable/25773828](http://www.jstor.org/stable/25773828)> accessed 29 November 2019.

### 2.3 State Corporations in Kenya

In Kenya, State Corporations were established during the colonial era by the government to supplement services that were currently not being provided by the public sector. It is through the Sessional Paper No. 10 of 1965 after Kenya attaining its independence that the concept of nationalization was borne and the principles guiding it set forth. The government embarked on measures that would drive rapid economic growth for the country as well as various programs for Africanization of Kenya's economy.<sup>56</sup> It was focused on development of the economy and had already identified the key sectors that required intervention in order for it to succeed. However, the State Corporations had many shortfalls that resulted in the collapse of many corporations despite the various reforms undertaken by the different regimes since the 1960s.<sup>57</sup>

Due to the issues plaguing State Corporations regardless of the reforms that had been previously undertaken, it was noted that more reforms were needed in order to salvage the situation and ensure that State Corporations contribute to economic growth and development as the government had initially intended. The Government therefore enacted the State Corporations Act.<sup>58</sup>

A State Corporation also known as a parastatal or State Owned Enterprise is established under the State Corporation Act.<sup>59</sup> A State Corporation under Section 3 of the State Corporation Act is defined to mean a body corporate established by the President to perform specific functions. State corporations have undergone various reforms since Kenya attained its independence in 1963. The Government had already seen the importance of State

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<sup>56</sup> Tiyanbe Zeleza, 'Economic Policy and Performance In Kenya Since Independence' (1991), *Transafrican Journal of History*, 20, 35-76 <<http://www.jstor.org/stable/24520302>> accessed 17 September 2020.

<sup>57</sup> S. Muindi, 'Public Enterprises In Reform and Privatisation In Kenya' <<http://unpan1.un.org/intradoc/groups/public/documents/AAPAM/UNPAN028231.pdf>> accessed 16 October 2019.

<sup>58</sup> CAP 446.

<sup>59</sup> Ibid.

Corporations in Kenya as they were critical in promoting development though it resulted in monopolies being created such as we currently have Kenya Power and Lighting Company. There was a strong push to create State Corporations and this was discussed and put forth through Sessional Paper No. 10 of 1965.<sup>60</sup>

The basis of establishment of State Corporations was well intended, but its continuity and ensuring its survival in the ever evolving economic sphere was hampered due to the rigidity of most State Corporations in Kenya which did not have a clear end goal. State Corporations were still deteriorating and this was due to the fact that they continued to rely on public sector financing so as to sustain their activities. This now translated to the State Corporations being unable to reinvest, lack of provision of proper services, inability to meet demands of supply and demand.<sup>61</sup>

Due to the failure occasioned by the State Corporations Act<sup>62</sup> the government needed to re-strategize. Sessional Paper No.4 of 1991 on Development and Employment in Kenya sought to offer a solution with a need to re-evaluate the basis of creation of State Corporations during that period in time.<sup>63</sup> The needs of the country had changed as compared to when the country had just attained its independence and the government had an opportunity to fix the problems the State Corporations were currently experiencing. From the period when the country gained independence till 1990, the government had an exponential growth in the

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<sup>60</sup> African Socialism and its Application to Planning in Kenya <[http://siteresources.worldbank.org/INTAFRICA/Resources/257994-1335471959878/Sessional-Paper-No-10-\(1965\).pdf](http://siteresources.worldbank.org/INTAFRICA/Resources/257994-1335471959878/Sessional-Paper-No-10-(1965).pdf)> accessed 11 October 2019.

<sup>61</sup> African Socialism and its Application to Planning in Kenya <[http://siteresources.worldbank.org/INTAFRICA/Resources/257994-1335471959878/Sessional-Paper-No-10-\(1965\).pdf](http://siteresources.worldbank.org/INTAFRICA/Resources/257994-1335471959878/Sessional-Paper-No-10-(1965).pdf)> accessed 11 October 2019.

<sup>62</sup> Chapter 446 Laws of Kenya.

<sup>63</sup> Sessional Paper No.4 of 1991 on Development and Employment in Kenya. Government printer. Nairobi Kenya.

number of State Corporations that it had a stake in. There were a total of 240 State Corporations of which the Government had majority shareholding.<sup>64</sup>

The government therefore undertook comprehensive reforms through privatization and divestiture. According to Muindi, privatization and divestiture is concerned with transferring of functions from government entities to the private sector.<sup>65</sup> The reason for privatization was to reduce the government's burden in terms of production, delivery and supply of goods and services and shifting or leveraging the burden it currently had with the private sector as the government could not sustain the number of State Corporations it was supporting financial.

The privatization and divestiture was whereby it identified the most critical State Corporations and classified them into two categories which were either strategic or non-strategic.<sup>66</sup> Strategic State Corporations were those that were in charge of providing essential services such as health, national security and preservation of the environment while the non-strategic would be privatized. The primary objective of the privatization and divestiture process was to ease the governments' burden financially, create self-sufficient corporations that were commercially viable and vest these corporations in the hands of citizens who had the necessary skill set to ensure their continuity

#### **2.4 Application of the Mwongozo Code of Conduct in Kenya's State Corporations**

The Constitution of Kenya 2010 provided a basis for formulating a code of governance that would govern all State Corporations in Kenya which had already suffered losses over a period of years. The Constitution provides for national values and principles of governance under Article 10.

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<sup>64</sup> S. Muindi, 'Public Enterprises in Reform and Privatisation in Kenya' <<http://unpan1.un.org/intrdoc/groups/public/documents/AAPAM/UNPAN028231.pdf>> accessed 16 October 2019.

<sup>65</sup> Ibid.

<sup>66</sup> n 17.

The Constitution therefore paved way for formulation of Mwongozo the Code of Governance for State Corporations. The Mwongozo Code came to be through a taskforce that was appointed by His Excellency the President of the Republic of Kenya, Uhuru Muigai Kenyatta on 23rd July 2013 with its mandate being the review of parastatal reforms in Kenya.<sup>67</sup>

By implementing the Mwongozo Code, Kenya would also adopt the key principles as set out by the Convention of the Organization for Economic Cooperation and Development (OECD).<sup>68</sup> The Mwongozo Code was developed as a joint venture between various institutional bodies in Kenya namely the Implementation Committee in partnership with the State Corporations Advisory Committee (SCAC) and Institute of Certified Public Secretaries of Kenya (ICPSK) and in consultation with the World Bank.<sup>69</sup> The Mwongozo Code borrows from other policies and guidelines from other jurisdictions such as the United Kingdom, South Africa, Malaysia, Singapore and India.<sup>70</sup>

The Mwongozo Code addresses issues that have been raised over the course of years with incompetent boards, bloated boards, lack of transparency and disclosure, accountability, risk management, no internal control measures, ethical leadership and good corporate citizenship. It goes further by providing a platform for addressing the rights and obligations of shareholders and ensures that stakeholders' legitimate interests and expectations are managed. The implementation of Mwongozo was meant to ensure that sustainability among State Corporations is promoted and their performance would in turn aid in achieving the goals of Vision 2030 of the Country.<sup>71</sup> The Mwongozo Code provides a framework

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<sup>67</sup> Presidential Task Force on Parastatal Reforms <<http://www.scac.go.ke/2015-02-16-09-34-58/presidential-taskforce>> accessed 18 October 2019.

<sup>68</sup> G20/OECD, 'Principles of Corporate Governance' <<https://www.oecd.org/daf/ca/Corporate-Governance-Principles-ENG.pdf>> accessed 19 October 2019.

<sup>69</sup> n 20.

<sup>70</sup> Mwongozo The Code of Governance for State Corporations <<https://drive.google.com/file/d/0BytnSZLruS3GdVVuOFRRa0RrYTQ/view>> accessed 21 February 2019.

<sup>71</sup> n 23.



embodying board charters, codes of conduct, professional ethics and performance management.

## 2.5 Agency Theory

Agency theory is one of the fundamental theories of corporate governance as it is based on the principal-agent relationship and brings about the concept of separation of ownership.<sup>72</sup> In the context of a State Corporation, the public who are the shareholders are principals and the agents are the board of the State Corporation. The agency theory is thus put in a two dimensional aspect in that there is the agent who is hired by the principal in order to protect the interests of the principal but in essence this theory is skewed as in State Corporations the boards are appointed by the government and therefore a conflict of interest arises. This conflict of interest arises due to the fact that the agent should act in the best interest of the State Corporation which is similar to the interest of the shareholder in most instances however, the agent may end up serving the interests of his appointing authority.<sup>73</sup>

As seen in chapter 1 of this paper, agency theory aims to resolve the problems that arise due to conflict of interest between the principal and agent and the lack of a verification system whereby the principal is aware of the actions of the agent.<sup>74</sup> The Mwongozo Code under chapter 5 provides for shareholder rights and obligations. The governance principle in that chapter states that *the Board should protect the rights of all shareholders and optimize shareholder value*. We can see from this statement that the agency theory which is based on protecting the rights of the principal (shareholder) and the Mwongozo lays emphasis on this by providing for protection of all shareholder even minority shareholders.

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<sup>72</sup> Sorin Nicolae Borlea, Monica-Violeta Achim, 'Theories of Corporate Governance in Studia Universitatis "Vasile Goldiș"', Arad Economics Series Vol 23 Issue 1/2013.

<sup>73</sup> State Corporations Act, CAP 446, Section 6.

<sup>74</sup> Kathleen Eisenhardt, 'Agency Theory: An Assessment and Review' (1989), The Academy of Management Review, 14(1), 57-74. <http://www.jstor.org/stable/258191> 9 September 2020.

The Mwongozo Code also states that the Board should ensure that they provide the shareholders with all necessary information required to make decisions, educating shareholders on their rights among other rights.<sup>75</sup> The code therefore encompasses the agency theory trying to resolve any agency issues that may arise in the agency set up in a State Corporation.

## **2.6 Stakeholder Theory**

Stakeholders have been defined as any individual or group that is affected by the actions of an organization whether directly or indirectly.<sup>76</sup> They include the shareholders, managers, employees, suppliers, investors, customers, communities and many other groups that interact and influence the business of the company.<sup>77</sup>

This theory moves away from the traditional concept of principal-agent relationship which is focused only on the shareholder. The stakeholder theory as briefly mentioned in chapter 1 of this paper was aptly brought out in the Berle-Dodd debate whereby Berle was of the view that shareholder rights are the most important and that managers owe their duty solely to shareholders<sup>78</sup>, while Dodd was of the opposite view that managers should take into account other external parties that may affect the running of the corporation.<sup>79</sup>

The question that therefore arises as to whom can be classified as a stakeholder? These are other parties who impact on the corporation but may not be seen to directly interact with the corporation such as the communities where these State Corporations are located, the government which formulates laws, policies and regulations that affect the running of the

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<sup>75</sup> Chapter 5 of Mwongozo The Code of Governance for State Corporations.

<sup>76</sup> Robert E. Freeman, *Strategic Management: A Stakeholder Approach*. (Pitman, Boston, MA 1984).

<sup>77</sup> Sorin Nicolae Borlea, Monica-Violeta Achim,, 'Theories Of Corporate Governance in Studia Universitatis "Vasile Goldiș"', Arad Economics Series Vol 23 Issue 1/2013.

<sup>78</sup> Adolph A. Berle, 'Corporate Powers as Powers in Trust', 44 HARV. L. REV. 1049, 1049(1931).

<sup>79</sup> E. Merrick Dodd, 'For Whom Are Corporate Managers Trustees?', 45 HARV. L. REV. 1145,1148 (1932).

corporations, the media which can influence how a corporation is perceived in the public and other small groups.

A corporation can therefore view stakeholders as those who are affected by the corporations' actions. According to Clarkson, all stakeholders have equal rights and none should be given a priority over the other.<sup>80</sup> He further states that a managers responsibilities should now include fulfilling the corporation's responsibilities to its various stakeholders.<sup>81</sup> Clarkson further asserts that it is the mangers responsibility to resolve any disputes that may arise between the different stakeholder groups.<sup>82</sup>

Clarkson brings out an important aspect that it is upon the corporations and their managers to first off recognize the existence of stakeholders and their importance, secondly outline their responsibilities and obligations towards the various stakeholders and lastly recognize any claims that the stakeholders have.<sup>83</sup> Corporate success can therefore not be measured only by creation of wealth to the shareholder only but to all stakeholders.

The Mwongozo Code under chapter 6 has also recognized the need to protect stakeholder relations. The stakeholder theory is therefore perpetuated in the code of governance and allows for the Board to undertake mapping of stakeholders, developing policies that manage stakeholder relations, open communications lines with the stakeholders, document stakeholders interests, expectations and any influence they may have.

Stakeholder theory can therefore not be ignored as it plays a crucial role in the support and growth of a State Corporation as can be seen in its provision in Mwongozo the Code of

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<sup>80</sup> Max B. E. Clarkson, 'A Stakeholder Framework for Analyzing and Evaluating Corporate Social Performance' (1995), *The Academy of Management Review*, 20(1), 92-117 <<http://www.jstor.org/stable/258888>> 18 September 2020.

<sup>81</sup> Ibid

<sup>82</sup> Ibid.

<sup>83</sup> Max B. E. Clarkson, 'A Stakeholder Framework for Analyzing and Evaluating Corporate Social Performance' (1995), *The Academy of Management Review*, 20(1), 92-117 <<http://www.jstor.org/stable/258888>> 18 September 2020

Governance for State Corporations in Kenya. The Code has also made a provision for identification of rights of the key stakeholders, development of a dispute resolution mechanism and recognition of the national and county government as a stakeholder and to ensure proper relations are maintained with the state corporation.

## **2.7 Performance of State Corporations in Kenya**

The State Corporations Act has provided for two bodies who play a supervisory role in corporations in Kenya which is the Inspector-General (Corporations)<sup>84</sup> and the State Corporations Advisory Committee<sup>85</sup>. The Inspector-General (Corporations) is mandated to provide advisory services to the government in matters affecting the effective running of State Corporations together with other responsibilities one of which is undertaking investigations into any state corporation on behalf of the State Corporations Advisory Committee or the Auditor General.<sup>86</sup>

We therefore see two supervisory bodies that have been enacted under the State Corporations Act, Chapter 446 but none has proved its efficiency seeing as the State Corporations are yet to make a positive turnover as can be seen below.

The various scandals that have rocked the country in relation to State Corporations in Kenya, and the collapse of state owned entities has highlighted the problems we are currently facing which can be attributed to poor corporate governance practices in Kenya. It is therefore critical to enact legislation that can aid in regulation of these State Corporations. As mentioned in chapter 1, poor corporate governance practices have impacted our national carrier Kenya Airways with a reported net loss of KShs. 26.2bn which has gone up from the

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<sup>84</sup> State Corporations Act, CAP 446, Section 18.

<sup>85</sup> Ibid Section 27.

<sup>86</sup> <sup>86</sup> State Corporations Act, CAP 446, Section 18.

previous year.<sup>87</sup> Other sectors have also been affected whereby we have witnessed the collapse of banks which have been placed under receivership such as Imperial Bank Limited and just recently Chase Bank Kenya Limited.<sup>88</sup> Imperial Bank of Kenya was placed under receivership in the year 2015 after it was discovered that shareholders deposit in the amount of Kshs. 34 billion was missing.<sup>89</sup>

Is it the management that can be blamed for the crisis that befalls these companies and what role does the government play in ensuring that good corporate governance practices are employed in the public sector. In giving his views on a board, Rogers CJ in *AWA Ltd v Daniels (1995) 13 ACLC 299*, said that the board is tasked with the authority to appoint the CEO, set goals and have appropriate plans which enable it to fulfil its objectives.

The Board of a State Corporation is responsible for the proper management of the affairs of the State Corporation. It carries the overall direction and management of the State Corporation. The corporate scandals are not limited to only Kenya but is a worldwide affair. There have been many scandals from around late 1990s to early 2000s such as mentioned earlier Enron, Worldcom and Tyco.<sup>90</sup> It is due to these scandals that the need for corporate governance arose and the importance of government regulation realized.

The Mwongozo Code takes the approach of “comply or explain” and therefore does not make it mandatory to comply with the code. If the Mwongozo Code was made mandatory to all State Corporations, it would enhance efficiency of Corporate Governance principles and reduce the number of issues that are plaguing them especially incidences of corruption which are affecting the ability of the government to deliver to its citizens and contributing to the

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<sup>87</sup> Financial Times, <https://www.ft.com/content/006aacfe-4f44-11e6-8172-e39ecd3b86fc> accessed on 24 November 2016.

<sup>88</sup> CBK officials probed over Imperial Bank mega fraud <<https://www.businessdailyafrica.com/corporate/companies/CBK-officials-probed-over-Imperial-Bank-mega-fraud/4003102-4579102-w31ueaz/index.html>> accessed 21 October 2019.

<sup>89</sup> Ibid.

<sup>90</sup> The 10 Worst Corporate Accounting Scandals of All Time <<https://www.accounting-degree.org/scandals/>> accessed 19 October 2019.

government having to resort to obtaining loans for purposes of aiding development from international organizations such as the World Bank. Recent reported cases of corruption can be seen in the National Youth Services (NYS), Kenya Revenue Authority (KRA), Kenya Power & Lighting Company (KPLC), National Hospital Insurance Fund (NHIF) and National Cereals and Produce Board (NCPB) where millions and billions have been lost and the cases are still under investigations and cases on-going.<sup>91</sup>

The failure in application of the principles of corporate governance such as accountability, responsibility, fairness, transparency means the boards are lax in undertaking and overseeing their mandate yet there is the existence of the Mwongozo Code. It is quite apparent that the Mwongozo Code has failed in its entirety just by the mere examination of the corporate scandals that are rocking the country. It is quite perplexing to indicate that we have the Mwongozo Code but its application is yet to be felt.

We are still experiencing challenges in the implementation of the Mwongozo Code such as;

- (a) Most State Corporations are established by an Act which governs their operations for example KALR Act<sup>92</sup> and the NHIF Act.<sup>93</sup> Provisions of these governing Acts are in conflict with some provisions of Mwongozo whereby Mwongozo states that the board membership should be between seven and nine members while the individual Acts governing various corporations have a higher number such as the KALR Act and NHIF Act. These Acts therefore are not in conformity with the Mwongozo Code and since the Code is simply a policy document, the Act prevails and is applicable whenever a conflict arises;

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<sup>91</sup> It didn't start with the dams: A journey through Jubilee scandals  
<<https://www.standardmedia.co.ke/article/2001315620/damning-scandals-it-didn-t-start-with-the-dams>>  
accessed 24 August 2019.

<sup>92</sup> Kenya Agricultural and Livestock Research Act 2013.

<sup>93</sup> National Hospital Insurance Fund Act, CAP 255.

- (b) Key positions in State Corporations remain vacant for long periods of time which cripples operations<sup>94</sup> due to a lack of fully constituted boards.<sup>95</sup> The government is not focused in assisting in the implementation of the Mwongozo Code as failure on its part to constitute boards shows the nature of irreverent on the governments' side. How can a State Corporation during this day and age operate without a board? The government is lacking on its part and is part of the problem being experienced by State Corporations;
- (c) Most of the board appointments are more political rather than being skills based.<sup>96</sup> A board appointment in Kenya is attributed to your political affiliation and is seen as a reward for offering support to the current government in place; and
- (d) Lack of adequate funding as some recommendations of Mwongozo require finances to implement such as board induction and continuous development of skills. The Mwongozo Code also requires governance audits to be undertaken which also requires finances.

The Mwongozo Code in its application lacks the backbone to ensure State Corporations comply with the principles, not just on paper but actual application. Most of the Codes which were relied on when the Mwongozo Code was being formulated such as the Malaysian Code, South African Code and the UK Code have all been revised and Kenya should do the same having had a chance to see where its application has failed. This process should involve all stakeholders while taking into account how the Code affects State Corporations in Kenya so

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<sup>94</sup> Watchdog committee alarmed by lack of full boards for parastatals  
<<https://www.standardmedia.co.ke/article/2001275168/watchdog-committee-alarmed-by-lack-of-full-boards-for-parastatals>> accessed 21 October 2019.

<sup>95</sup> 69 State agencies have no boards  
<<https://www.standardmedia.co.ke/article/2001280617/69-state-agencies-have-no-boards>> accessed 21 October 2019.

<sup>96</sup> Published in the Kenya Gazette, as Vol. CXXI—No. 56,  
<[http://kenyalaw.org/kenya\\_gazette/gazette/volume/MTk1NA--/Vol.CXXI-No.56/](http://kenyalaw.org/kenya_gazette/gazette/volume/MTk1NA--/Vol.CXXI-No.56/)> accessed 20 August 2019.

that it fits our unique situation with clear objectives on what we want to achieve economically.

## **2.8 Implications of COVID-19 on Corporate Governance in State Corporations**

Even as Kenya grapples with trying to implement the Mwongozo Code in State Corporations, corporate governance has been dealt a blow with the emergence of a pandemic known as COVID-19.<sup>97</sup> The emergence of COVID-19 has resulted in extreme measures being adopted so as to curb the spread of the virus<sup>98</sup> as it was suggested that the virus was spread from direct and indirect contact from contaminated surfaces and people who were infected, and affected a person's respiratory system for those who got the most severe form of the virus which could lead to death.<sup>99</sup>

The restrictions put in place in Kenya included cessation of movement into and out of certain counties such as Nairobi, Mombasa, Kilifi and Kwale, a nationwide dusk to dawn curfew, no international flights coming into or out of the country in a move to try and curb the spread of the virus.<sup>100</sup> According to a World Bank report the global COVID-19 pandemic will have a negative impact on the Kenyan economy as it had already been observed from that the GDP growth in 2019 stood at 5.4%, which was down from 6.3% percent in 2018.<sup>101</sup>

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<sup>97</sup> <https://www.who.int/csr/don/05-january-2020-pneumonia-of-unkown-cause-china/en/> accessed 17 September 2020.

<sup>98</sup>Address to the nation by H.E. UHURU KENYATTA, C.G.H, President of the Republic of Kenya and Commander-in-chief of the defence forces on COVID-19, commonly known as coronavirus at Harambee House, Nairobi on 15TH MARCH 2020  
<https://www.president.go.ke/2020/03/15/address-to-the-nation-by-h-e-uhuru-kenyatta-c-g-h-president-of-the-republic-of-kenya-and-commander-in-chief-of-the-defence-forces-on-covid-19-commonly-known-as-coronavirus/> accessed 17 September 2020.

<sup>99</sup>Q&A: How is COVID-19 transmitted?  
[https://www.who.int/emergencies/diseases/novel-coronavirus-2019/question-and-answers-hub/q-a-detail/q-a-how-is-covid-19-transmitted?gclid=CjwKCAjwkoz7BRBPEiwAeKw3q6zpb10Lsj9KT5qaWKC5YDc7u1RiyR\\_VfdE66NLneh\\_6B0Pq9a-iChoCb6oQAvD\\_BwE](https://www.who.int/emergencies/diseases/novel-coronavirus-2019/question-and-answers-hub/q-a-detail/q-a-how-is-covid-19-transmitted?gclid=CjwKCAjwkoz7BRBPEiwAeKw3q6zpb10Lsj9KT5qaWKC5YDc7u1RiyR_VfdE66NLneh_6B0Pq9a-iChoCb6oQAvD_BwE) accessed 18 September 2020.

<sup>100</sup> COVID-19: Kenya bans travel in and out of Nairobi, other areas  
<https://www.aljazeera.com/news/2020/04/covid-19-kenya-bans-travel-nairobi-areas-200406163601579.html> accessed 17 September 2020.

<sup>101</sup> Kenya Economic Update, April 2020|Edition No. 21, Turbulent Times for Growth in Kenya Policy Options during the COVID-19 Pandemic,



The COVID-19 global pandemic has therefore brought to the forefront issues on leadership, management of boards, role of shareholders, how annual general meetings can be conducted and whether there are appropriate systems and processes in place to ensure continuity of corporations even during these times.<sup>102</sup>

The global pandemic has exposed the flaws in State Corporations in regards to corporate governance. This can be seen in the most recent saga involving the Kenya Medical Supplies Agency (KEMSA) which is a State Corporation under the Ministry of Health established under the KEMSA Act 2013. KEMSA recently requested the government of Kenya for a Kshs. 5 billion bailout claiming that it is broke.<sup>103</sup> The State Corporation had been given an approval for the amount of Kshs. 758 million in order to aid in the fight against COVID-19 but their expenditure grew to over Kshs. 9 billion.<sup>104</sup> This shows a clear disregard for the law and procurement processes in place. How did the expenditure grow to Kshs. 9 billion without the board of directors having approved the same?

COVID-19 has therefore brought to light issues of lack of oversight authorities by the board, lack of proper communication between the board and the management team, lack of a disaster management plan which can assist whenever a crisis comes about, identification of potential risks which may affect the State Corporation which is also provided for under chapter 3 of the Mwongozo Code. Another problem identified during this period is the lack of a succession plan for example if any of the key people fall ill who undertakes their duties.

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<http://documents1.worldbank.org/curated/en/683141588084127834/pdf/Kenya-Economic-Update-Turbulent-Times-for-Growth-in-Kenya-Policy-Options-during-the-COVID-19-Pandemic.pdf> accessed 17 September 2020.

<sup>102</sup> The Implications of COVID 19 on Corporate Governance in Kenya <https://mman.co.ke/content/implications-covid-19-corporate-governance-kenya> accessed 17 September 2020.

<sup>103</sup> Graft-ridden Kemsas seeks Sh5bn to stay afloat, donors start probe <https://nation.africa/kenya/news/graft-ridden-kemsa-seeks-sh5bn-to-stay-afloat-donors-start-probe-1922816> accessed 17 September 2020.

<sup>104</sup> Ibid.

There have been allegations of inflation of prices, lack of following proper procurement processes. KEMSA officials were also summoned by the Senate Health Committee but failed to provide the requested documents.<sup>105</sup> COVID-19 has therefore brought to the limelight corporate governance failures in our State Corporations in the midst of a pandemic. It is apparent that the Mwongozo Code is not being followed as it provides for the establishment of an audit committee, an annual governance audit to be undertaken and lays out the governance structure for the board in order to undertake its mandate and ensure compliance with the relevant laws.<sup>106</sup>

## **2.9 Conclusion**

State Corporations have experienced a multitude of problems which are associated with poor management processes, lack of any internal controls, lack of a qualified board to discharge its duties, political interference in the appointment of directors, lack of unified laws as different State Corporations are bound by their enabling legislation and is not harmonized. The importance of State Corporations when it comes to aiding development especially in developing countries cannot be ignored.

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<sup>105</sup> Senators furious as Kemsas bosses fail to present papers in graft probe, <https://nation.africa/kenya/news/senators-furious-at-kemsa-bosses-1907664> accessed 17 September 2020.

<sup>106</sup> Chapter 1 of Mwongozo the Code of Governance for State Corporations

**CHAPTER THREE**

**CRITIQUE ON THE ADEQUACY OF THE MWONGOZO CODE IN ADDRESSING  
THE CORPORATE GOVERNANCE NEEDS OF STATE CORPORATIONS IN  
KENYA**

**3.1 Introduction**

This chapter will address the challenges the Mwongozo Code is experiencing in its current state. It looks at the intent of drafting the code and the problems it was meant to address as five years down the line there is yet to be enacted any legislation that aids in the implementation of the principles of good corporate governance practices in our State Corporations. This chapter will further evaluate the legal and regulatory framework for the governance of State Corporations in Kenya and whether this is sufficient in addressing the current governance problems most of our State Corporations are facing.

**3.2 A Critique of the Mwongozo Code as a Policy Document**

Mwongozo the Code of Governance for State Corporations came to be through Executive Order No. 7 that was issued by H.E Hon. Uhuru Kenyatta, C.G.H. President and Commander - in - Chief of the Defence Forces of the Republic of Kenya.<sup>107</sup> The code in itself is not law but merely provides a framework for good corporate governance principles whose provisions are persuasive at most and lacks any legal bearing.<sup>108</sup> This therefore means that one cannot compel a State Corporation to adhere to the provisions of the Code as there is no legal requirement. In the foreword of the Mwongozo, H.E Hon. Uhuru Kenyatta had stated that it would be issued as a Regulation under section 30 of the State Corporations Act.<sup>109</sup> This has yet to be done even five years down the line. The problems identified by the task force such

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<sup>107</sup> <http://www.scac.go.ke/2015-02-16-09-34-58/mwongozo> accessed 21 September 2020.

<sup>108</sup> Stanley Manduku, 'The Place of Good Governance In Kenya: An Exposition of The Mwongozo Code of Governance For State Corporations' <<https://www.linkedin.com/pulse/place-good-governance-kenya-exposition-mwongozo-code-state-manduku/>> accessed 21 September 2020.

<sup>109</sup> Mwongozo The Code of Governance for State Corporations.

as lack of uniformity in the application of appointment procedures, poor appointment processes for the CEOs, failure to understand the role of the Board are still being experienced, absence of a clear framework for recruitment, selection appointment and induction of boards.<sup>110</sup>

The Judicature Act<sup>111</sup> clearly sets out the sources of law under section 3 in order of hierarchy with the first one being the Constitution followed by Acts of Parliament. These are the primary sources of law and there are secondary sources such as precedent, by-laws and African Customary Laws as long as it is not repugnant to justice and morality.<sup>112</sup> It is quite clear from the above that the Mwongozo Code is not a law and any Act that regulates the State Corporations will be in effect as they are superior to the Mwongozo Code as it is yet to be enacted as a law.

State Corporations are therefore not bound to adhere to the Mwongozo Code as it has no legal basis. It merely provides a framework for good corporate governance principles which the State Corporations can choose to apply or not. A further look at the introduction of the Mwongozo Code whereby it states that it is based on the “comply or explain” basis. This means that State Corporations can apply the principles set out in the Code or if they fail to do so will simply explain the reason for not incorporating those principles. The question that therefore arises is why State Corporations would take it upon themselves to comply with principles which are not backed by any legal regulations and no ramifications for non-adherence.

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<sup>110</sup> Presidential Task Force on Parastatal Reforms <<http://www.scac.go.ke/2015-02-16-09-34-58/presidential-taskforce>> accessed 18 October 2019.

<sup>111</sup> CAP 8.

<sup>112</sup> Judicature Act, CAP 8, Section 3 (2).

### 3.3 Public Participation in Policy Making Process

Public participation is a very important aspect when it comes to enactment of any laws. It is critical in a democratic state as it advances the notion of a government of the people, by the people and for the people.<sup>113</sup> It is a fundamental principle of democracy as it promotes the notion of equality among citizens as they all have a say in the legislative process.

According to the International Association for Public Participation there are five levels of participation which are inform, consult, involve, collaborate and empower.<sup>114</sup> These five levels assist in ensuring community engagement is achieved in any process as the public is informed of the problem and provided with all necessary information, they are then consulted by giving their views on issues, they are then involved in the process seeking to find a solution to the problems raised, the public also collaborates in coming up with solutions and lastly empowered to make a decision as can be seen in the referendum on the constitution that was held in Kenya on 4<sup>th</sup> August 2010.<sup>115</sup>

The Constitution<sup>116</sup> makes it a requirement for public participation in key decision making processes. It is therefore a constitutional principle that should be respected and upheld as under Article 2 it states that the Constitution is the supreme law of the Republic and binds all persons and all State organs at both levels of government.<sup>117</sup>

In analyzing the Mwongozo Code, this study seeks to establish whether it crosses the threshold of having provided for public participation in its entirety when it was being drafted by the Presidential Taskforce on Parastatal Reforms (PTPRs). The PTPRs in its Report stated that it executed its mandate for a period of six (6) weeks which begs the question whether

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<sup>113</sup> Gettysburg Address [https://en.wikipedia.org/wiki/Gettysburg\\_Address](https://en.wikipedia.org/wiki/Gettysburg_Address) accessed 21 September 2020.

<sup>114</sup> What is the Spectrum of Public Participation <https://sustainingcommunity.wordpress.com/2017/02/14/spectrum-of-public-participation/> accessed 21 September 2020.

<sup>115</sup> 2010 Kenyan constitutional referendum [https://en.wikipedia.org/wiki/2010\\_Kenyan\\_constitutional\\_referendum](https://en.wikipedia.org/wiki/2010_Kenyan_constitutional_referendum) accessed 21 September 2020.

<sup>116</sup> Articles 1(2), 10(2), 35, 69(1)(d), 118, 174(c) and (d), 184(1)(c), 196, 201(a) and 232(1)(d).

<sup>117</sup> The Constitution of Kenya.

that was sufficient time to allow for public participation or it was selective in rendering the same. It further states that views of the general public, professional, government ministries/departments and State Corporations were invited in relation to the terms of reference.<sup>118</sup>

As seen above, public participation has five levels which are determinants of whether these levels were followed or the PTPRs merely received views from interested parties and did not seek to undertake any community engagement whereby they should have sought to inform, consult, involve, collaborate and empower. It was developed by the Implementation Committee, in conjunction with State Corporations Advisory Committee (SCAC) and the Institute of Certified Public Secretaries of Kenya (ICPSK) in consultation with World Bank.<sup>119</sup>

The Mwongozo Code therefore fails as most of the general public are not even aware of its existence. Six weeks was not sufficient to undertake the exercise on public participation and it only invited stakeholders who were directly affected by review of State Corporations. The right to public participation as provided for in our Constitution has been reinforced time and again in our courts as was seen in the case of *Gakuru & Others*.<sup>120</sup> The issue of public participation cannot be emphasized enough as any legislation that is made without public participation is null and void as held in the South African Case, *Doctors for Life*.<sup>121</sup>

The Mwongozo Code should therefore have been subjected to public participation as envisioned in our Constitution which would in turn allow for implementation of the code as a regulation in the State Corporations Act.

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<sup>118</sup> Report of The Presidential Taskforce on Parastatal Reforms.

<sup>119</sup> Mwongozo The Code of Governance for State Corporations.

<sup>120</sup> Robert N. Gakuru & Others vs. Governor Kiambu County & 3 others [2014] eKLR.

<sup>121</sup> *Doctors for Life International vs. Speaker of the National Assembly and Others* (CCT12/05) [2006] ZACC 11; 2006 (12) BCLR 1399 (CC); 2006 (6) SA 416 (CC).

### 3.4 Multiple Regulations Governing State Corporations

There are currently over 220 State Corporations that are operational in Kenya.<sup>122</sup> These State Corporations are governed by the State Corporations Act<sup>123</sup> or their enabling legislation. An example of this can be seen in the existence of the Communications Commission of Kenya which was established by the Kenya Information and Communications Act<sup>124</sup>, Commission for Higher Education as established by the Universities Act<sup>125</sup>. Each Act therefore has its own provisions which differ from the other. There is no uniformity in that each Act has its own provision such as the SCA provides that a board of a corporation shall have not more than 16 members<sup>126</sup>, the Kenya Information and Communication Act states that the board shall have 11 members<sup>127</sup> while the Universities Act states that it should have 8 members<sup>128</sup>.

The Mwongozo Code in setting out the framework for corporate governance in State Corporations has set out the minimum standards that should be observed by these corporations so as to ensure their continuity and achieving the set out objectives. Chapter 1 of the Mwongozo Code is on the board of directors and it provides that in order for a board to function efficiently, it should have a membership between 7 and 9. This is quite different as compared to the Acts referred to above such as the State Corporations Act which can have up to 16 members which leads to board inflation. There is no uniformity in the number of board members and each Act can have as many as they please when the enabling legislation is being formulated.

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<sup>122</sup> Inspectorate of State Corporations <https://www.isc.go.ke/> accessed 21 September 2020.

<sup>123</sup> CAP 446.

<sup>124</sup> CAP 411A.

<sup>125</sup> Universities Act, CAP 210B, Section 3.

<sup>126</sup> State Corporations Act, Section 6.

<sup>127</sup> Kenya Information and Communications (Amendment) Act, 2013, Section 6.

<sup>128</sup> The Universities (Amendment) Act 2016.

### 3.5 Appointment of Board of Directors

The State Corporations Act grants the President the authority to appoint a chairperson to the board of any State Corporation at his own discretion.<sup>129</sup> The Government appoints the boards in this category as part of its constitutional mandate to protect the interest of the public. A further look at the Act shows that other members of the board include the Permanent Secretary of the parent ministry, Permanent Secretary to the treasury, auditor-general or his representative and not more than eleven member's three of whom shall be appointed by the Minister.<sup>130</sup>

Appointment of Board of Directors is therefore done pursuant to the provisions of the State Corporations Act or the enabling legislation for the specific State Corporation as seen for example in the Universities Act.<sup>131</sup> Unfortunately, appointments are mostly done based on other factors and are not based on merit. The appointment process is based on who has more support and knowing the right people.<sup>132</sup>

According to Mwaura,<sup>133</sup> the appointment of directors by the President politicizes the whole process as it seems more like a reward system to those who supported the presidency and therefore those who end up getting the appointment have a conflict of interest as in essence they should be serving the needs of the public, but due to the political appointment process they end up serving their political interests of those of the appointing authority.

The poor performance of State Corporations can therefore be attributed to the flawed appointment process seeing as the President wields all the power to either appoint or remove directors. Ireri argues that most of the appointment in State Corporations are mainly guided

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<sup>129</sup> CAP 446, Section 6.

<sup>130</sup> CAP 446, Section 6.

<sup>131</sup> The Universities (Amendment) Act 2016.

<sup>132</sup> FULL LIST: Uhuru appoints former MPs, Governor to top parastatal jobs <https://citizentv.co.ke/news/full-list-uhuru-appoints-former-mps-governor-to-top-parastatal-jobs-243982/> accessed 22 September 2020.

<sup>133</sup> Kiarie Mwaura, 'The Failure of Corporate Governance in State Owned Enterprises and the Need for Restructured Governance in Fully and Partially Privatized Enterprises: The Case of Kenya' 34 at.p.43-74 <https://ir.lawnet.fordham.edu/cgi/viewcontent.cgi?article=2080&context=ilj> accessed 7 September 2020.



by politics, ethnicity and patronage.<sup>134</sup> This can be seen in the most recent appointments in August 2020 whereby a review of those who were appointed by the President as board members were relatives of close political allies.<sup>135</sup> The recent appointments such as the appointment of Beryl Okumu as the new chairperson of the Athi Water Works Development Agency who happens to be the sister to Raila Odinga who is the opposition leader, appointment of Pauline Njoroge to the Tourism Regulatory Authority, for a period of three years, who is an ardent supporter of the Jubilee party and the President H.E. Hon Uhuru Kenyatta and appointment of Kevin Muasya as a board member to the Tourism Regulatory Authority, for a period of three years who happens to be the son of Wiper leader Kalonzo Musyoka just shows how deep rooted the problem is.<sup>136</sup>

The Ndegwa committee made various recommendations when it came to the appointment process. It suggested that appointments should be based on capability, decision making skills and honesty. There should be a clearly laid out process that ensures all the criteria for appointment to a board is achieved.<sup>137</sup>

The appointment of board of directors is therefore influenced by the President and seems to be a political position therefore those appointed would ordinarily serve the needs of the appointing head. Chapter 1 of the Mwongozo Code tries to remedy this providing for board appointments to be done through a transparent and formal process governed by the principle of merit. At the moment, we cannot rely on the Mwongozo Code as it is not a law, the President can continue with Board appointments arbitrarily as the State Corporations Act

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<sup>134</sup> Elijah Njagi Ileri, 'Assessment of Problems Facing State Owned Enterprises in Kenya', International Journal of Business, Humanities and Technology, Vol.6, No.4, December 2016.

<sup>135</sup> Raila, Matiangi's relatives reap big from Uhuru's latest state appointments <https://www.the-star.co.ke/news/2020-08-08-raila-matiangis-relatives-reap-big-from-uhurus-latest-state-appointments/> accessed 22 September 2020.

<sup>136</sup> Ibid.

<sup>137</sup> Ndegwa Committee Report of 1979.

authorizes him to act in that capacity. The Mwongozo is simply a guiding principle and the enabling legislation is superior.

### **3.6 The Office of the President**

Under the State Corporations Act, the holder of the office of the President can establish State Corporations<sup>138</sup>, assign ministerial responsibility<sup>139</sup>, appoint chairpersons of Board of Directors<sup>140</sup> and give directions of a specific or general nature to the board<sup>141</sup>. In addition the President has powers to revoke the appointments earlier made and constitute new boards if the need arises.<sup>142</sup>

The Katiba Institute in conjunction with the Africa Center for Open Governance had filed a petition at the High Court whereby they sought to challenge to constitutionality of appointment process to boards of various State Corporations through various Gazettes notices between March and July 2016.<sup>143</sup> They are challenging the powers of the President and the Cabinet Secretaries in making the appointments and arguing that the appointments violate Articles 2 (2) and (4), 10 and 232 of the Constitution.

### **3.7 Weak Oversight Authorities**

The State Corporations Act provides for the creation of two bodies who provide oversight authority to State Corporations in Kenya namely the Inspector-General (Corporations)<sup>144</sup> and the State Corporations Advisory Committee (SCAC)<sup>145</sup>.

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<sup>138</sup> State Corporations Act, CAP 446, Section 3.

<sup>139</sup> Ibid Section 4.

<sup>140</sup> Ibid Section 6.

<sup>141</sup> Ibid Section 7.

<sup>142</sup> Ibid.

<sup>143</sup> Public Interest Petition on appointments to Parastatal Boards <<https://katibainstitute.org/public-interest-petition-on-appointments-to-parastatal-boards/>> accessed 21 September 2020.

<sup>144</sup> State Corporations Act, Section 18.

<sup>145</sup> Ibid Section 26.

The mandate of the Inspector-General (Corporations) is to advise the Government on the effective management of State Corporations in Kenya and thus the Inspectorate of State Corporations (ISC) was established under this provision. The duties of the ISC are namely to advise the government on all matters that affect the effective running of State Corporations, report to the relevant arms of government on the management practices of any State Corporation, report to the Auditor General on any misappropriation of money as apportioned by Parliament to State Corporations, conduct investigations on State Corporations as requested by the State Corporations Advisory Committee and the Auditor-General and to undertake surcharge action against any person who incurs or authorizes irregular expenditure of state corporation funds or any person who through negligence or misconduct causes loss of funds to the State Corporation.<sup>146</sup>

The ISC has a specific mandate to advise the government on all matters pertaining to State Corporations but how do we ensure that they perform their duties as envisioned in the State Corporations Act. The ISC is a toothless dog as there are no measures to ensure that the government takes into consideration any recommendations that it makes. They should be able to conduct an audit of all State Corporations annually to ensure they are in line with their objectives and make recommendations on how these corporations can be improved so as to serve public interests.

The State Corporations Advisory Committee (SCAC) is one of a supervisory nature as it may advise the President on the establishment, re-organization or dissolution of a State Corporation, review the affairs of a State Corporation, advise on the appointment, removal or transfer of officers and staff of State Corporations, examine any agreements made between

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<sup>146</sup> <<https://www.isc.go.ke/mandate/>> accessed 22 September 2020.

State Corporations and other parties and any proposals by State Corporations in relations to any interests they may want to acquire in a business.<sup>147</sup>

We have two bodies that are created by the State Corporations Act, yet none that has been able to achieve or fulfill its mandate. It is quite clear that the President plays a big role in all this bodies as he has been mandated by the State Corporations Act to appoint the heads. There is therefore a conflict of interest whereby the SCAC or the ISC reviews a State Corporation whose board members have been appointed by the President directly or indirectly. All these people serve common interest which are of a political nature. There is no independence or separation of powers as they are all intertwined.

### **3.8 Implanting of Foreign Codes without Adapting them to our unique Kenyan System**

The Mwongozo Code borrows from other policies and guidelines from other jurisdictions such as the United Kingdom, South Africa, Malaysia, Singapore and India.<sup>148</sup> The economies of each country is different to the other and all at different stages of development. Kenya is a developing country and the problems experienced here are unique to our situation. When you look at the history of corporate governance in the UK it has undergone a lot of changes and reviews since the Cadbury Report of 1992. It has been consistently updated upon consultation so as to be in line with the economic situation and needs of the country.<sup>149</sup> There can be no comparison between our Kenyan situation to that of the UK as the Mwongozo Code is yet to be implemented five years down the line.

The Malaysian Code which we also relied on has undergone various reform processes with the initial one developed in the year 2000 in response to the Asian financial crisis of

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<sup>147</sup> State Corporations Act, Section 27.

<sup>148</sup> Mwongozo The Code of Corporate Governance for State Corporations.

<sup>149</sup> History of the UK Corporate Governance Code, <https://www.frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code/history-of-the-uk-corporate-governance-code> accessed 22 September 2020.

1997/1998.<sup>150</sup> We can therefore see that once a code of governance has been developed that is not an end in itself and that it should be reviewed and updated regularly to be in line with the needs of the current.

According to Markkanen<sup>151</sup>, you will find that African countries have developed governance codes that are quite similar to those of their colonizers as opposed to developing a code that is better suited to their environment. She goes on to state that when a country is developing its code of governance it should take into account the country's history, culture and economic development. There is no standard code that is suitable to all economies as they are all at different stages and the issues inflicting on one economy may be different in another one.

Some of the problems experienced in African countries are unstable political regimes, corruption, poor regulatory framework, low per capita income and diseases for example Ebola in West Africa which rightly affects the economy of a country.<sup>152</sup> These situations are unique to developing countries as already seen in our Kenyan situation where appointments to board of directors is based on ethnicity or political patronage.<sup>153</sup> How then is it expected that these same directors who are political appointees to implement the code of governance if they are not recruited through a merit based system. The code already assumes that the basic concept of corporate governance exists and there is only a need for provisions on how the same should be applied. This however is not the case in Kenya due to persistent issues on corruption in our State Corporations such that if a code is developed, it needs to be enacted as

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<sup>150</sup> Corporate Governance Developments in Malaysia [https://www.icgn.org/sites/default/files/Corporate%20Governance%20Developments%20in%20Malaysia\\_0.pdf](https://www.icgn.org/sites/default/files/Corporate%20Governance%20Developments%20in%20Malaysia_0.pdf) accessed 22 September 2020.

<sup>151</sup> Sanni Markkanen, 'Corporate Governance in Africa: Comparative Study' <[https://aaltodoc.aalto.fi/bitstream/handle/123456789/18379/hse\\_thesis\\_14053.pdf?sequence=1&isAllowed=y](https://aaltodoc.aalto.fi/bitstream/handle/123456789/18379/hse_thesis_14053.pdf?sequence=1&isAllowed=y)> accessed 22 September 2020.

<sup>152</sup> Benjamin Mwanza Mulili, & Peter Wong, P, 'Corporate governance practices in developing countries: The case for Kenya' (2011), International Journal of Business Administration 2(1), <<http://www.sciedu.ca/journal/index.php/ijba/article/view/37>> accessed 8 September 2020.

<sup>153</sup> Raila, Matiangi's relatives reap big from Uhuru's latest state appointments <<https://www.the-star.co.ke/news/2020-08-08-raila-matiangis-relatives-reap-big-from-uhurus-latest-state-appointments/>> accessed 22 September 2020.

a legislation as that is the only way it can be incorporated in our State Corporations. This will just be chasing our own tails trying to implement a code that has no legal standing therefore will not command respect from those managing the State Corporations. They will seek to hide behind the State Corporations Act and other enabling legislations just to show they are observing the bare minimum as provided for under the law.

The purpose of the Mwongozo Code is to provide the minimum standards required from shareholders, directors, chief executive officers and management of a listed company or an unlisted company in order to promote high standards of conduct as well as ensure that they exercise their duties and responsibilities with clarity, assurance and effectiveness. The areas of focus for the corporate governance code include Board composition, roles and responsibilities; accountability, risk management and internal control; ethical leadership and corporate citizenship; shareholder rights and obligations; stakeholder relationship; sustainability and performance management and compliance with laws and regulations.<sup>154</sup>

The Mwongozo Code as it stands can only be suitable in a country that can be able to regulate itself, and having looked at the various scandals in our state corporations, it is not possible for Kenya to cope with self-regulation.<sup>155</sup> There is a need to enact legislation that can assist in advancing good corporate governance practices among our State Corporations and addresses issues of corruption and political interference.

### **3.9 Weaknesses in our Institutional Framework for Governance in Kenya**

There is increasing evidence that a country's legal system plays a significant role in determining the success of its corporate governance system. The findings of this study have shown that good corporate governance is associated with countries with a strong legal system.

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<sup>154</sup> Mwongozo The Code of Governance for State Corporations.

<sup>155</sup> Lois M. Musikali, 'The Law Affecting Corporate Governance in Kenya: A need for review' (2018), International Company and Commercial Law Review.

The continued prevalence of corruption, mismanagement of public resources, and lack of accountability in Kenya can be traced to the institutional failures and enforcement machinery in the system which is attributed to uncoordinated approaches to governance of State Corporations. These problems experienced in our State Corporations have continued to prevail due to institutional failure, this study opines that that responsibility must be apportioned to the various institutions as they contribute to the problem. Institutions charged with the responsibility to drive anti-corruption initiatives in the country and prosecuting corruption cases have failed.

The Ethics and Anti-Corruption Commission (EACC) is a body vested with powers under the Ethics and Anti-Corruption Commission Act, 2011 to investigate all corruption cases.<sup>156</sup> The commission was established by virtue of the Constitution of Kenya under Article 79. It is the overall body mandated to oversee corruption matters in Kenya. The mandate of the EACC also originates from other Acts of Parliament.<sup>157</sup> Once the EACC have conducted their investigations and have found evidence of corruption they ought to recommend the cases to the Office of Director of Public Prosecutions (ODPP) for prosecution.<sup>158</sup>

The EACC does not have prosecutorial powers and they are therefore limited in their work. As seen above, they can only make recommendations and as such it is upon the ODPP to prosecute any cases brought forth by the EACC. There are other problems such as lack of enough budgetary allocation in order for them to carry out investigations, they are also understaffed meaning that they cannot undertake proper investigations on all corruption cases

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<sup>156</sup> Ethics and Anti-Corruption Commission Act, Section 11.

<sup>157</sup> This include the Anti-Corruption and Economic Crimes Act, 2003, Public Officer Ethics Act, 2003 and the Leadership and Integrity Act, 2012 (No. 19 of 2012).

<sup>158</sup> Ethics and Anti-Corruption Commission Act, Section 11 (d).

reported to them and of course which limits them when it comes out to carrying out civic exercises such as creating awareness among citizens.<sup>159</sup>

The current system in Kenya sees different institutions which must work together and in this instance when it comes to matters relating to poor corporate governance practices whereby there are issues of corruption, the process is that the EACC investigates the matter and based on the findings of the investigation they make the appropriate recommendation to the ODPP and finally it is the duty of the ODPP to take the matter to court which is the Judiciary. We therefore have three key institutions namely the EACC, the ODPP and the Judiciary.

The Office of Director of Public Prosecution is established by the Constitution under Article 175 with their overall mandate being instituting criminal proceedings against any person before a court of law. The ODPP has the powers to order investigations into any alleged cases of corruption. If there is sufficient evidence the ODPP then prosecutes the case.

There are challenges that are experienced in the prosecution of corruption cases as there are usually delays, limited resources to undertake proper investigations into the cases and therefore we can see few corruption cases that have been successfully concluded. The most recent case we can review is the National Cereals and Produce Board whereby the EACC was investigating the allegations of fraudulent acquisition of public funds.<sup>160</sup> The accused persons were found guilty of having received Kshs. 300 million from the National Cereals and Produce Board in the year 2009.<sup>161</sup>

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<sup>159</sup> Report of The Task Force On The Review Of The Legal, Policy And Institutional Framework For Fighting Corruption In Kenya <<https://statelaw.go.ke/wp-content/uploads/2020/07/Report-of-the-Task-Force-on-the-Review-of-the-Legal-Policy-and-Institutional-Framework-for-Fighting-Corruption.pdf>> accessed 21 November 2020.

<sup>160</sup> Criminal Case No 31 of 2018- Republic v Grace Sarapay Wakhungu, John Koyi Waluke and Erad Supplies & General Contracts Limited

<sup>161</sup> MP John Walukhe guilty as charged in Sh300mn maize scandal <<https://www.capitalfm.co.ke/news/2020/06/mp-john-walukhe-guilty-as-charged-in-sh300mn-maize-scandal/>> accessed 21 November 2020.



Our institutions are clearly flawed due to the delayed period when it comes to instituting criminal cases against those who flaunt the laws and undue disregard given to good corporate governance practices despite having Acts such as the Leadership and Integrity Act<sup>162</sup>, the Penal Code<sup>163</sup>, Anti-Corruption and Economic Crimes Act<sup>164</sup>, the Constitution of Kenya and a multitude of other laws that can be used to combat some of the governance problems being experienced in State Corporations.

Kenya has the necessary Acts needed in aiding in prosecution of cases but there are delays in disposal of cases and laxity on the part of the court to give deterrent sentences. This has impacted negatively in enhancing governance of State Corporations.

### **3.10 Conclusion**

Good corporate governance is associated with countries with a strong legal system. The lack of public participation in drafting the Mwongozo Code makes it difficult to enforce as the public is not aware of the standards the board of directors should be held accountable to. Public participation would ensure that the process of enacting legislation is followed until completion as the Code should have been issued as a Regulation under section 30 of the State Corporations Act.

The appointment, removal and oversight over State Corporations is controlled by the President and thus is prone to abuse as it is used as an award system for those who are loyal. Politicization of appointment processes although the State Corporations Act is the principal statute which regulates appointments and removal of the Board, it does not give clear guidelines to regulate based on certain qualifications.

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<sup>162</sup> No. 19 of 2012

<sup>163</sup> CAP 63

<sup>164</sup> No. 3 of 2003

There are efforts to train directors, but this does not cure the problems currently being experienced and without the enactment of legislation which will ensure State Corporations and their directors adhere to them the corporations cannot survive. The Mwongozo code simply provides a framework but it is not binding on state corporations and is subordinate to the State Corporations Act as it is not a law.

There are also overlapping regulations which makes it difficult to enforce certain provisions and also weak oversight authorities such as the SCAC and the ISC who cannot be held accountable as they should be advising the President on the affairs of state corporations in Kenya.

## CHAPTER FOUR

### COMPARATIVE ANALYSIS

#### 4.1 Introduction

This chapter will be a comparative analysis of the Mwongozo Code vis-a-vis other established codes of different countries such as Malaysia, South Africa and the United Kingdom which were used as a basis for developing the Mwongozo Code in Kenya. This chapter examines how the different codes have shaped good corporate governance practices in their countries and whether the continued reviewing of the codes and enactment of enabling legislation is something we should consider.

#### 4.2 Corporate Governance in Malaysia

The rise of corporate governance in Malaysia can be attributed to the Southeast Asian Financial Crisis of 1997-98 which led to many Asian countries realizing there is a need to provide for a policy framework which would address the poor governance practices that had led to the financial crisis.<sup>165</sup> The financial crisis was first experienced in Thailand due to withdrawal of capital by foreign investors which had a trigger effect on neighboring countries such as Indonesia, Malaysia, South Korea and the Philippines.<sup>166</sup>

There were many reasons which were advanced as having contributed to the Financial Crisis of 1997-98 but it was majorly attributed to lack of proper regulations, loan policies that were state-directed, poor governance in institutions and risk management.<sup>167</sup> It affected the real estate and banking sector and it led to high interest rate and credit contraction.<sup>168</sup> Malaysia

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<sup>165</sup> Kamini Singam, 'Corporate Governance in Malaysia' (2003)  
<<http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.874.3302&rep=rep1&type=pdf>> accessed 23 September 2020.

<sup>166</sup> Abdul Hadi bin Zulkafli, M.Fazilah bt. Abdul Samad, Md Ishak Ismail, 'Corporate Governance in Malaysia' <https://pdfs.semanticscholar.org/61c9/01059394f4f6ce33a964848a7bb43b095b2a.pdf? ga=2.54946731.1640799155.1600766744-2093833358.1600331628> accessed 23 September 2020

<sup>167</sup> Ibid.

<sup>168</sup> n 2.

also had other issues such as bribery, corruption and favoritism which points to poor corporate governance practices in the country.<sup>169</sup>

The Malaysian Government therefore undertook corporate reforms in both the public and private sector which would ensure that the level of corporate governance would be improved and to prevent another financial crisis in the future.<sup>170</sup>

#### **4.2.1 Institutional Reforms**

The corporate governance reforms agenda in Malaysia was undertaken by three main bodies namely the Finance Committee on Corporate Governance which developed the Malaysian Code on Corporate Governance, Securities Commission which developed the Capital Market Master Plan (CMP) and the Bank Negara Malaysia which developed the Financial Sector Master Plan (FSMP).<sup>171</sup> There are also various institutions that were established with the aim of advancing corporate governance practices such as the Malaysian Institute of Corporate Governance (MICG) and the Minority Shareholders Watchdog Group (MSWG).<sup>172</sup>

The Malaysian Institute of Corporate Governance (MICG) was founded by various interested parties namely the Malaysian Institute of Certified Public Accountants (MICPA), Federation of Public Listed Companies (FPLC), Malaysian Institute of Accountants (MIA), and Malaysian Institute of Chartered Secretaries and Administrators (MAICSA) with their principle objective being the promotion and education on good corporate governance practices for its members and other interested bodies.<sup>173</sup>

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<sup>169</sup> Michael Backman, *Asian Eclipse – Exposing the Dark Side of Business in Asia* (2001), Revised Edition, 2.

<sup>170</sup> Nor Azizah Zainal Abidin and Halimah Nasibah Ahmad, 'Corporate Governance In Malaysia: The Effect Of Corporate Reforms and State Business Relation in Malaysia' (2007), *Asian Academy of Management Journal*, Vol. 12, No. 1, 23–34, <<http://web.usm.my/aamj/12.1.2007/AAMJ%2012-1-2.pdf>> accessed 23 September 2020

<sup>171</sup> Abdul Hadi bin Zulkafli, M.Fazilah bt. Abdul Samad, Md Ishak Ismail, 'Corporate Governance in Malaysia' <[https://pdfs.semanticscholar.org/61c9/01059394f4f6ce33a964848a7bb43b095b2a.pdf?\\_ga=2.54946731.1640799155.1600766744-2093833358.1600331628](https://pdfs.semanticscholar.org/61c9/01059394f4f6ce33a964848a7bb43b095b2a.pdf?_ga=2.54946731.1640799155.1600766744-2093833358.1600331628)> accessed 23 September 2020

<sup>172</sup> Ibid.

<sup>173</sup> <<http://www.micg.org.my/Static/AboutUs>> accessed 25 September 2020

The Minority Shareholders Watchdog Group (MSWG) is a government initiative following the Asian Financial crisis and is focused in protecting the rights of minority shareholders in Malaysia by encouraging good governance among public listed companies.<sup>174</sup>

#### **4.2.2 Malaysian Code on Corporate Governance**

The first Malaysian Code on Corporate Governance was developed in the year 2000 and has since then undergone review and subsequent Codes published in the year 2007, 2012 and 2017. The first Code after the financial crisis was developed by the Working Group on Best Practices in Corporate which comprised of both public and private sector representatives and was approved by the Finance Committee on Corporate Governance.<sup>175</sup> The key areas of focus for the committee was in relation to the board of directors, remuneration of directors, shareholders and accountability and audit.<sup>176</sup>

The initial code marked the groundwork through the introduction of good corporate governance practices in Malaysia and was applicable to all the companies. It was divided into two parts with the first part containing the Principles of Good Governance and the second part Best Practices in Corporate Governance.<sup>177</sup> We shall review the 2012 and 2017 codes to see if there are any significant changes or deviations that would necessitate and inform us of the need to review our Mwongozo Code so as to better suite our circumstances.

The Malaysian Code on Corporate Governance 2012 was based on 8 principles and 26 recommendations on structures and processes that companies could apply in their businesses

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<sup>174</sup> <<https://mswg.org.my/who-we-are>> accessed 25 September 2020

<sup>175</sup> Elsa Satkunasingam, Nagiah Ramasamy, 'Is The Malaysian Code On Corporate Governance 2000 An Effective Challenge To Cronyism?' <[https://www.researchgate.net/publication/273441616\\_Is\\_the\\_Malaysian\\_Code\\_of\\_Corporate\\_Governance\\_2000\\_an\\_Effective\\_Challenge\\_to\\_Cronyism/link/5500ee4b0cf2aee14b58ea67/download](https://www.researchgate.net/publication/273441616_Is_the_Malaysian_Code_of_Corporate_Governance_2000_an_Effective_Challenge_to_Cronyism/link/5500ee4b0cf2aee14b58ea67/download)> accessed 25 September 2020

<sup>176</sup> n 7.

<sup>177</sup> n 8.

so as to be in line with promoting good corporate governance in their day to day running.<sup>178</sup> The principles outlined in the Code were namely to establish clear roles and responsibilities, strengthen composition, reinforce independence, foster commitment, uphold integrity in financial reporting, recognize and manage risks, ensure timely and high quality disclosure and strengthen relationship between company and shareholders.<sup>179</sup> The code was based on the “comply or explain” basis which is what we currently have in the Mwongozo Code.

The latest version of the Malaysian Code on Corporate Governance 2017 (MCCG 2017) which took effect on 26<sup>th</sup> April 2017 has some notable changes from the previous version in that it moves away from the “comply or explain” basis to a new approach referred to as the “Comprehend, Apply and Report” (CARE) approach.<sup>180</sup> This is a complete shift from the “comply or explain” approach in that it provides for greater flexibility to companies in that they first have to understand the principles themselves, select the principles and practices that are applicable to their company and go further to explain an alternative that they opted to use that was better suited to the needs of their company.

The MCCG 2017 is applicable to all the public listed companies and it has encouraged the non-listed companies including state-owned enterprises and smaller companies to embrace the new Code.<sup>181</sup> There are however certain practices that only apply to large companies that are listed on the FTSE Bursa Malaysia Top 100 Index or those with a market capital of RM2 billion. The code has three core principles and 36 practices that are aimed at supporting the principles. The principles are namely board leadership and effectiveness, effective audit and

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<sup>178</sup> Malaysian Code on Corporate Governance 2012 – An Overview and Summary <<https://www.complianceonline.com/malaysia-code-of-corporate-governance-2012-an-overview-and-summary-13470-prdad>> accessed 25 September 2020

<sup>179</sup> Malaysian Code on Corporate Governance 2012 <[https://www.complianceonline.com/articlefiles/Malaysia\\_Code\\_Of\\_Corporate\\_Governance.pdf](https://www.complianceonline.com/articlefiles/Malaysia_Code_Of_Corporate_Governance.pdf)> accessed 25 September 2020

<sup>180</sup> The Malaysian Code on Corporate Governance 2017 <<https://www.christopherleeong.com/media/2803/clo-2017-05-the-malaysian-code-onf.pdf>> accessed 25 September 2020.

<sup>181</sup> Ramesh Ruben Louis, ‘What the new Malaysian corporate governance code will mean for companies’ <<https://www.accaglobal.com/hk/en/member/discover/cpd-articles/governance-risk-control/mycorpgov-cpd.htm>> accessed 25 September 2020.

risk management and integrity in corporate reporting and meaningful relationship with stakeholders.<sup>182</sup>

The review of the Code was so that it could be in line with the global best practices on corporate governance which just shows that in the global economy there are many changes that a country cannot limit itself by not adjusting its corporate reforms so as to attract investors. The MCCG 2017 has also seen the introduction of intended outcomes which is meant to aid companies in visualizing how they would benefit from application of the corporate governance principles as set out in the code. The intended outcome shows that the company is working towards achieving a certain objective. It has certain targets that it has set out thus they employ practices that will assist in fulfilling their intended outcome.

The introduction of the CARE approach is the most distinct feature in the code and we cannot ignore its importance as it provides for greater flexibility in applying good corporate governance practices. The CARE approach contends that a company must be able to ‘comprehend’ by understanding how the practices will be of benefit to it as they are geared toward sustainability of the company. The code is therefore to assist the company be successful and ensure sustainability.

The ‘apply’ practice sees a shift to ‘apply or explain an alternative approach’ basis which means that companies can choose which practices are suitable to them taking into account externalities such as size of the company, environment and other factors that may affect the company. Companies are therefore not bound to apply the principles simply to be seen as adhering to the code but can opt to apply those that will enable it achieve its intended outcome.

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<sup>182</sup> Malaysian Code On Corporate Governance  
<<https://www.sc.com.my/api/documentms/download.ashx?id=70a5568b-1937-4d2b-8cbf-3aefed112c0a>>  
accessed 25 September 2020

Lastly is ‘report’ which is on disclosures and it shows transparency to the shareholders and stakeholders in that the board will report on which practices it applied and where there was a departure state the reason for the departure. This information should be availed for transparency purposes and show how by applying the practices it was able to achieve its intended outcome.

The MCCG 2017 has a few other differences with the 2012 code in that it now requires that at least half of the board should comprise of independent directors and for large companies majority should be independent directors. It further states that the board should have a policy on tenure of independent directors that should be 9 years.<sup>183</sup> The code also promotes diversity in the board by providing that 30% of the directors should be women. This promotes gender inclusion in board decisions and running of companies in Malaysia.

#### **4.2.3 Lessons for Kenya from Malaysia**

Malaysia had similar issues to Kenya such as bribery, corruption and favoritism which inevitably resulted in the financial crisis in 1997/98 yet the country has had four versions of the Malaysian Code on Corporate Governance with each adopting better principles to be in line with global best practices. Kenya developed its code in 2015 and yet 5 years down the line we still have the same problems plaguing our State Corporations. Continual revision of the Malaysian Code and a greater emphasis on the benefits of good corporate governance practices raises awareness on its importance and encourages companies to apply this principles and practices which are beneficial to their companies.

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<sup>183</sup> Malaysian Code On Corporate Governance  
<<https://www.sc.com.my/api/documentms/download.ashx?id=70a5568b-1937-4d2b-8cbf-3aefed112c0a>>  
accessed 25 September 2020



### 4.3 Corporate Governance in South Africa

The first King Report on Corporate Governance in South Africa was published in the year 1994 by the King Committee on Corporate Governance which was headed by former High Court Judge, Mervyn King S.C.<sup>184</sup> The King Committee on Corporate Governance which was the first of its kind was established in 1992 which was also around the same time the Cadbury Committee in the United Kingdom had published the Cadbury Report and it drew a lot of inspiration from the report.<sup>185</sup> South Africa is a former colony of Britain and therefore most of their practices are mostly adopted from the UK<sup>186</sup> as is the case with most colonies and a clear example can be seen here in Kenya where we have adopted most of their legislation with slight modifications trying to create a hybrid.<sup>187</sup>

The King I was a progressive document which incorporated a code of corporate practices and conduct and was aimed at promoting the highest standards of corporate governance in the region. The Code applied to all companies listed in the Johannesburg Stock Exchange, large public entities, financial institutions, banks, insurance and large unlisted public companies.<sup>188</sup> In an emerging economy, South Africa had made great strides through the publication of King I which advocated for an integrated approach to good governance in the interests of a wide range of stakeholders.<sup>189</sup>

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<sup>184</sup> Governance is King! <<https://www.ifac.org/system/files/downloads/1.3-king-governance-is-king-final.pdf>> accessed 26 September 2020

<sup>185</sup> Stefan Andreasson, 'Understanding Corporate Governance Reform in South Africa: Anglo-American Divergence, the King Reports, and Hybridization', (2011).

<sup>186</sup> Ibid.

<sup>187</sup> Judicature Act, Section 3, which states that Acts of Parliament of the United Kingdom, common law, doctrines of equity and Statutes of General application as provide as sources of law in Kenya.

<sup>188</sup> The Code of Corporate Practices & Conduct <[https://ecgi.global/sites/default/files//codes/documents/king\\_i\\_sa.pdf](https://ecgi.global/sites/default/files//codes/documents/king_i_sa.pdf)> accessed 26 September 2020.

<sup>189</sup> Ibid.

### 4.3.1 Institutional Reforms

The King I was a progressive document but with the changes in the global economy necessitated that it be reviewed and updated to conform to international best practices. To this end, the King Committee on Corporate Governance developed the King report over the course of years with the second version King II published in 2002, third version King III in 2009 and the latest version that was published in 2016.<sup>190</sup>

King I saw the introduction of a code of ethics, social standards and the recognition of environmental issues.<sup>191</sup> King II moved away from emphasis being on the shareholder value but now incorporated other aspects such as sustainability which meant the integration of different aspects such as social, economic and environmental performance aspects of a company's activities which was labelled as 'triple bottom line'.<sup>192</sup> King II therefore acknowledges that successful companies should adopt an inclusive and not exclusive approach. King III was different in that it was applicable to all entities be it public or private entities or non-profit organizations, it had 75 principles and used the 'apply or explain' approach for companies.<sup>193</sup>

### 4.3.2 King IV

There was a significant shift in corporate governance practices internationally hence the need to review the King III and update it so as to be in line with the different regulatory developments both locally and internationally. The King IV was published in November

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<sup>190</sup> King Report on Corporate Governance <[https://en.wikipedia.org/wiki/King\\_Report\\_on\\_Corporate\\_Governance](https://en.wikipedia.org/wiki/King_Report_on_Corporate_Governance)> accessed 26 September 2020.

<sup>191</sup> Tshepo Mongalo, 'South Africanizing Company Law for a Modern Global Economy', 121 S. AFR. L. J. 93, 93 (2004).

<sup>192</sup> King Report on Corporate Governance for South Africa <[https://www.mervynking.co.za/downloads/CD\\_King2.pdf](https://www.mervynking.co.za/downloads/CD_King2.pdf)> accessed 26 September 2020.

<sup>193</sup> Corporate Governance and King III <<https://assets.kpmg/content/dam/kpmg/pdf/2016/07/Corporate-Governance-and-King-III.pdf>> accessed 25 September 2020

2016 and became effective on 1<sup>st</sup> April 2017.<sup>194</sup> The main difference to note is that King IV moves away from the ‘apply or explain’ approach to the ‘apply and explain’ approach, it has reduced the number of principles from 75 to just a handful of 17 principles with one of them only applicable to institutional investors.<sup>195</sup> The foundation of the King IV was leadership that is ethical, corporate citizenship, organization in society, sustainable development, inclusivity of stakeholders and integrated thinking and reporting.<sup>196</sup>

King IV’s inclusion of the ‘apply and explain’ approach moves away from the previous ‘apply or explain’ approach which was compliance based where companies just tick a box or simply explain failure to apply the practice. The ‘apply and explain’ approach allows for greater flexibility in that companies seek to understand the principles and practices which apply to their company so as to achieve their intended outcomes. This also encourages companies to understand the principles which they cannot simply just ignore.<sup>197</sup>

The principles as set out in the King IV Code on Corporate Governance can be summarized as addressing issues of ethics and cultivating an ethical culture in the organization, perception of the organization by the society, promotion of sustainability, access to information for all stakeholders so that they can make well informed decisions, the governing board as custodians of the organization, board diversity in relation to skills, knowledge, independence of the governing body, evaluation, appointment procedure, risk management, oversight role on information technology, ensure regulatory compliance, remuneration policy and recognition of stakeholder interests.<sup>198</sup>

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<sup>194</sup> King IV Summary Guide

<https://home.kpmg/za/en/home/insights/2016/10/king-iv-summary-guide.html> accessed 26 September 2020

<sup>195</sup> King IV Report on Corporate Governance for South Africa 2016.

<sup>196</sup> Ibid.

<sup>197</sup> Parmi Natesan and Prieur du Plessis, ‘Why King IV’s “apply and explain” is so important.’ <https://www.iodsa.co.za/news/438882/Why-King-IVs-apply-and-explain-is-so-important.htm> accessed 26 September 2020.

<sup>198</sup> n 31.

It is quite interesting that King IV has made a provision for information and technology which is under principle 12 whose impact and role in the economy cannot be ignored. The South African code on corporate governance is progressive in that it is adapting to the world whereby information and technology is now playing a big role. The Code states that the governing body should make a provision in the management of information and technology in the organization in addition to policy regulating the same which will in turn enable it achieve its objectives.

The King IV places emphasis on organizational ethics as embodied in principle 1 and 2 whereby the governing body and the organization should be led ethically through conduct that displays integrity, transparency, competence, fairness, responsibility and accountability.<sup>199</sup> The leaders should direct the company to achieve sustainable economic, social and environmental performance.

The King IV code on corporate governance provides for the responsibilities of the governing body and acknowledges that they should be the primary custodians of corporate governance in the organization by approving policies and protocols that are used to set out meeting requirements, custody of documentation etc. there should be a mix of skills, knowledge experience, industry, business such that each person brings something beneficial to the organization. The body should be diverse and also take into account race and gender representation.<sup>200</sup> The whole process for appointment of members to the governing body should be formal and transparent. Members should be appointed on merit basis only.

Remuneration of directors is also captured in the code under principle 14 which requires the governing body should approve policy in relation to remuneration which should be transparent, fair and responsible. The governing body should ensure that the remuneration

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<sup>199</sup> King IV Report on Corporate Governance for South Africa 2016.

<sup>200</sup> Principle 7, King IV Report on Corporate Governance for South Africa 2016

policy for the executive management in place is fair and responsible compared to the overall employee remuneration of the organization. This means that there has to be a structure in place which allows for transparent in remuneration of the executive management and not the allocation of exorbitant amounts which are not in line with the remuneration of the employees in the organization.

King IV also has a provision for sector supplements under part 6 which is applicable to municipalities, non-profit organizations, retirement funds, small and medium enterprises and state owned entities.<sup>201</sup> The Code is applicable to all types of companies and not just the listed companies. The basis of issuance of the supplements to the specific categories referred to earlier on is that they represented a majority of the different sectors in South Africa.<sup>202</sup> Part 6.6 deals specifically with state owned entities whose importance is geared towards advancing economic growth in South Africa. The Presidential Review Committee on State-Owned Entities made recommendations that would ensure that state-owned entities would respond to the developmental state<sup>203</sup> agenda of South Africa, bridge the gap between the rich and poor, black and white and drive the economy to greater heights.<sup>204</sup>

The principles in the King IV report can be summarized as leadership, sustainability and good corporate citizenship. The initiatives main agenda is to improve transparency and accountability of the South African corporate governance environment. It views sustainability as the primary moral and economic imperative of this century; the code's view on corporate citizenship flows from a company's standing as a juristic person.

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<sup>201</sup> Ibid.

<sup>202</sup> Guide - Corporate Governance In South Africa <<https://www.bowmanslaw.com/wp-content/uploads/2017/04/Guide-Corporate-Governance-in-SA.pdf>> accessed 26 September 2020

<sup>203</sup> Developmental state is defined as a state led by a government that pursues rapid and deliberate economic growth and development. Presidential Review Committee on State-Owned Entities <[https://www.gov.za/sites/default/files/gcis\\_document/201409/presreview.pdf](https://www.gov.za/sites/default/files/gcis_document/201409/presreview.pdf)> accessed 26 September 2020

<sup>204</sup> Presidential Review Committee on State-Owned Entities <[https://www.gov.za/sites/default/files/gcis\\_document/201409/presreview.pdf](https://www.gov.za/sites/default/files/gcis_document/201409/presreview.pdf)> accessed 26 September 2020

### **4.3.3 Lessons for Kenya from South Africa**

The King IV is robust and progressive as it has principles that touch on information and technology whose impact in this day and age cannot be ignored. This shows that regulations laws and policies should be adapted to the needs of the society and the role information and technology plays has changed the perception of the economy due to technological advances. Kenya can therefore learn from South Africa which is an emerging market if we want to progress our economy and be in line with international best corporate governance practices.

The King IV Code on Corporate Governance has also set out principles that promote organizational ethics. This is not just for the governing body but the organization as well. Ethics is an important aspect of good corporate governance practice and should be promoted in the whole organization. It also allows for a remuneration policy to be approved that is in line with the general remuneration of employees. This is a good initiative as it will curb the management and governing body from allocating themselves with the absurd benefits as compared to the employee remuneration scale. There should be a consensus between the two and unfortunately in Kenya you find the board and management being paid allowances that are well beyond the remuneration of the employees in the company. There is a discord in the remuneration of employees and that of the board of directors in Kenya. If the remuneration of directors is capped and attached to the performance of the company it can motivate the directors and management to ensure profitability of the company which would in turn translate to earning bonuses. We can therefore learn a lot from our South African counterparts.

Another leaf Kenya can borrow from South Africa is on the concept of ‘apply and explain’ which is a shift from their previous King III code. This would make organizations accountable to stakeholders as they have to explain how they have applied the code and where they have deviated to explain the rationale for it so as to achieve their objectives. Their

code is also applicable to all corporations and has a part that is specific to different sectors such as state owned entities which is the equivalent of our State Corporations. The King IV code encompasses all types of corporations even the non-profit organizations. The code seeks to streamline good corporate governance practices across all sectors which in turn drive the economy and drive to achieve a developmental state for South Africa.

#### **4.4 Corporate Governance in the United Kingdom**

Corporate governance movement gained momentum in the UK in the early 1990s due to a few scandals that were experienced in the country such as the Maxwell case that resulted in the loss of £2.8 billion to bankers as well as loss of pension funds in the amount of £530 million to employees.<sup>205</sup> The problems seen in companies were associated with issues such as financial irregularities, misappropriation of funds, lack of separation of power and ownership just to name a few.<sup>206</sup>

The corporate fails therefore resulted in formation of the Cadbury Committee in May 1991 which was set up by the Financial Reporting Council, the London Stock Exchange and a few members of the accountancy professions with the aim of addressing the issues that were afflicting companies and would later draft the first code of best practice in the UK.<sup>207</sup> The Cadbury Committee that was chaired by Sir Adrian Cadbury first defined corporate governance as a *system by which companies are directed and controlled* and developed the

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<sup>205</sup> Ghulam Abid & Alia Ahmed, 'Failing in Corporate Governance and Warning Signs of a Corporate Collapse' Pakistan Journal of Commerce and Social Sciences 2014, Vol. 8(3), 846-866 <<http://www.jespk.net/publications/212.pdf>> accessed 27 September 2020.

<sup>206</sup> Elewechi Okike, 'Corporate Governance in the United Kingdom' <[https://www.researchgate.net/publication/332694263\\_Corporate\\_Governance\\_in\\_the\\_United\\_Kingdom/link/5cc3ab6d92851c8d22079485/download](https://www.researchgate.net/publication/332694263_Corporate_Governance_in_the_United_Kingdom/link/5cc3ab6d92851c8d22079485/download)> accessed 27 September 2020.

<sup>207</sup> Brian R. Cheffins, 'The Rise of Corporate Governance in the U.K.: When and Why' <<https://www.repository.cam.ac.uk/bitstream/handle/1810/253481/Cheffins%202015%20Current%20Legal%20Problems.pdf?sequence=1&isAllowed=y>> accessed 27 September 2020.

first set of principles of good corporate governance.<sup>208</sup> It was also the introduction of the ‘comply or explain’ approach.

#### **4.4.1 Institutional reforms**

Since the Cadbury Report there have been numerous other committees that have guided and shaped corporate governance in the UK. These committees are such as the Greenbury Committee which was established in 1994 and it dealt with remuneration of directors, the Hampel Committee whose report led to the publication of The Combined Code on Corporate Governance (The Combined Code) in 1998, thereafter there was the Turnbull Committee which provided guidance on internal control and made provision for risk management measures.<sup>209</sup> The Combined Code has undergone various reforms through the years from 1998, 2003, 2006, 2008, 2010, 2012, 2014, 2016 and the latest version that was published in 2018.<sup>210</sup> This shows how policy on corporate governance is an area that needs to be updated regularly so as to take into account various external factors such as societal concerns, changes in the economy and international best practices.

#### **4.4.2 UK Corporate Governance Code (2018)**

The UK Corporate Governance Code (2018) is shorter and simpler as compared to the previous codes. The Code was published together with a *Guidance on Board Effectiveness* (the Guidance) whose aim is to support the activities of the board. The UK Code is divided into five sections which deal with leadership, purpose, responsibilities, the composition, audit and remuneration of the board. The 2016 code was based on five principles which is similar to what we have in Kenya in our Mwongozo Code of Governance for State Corporations.

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<sup>208</sup> Report of the Committee on the Financial Aspects of Corporate Governance (1992) <<http://www.ecgi.org/codes/documents/cadbury.pdf>> accessed 17th September 2020.

<sup>209</sup> History of the UK Corporate Governance Code <<https://www.frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code/history-of-the-uk-corporate-governance-code>> accessed 27 September 2020.

<sup>210</sup> Ibid.



The aim of the 2018 Code is to provide guidance to the board of directors who should apply the principles in order to promote the purpose, values and future success of the company. The Code therefore focuses on growth and sustainability. It applies the principle of ‘comply or explain’ and urges the board to be flexible and use an approach that is most suitable to their company. Unlisted companies may elect to follow the UK Corporate Governance Code and it is on a voluntary basis but the Listing Rules require premium listed companies to apply the Principles and comply with the provisions and to report to shareholders on this.<sup>211</sup>

The first principle is on board leadership and company purpose. It places on the board the responsibility of ensuring that it steers the company in a direction that results in growth and sustainability for the company. It should look for opportunities to grow the business and ensure it has policies in place that promote the values of the company. The board should lead by example by being honest in their dealings.

The second principle in the UK code of governance is concerned with having a separation in the duties of the board and that of the management of the corporation. There should be no individual with unrestricted powers when it comes to decision making process. The third principle is on composition, succession and evaluation. They should take into account other societal issues when appointing members to the board and committee such as gender inclusion and different ethnicities.

The fourth principle on audit, risk and internal control provides that the board should be actively engaged in identifying any risk areas for the company which may threaten the performance of the company in the future and provide an explanation on how these identified risks have been managed. This means that boards are encouraged to be pro-active in discharging their duties.

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<sup>211</sup> The UK Corporate Governance Code (2018).

The last principle on remuneration provides that there should policy on how the remuneration of directors is fixed. The policy should be developed in a manner that encompasses a process that it transparent. Whether in the UK or Kenya; the board of directors has a primary objective in corporate governance. First, the board is charged with oversight, monitoring and control of the management of a corporation company and all its critical functions; secondly, setting the strategic direction of the organization.

#### **4.4.3 Lessons for Kenya from the United Kingdom**

The 2018 Code sets out the principles that will enable the board to ensure sustainability and success of the company which is something that is lacking in our own State Corporations. They do not have strategic objectives to realize profit maximizations nor ensure continuity of the corporations. The UK Code on Corporate Governance has been revised around eight times with revisions undertaken every two years which shows that good corporate governance practices change with time and we need to accommodate any new changes. In Kenya, the Mwongozo Code was published in 2015 and yet there have been nor revision since then and its impact is yet to be felt. We do not have enabling legislation that support implementation of the principles of good corporate governance as State Corporations cannot be entrusted with self- regulation.

#### **4.5 Corporate Governance in Kenya**

Mwongozo, the Code of Governance for State Corporations is the policy document by the government of Kenya that seeks to incorporate the principles of corporate governance in the management and governance of State Corporations in Kenya. It is an integral part of the reform recommendations developed by the PTPR. It aims to entrench principles and values of public service and best practices in the management of State Corporations.

The road towards achieving corporate responsibility among State Corporations in Kenya has been dormant ever since the publication of Mwongozo the Code of Governance for State Corporations in the year 2015. The Code is divided into eight chapters namely the Board of Directors, Transparency and Disclosure, Accountability, Risk Management and Internal Control, Ethical Leadership and Corporate Citizenship, Shareholder Rights and Obligations, Stakeholder Relationships, Sustainability and Performance Management and lastly Compliance with Laws and Regulations.<sup>212</sup> The Code is based on the ‘comply or explain’ basis which means that it is upon the discretion of the State Corporation to choose which principles it will apply and those they do not the Corporation simply explains why it did not apply it. Each chapter has guiding principles which have been set out together with the governance parameters and the practices that should guide the State Corporations.

#### **4.5.1 The Mwongozo Code**

Chapter 1 of the Mwongozo Code is on the Board of Directors and it provides for the appointment, composition and size of the Board as you will find in most instances the State Corporations have bloated boards which is counterproductive. Appointment of the Board should be in line with the Constitution<sup>213</sup> and it goes further in providing that when directors are being appointed there are certain factors that should be taken into consideration such as their qualifications and at least one of them should be a financial expert. The Board of Directors should therefore be appointed based on merit and what they have to offer the State Corporation. The code goes further to limit the size of the board which should ideally be between 7 and 9 members only.<sup>214</sup> The code places a responsibility on each individual Board member to act with a duty of care and skill, exercising sound judgment, avoiding personal conflicts of interest and ensure they enhance and update their skills regularly.

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<sup>212</sup> Ibid.

<sup>213</sup> The Constitution of Kenya, Article 27.

<sup>214</sup> Chapter 1, Mwongozo the Code of Governance for State Corporations

It also outlines the roles and duties of the board, sets a limit on the term a person can serve on the board to a maximum of six years with two terms of three years each, and limits the number of directorships an individual can have in State Corporations so as to be able to discharge their duties effectively. The code also provides guidance to the Board on the committees that should be in place such as the audit committee and three other committees, provision on ensuring there is a Board work plan in place, induction to the Board, evaluation of the Board, and process of appointing a CEO. The Code places an emphasis on having a CEO and Chairperson to the Board who should be independent and the need for a Corporation Secretary. All three positions should be filled by different people to ensure independence of the Board and they are able to discharge their duties as provided in the code. The Board should not be involved with the day-to-day running of the State Corporation as this is the responsibility of the Management.

Chapter two deals with transparency and disclosure. A key important provision of the code is that the annual report should include information such as compliance to existing laws and regulations, state the extent of the application of the code, include the governance structure in place, disclose the remuneration policy for the Board, .have a code of ethics and whistle blowing policy, outline the procurement procedures in the State Corporation. The Code also has a provision whereby the Board should disclose whether the State Corporation has a policy on corporate social responsibility (CSR) and investments. The annual report should also indicate whether the State Corporation is sustainability in that it has enough resources as needed to cater for its activities in the future.

Chapter three deals with issues of accountability and how risks should be identified and managed by the board. They should ensure they obtain all the financial reports for purposes of identifying any risks that may be there. It also provides for internal control measures to be put in place. The external auditor should be qualified and independent as they guarantee the

Board that the financial records show the true position of the State Corporation. The chapter provides how the process of procurement will be undertaken as well as stating the importance of having an internal and external audit and how it ought to be done. There ought to be an independent audit committee which ensure the financial reporting is accurate and transparent. It also makes a provision for the Board putting in place an ICT policy as per the objectives of the State Corporation.

Chapter four of the code is on leadership by the board which should be ethical. The board and management should be upright in their dealings which will in turn lead to good corporate citizenship. The board should be honest when discharging their duties and should also invest.

Chapter five and six deals with the rights and obligations of shareholders and stakeholders' relationships respectively. As seen in this study, the importance of both shareholders and stakeholders cannot be underscored as they impact the organization. The rights and interests of both should be identified and protected as each has their own role. The board should also ensure they protect how the corporation is viewed by the society.<sup>215</sup>.

Chapter seven and eight of the code deals with sustainability whereby the board ought to ensure that whatever decisions are made are made with a view to ensuring that the organization can be sustained in the future. There should be long-term goals for the organization and identification of any risks that may jeopardize the continuity of the organization. This goes hand in hand with the performance of the organization as if it performs poorly it can lead to its collapse. Chapter eight lays an emphasis on compliance with the laws and that the affairs of the organization should adhere to all applicable laws.

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<sup>215</sup>Mwongozo The Code of Governance for Kenya's State Corporations.

The Mwongozo Code was published through an executive order but it is not a law. In the forward to the Mwongozo code it is stated that the code was to be issued as a regulation under the SCA. This is yet to happen.

#### **4.5.2 Lessons for Kenya from Other Jurisdictions**

The key differences to note with other jurisdictions when it comes to drafting a Code of Governance for public institutions is that they are normally subject to review after a number of years. This takes into account the evolving economic and environmental changes in the society. As seen from other codes such as the Malaysian Code which promotes gender diversity in the board. This has been done by inclusion of a provision that at least 30% of the directors should be women. The Mwongozo Code in Chapter 1, under the principles only states that the Board should provide for gender diversity. There is no emphasis in the practice of the Mwongozo thus the part on gender inclusivity can be ignored by State Corporations. When you look at the South African Code it goes further to take into account its different diverse culture and races therefore it has a provision that states the Board should have a mix of races and gender. They also go further to ensure that the remuneration policy should be in line with the remuneration of the employees.<sup>216</sup>

#### **4.6 Conclusion**

Most of the Codes on Corporate Governance of different countries have been revised so as to adapt to the changing circumstances. Each Code has been drafted to suit the countries needs as we can see the Malaysian Code takes the CARE approach which is ‘comprehend, apply and report’. The Code has also made a provision for intended outcome meaning that the board has to apply the set out principles which will ensure the company achieves their targets. It is not simply applying the principles as a formality but with a clearly set out agenda. The CARE approach in its ‘apply’ part allows for companies to apply or explain an alternative

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<sup>216</sup> Principle 14, King IV Report on Corporate Governance for South Africa 2016.

approach on why they chose a particular action for their company which in turn saw them achieve their intended outcome. The Malaysian code has a part on gender inclusivity by requiring at least 30% of the board should be women.

The King IV in South Africa is based on the ‘apply and explain’ approach, it has made provision for the acknowledgement of information and technology in the corporate world and the need to make provisions which are up to date. It also has provisions that are specific to the different sectors in the country namely organizations that are non-profit, municipalities, retirement funds, SME’s and government owned entities. The King IV is aimed at promotion of organizational ethics which is concerned with making decisions that are good for the organization, stakeholders and the society at large. It also places emphasis on ensuring sustainability of the organization and good corporate citizenship.

The UK Code takes the ‘comply or explain’ approach and it makes provisions for ensuring continuity of the business through good utilization of resources, development of strategies that will allow for sustainability of the company, engagement of shareholders and stakeholders. The Code also recognizes the need for board diversity through inclusion of gender and ethnicity.

All these codes have been adapted to their situation as each takes a different approach be it ‘CARE, ‘apply or explain’ or ‘comply or explain’. Kenya should therefore adapt the Mwongozo Code to its environment but taking into account the international best corporate governance practices. We should Africanize the Mwongozo and find an approach that is best suited to our needs while capturing the key principles.

## CHAPTER FIVE

### CONCLUSION AND RECOMMENDATIONS

#### 5.1 Conclusion

The Mwongozo Code was drafted with the intent of aiding in the promotion of good corporate governance practices in our State Corporations which would in turn drive economic growth and development. State Corporations are meant to promote national development in the country, create job opportunities and ensure service delivery to its citizens

This is however, not the case in Kenya as State Corporations. Most are mainly affected by inefficient and ineffective board of directors whose duties and responsibilities when taking up the role are not defined. Most of the boards of State Corporations do not have a set target within which they can drive the activities of the State Corporations to ensure sustainability and profitability. The boards have been found to be the source of faults and gaps that hinder effective implementation of the Mwongozo Code and the State Corporations Act. For instance, Kenya Airways poor governance practices have caused the company to lose billions and have resorted to requesting for government bailout for the amount of Kshs. 70 million so as to cope during this COVID-19 period and this is after it already got a bailout in the year 2019 for the amount of Kshs. 50 million.

The findings indicate that State Corporations have not fully implemented the Mwongozo Code which has led to deterioration of State Corporations and their poor performance is attributed to weak legal frameworks, corruption and political interference.

There is massive institutional ineffectiveness stemming from the EACC, the ODPP and the Judiciary itself. These institutions are tasked with fighting corruption, upholding the law but they do not have sufficient resources which creates a hindrance when it comes to discharging their duties.



There is no clear framework for harmonizing and strengthening effective governance of State Corporations in terms of laws and regulations. Consequently there is no clear framework for developing ways and means of preventing and combating corruption in a comprehensive, coordinated, inclusive and sustainable manner.

State Corporations are prone to political leaders, using them to serve their self-political interests. Public officials are more likely bow down to political pressure so as to meet the needs of the electorate. In the worst case scenario, the objectives of the corporation are sidelined for the own commercial benefits as opposed to serving the corporation and looking out for its best interest and the society at large. For this reason, Kenya cannot rely on self-regulation among State Corporations as already seen in this study whereby none of them are self-sufficient but relies on the government for their day-to-day running. Most of these corporations deliver key services but none is profitable. The structures and processes that currently exist among State Corporations do not work and therefore the need to restructure our State Corporations in order to achieve different results and an example of this can be seen in Postal Corporation of Kenya which has been plagued with mismanagement claims and with the evolving technological advancements the State Corporation is still operating like in the 1990s instead of diversifying the business or remodel it to adapt to the changing times.

## **5.2 Recommendations**

### **5.2.1 The Judiciary**

The Judiciary should be strengthened so as to enhance their capacity as there are mandated to maintain and apply the law. It can be an efficient tool in aiding in the fight against corruption as they are meant to uphold the law. Those who are found guilty should be punished and meant to act as a deterrent to other offenders. The different agencies such as investigative

bodies and the prosecutors should work alongside each other as they have a common objective.

### **5.2.2 Strengthening of Institutions**

The EACC should be funded adequately so as to ensure they carry out proper investigations and to allow for proper staffing which will enable them handle all corruption cases. This will prevent files being returned by the ODPP due to lack of proper investigations.

The ODPP which is mandated to prosecute criminal cases is an important institution which should work closely with the various investigative agencies in Kenya. These agencies include the EACC as already mentioned, the police, the Directorate of Criminal Investigations (DCI) and other agencies. The ODPP is at the heart of the justice system in that they can either make or break a case and they should therefore work collaboratively with other investigative agencies to prevent cases being thrown out due to lack of sufficient evidence. If the institutions are empowered financially, staff recruited on a frequent basis and continuous training and development of the staff it will ensure that cases can be taken to trial with a prosecutor that is well informed and knowledgeable about corruption cases and economic crimes.

### **5.2.3 Public Participation**

Public participation as a legal right is provided for in the Constitution. It is an important element of democracy as the people should have a hand in laws that will inevitable have an effect on them and their environment. When the Mwongozo Code was being drafted, it sought the views of various targeted stakeholders such as the Institute of Certified Public Secretaries in Kenya (ICSPK), World Bank and the Public Service Commission. The whole exercise by the taskforce took six weeks only and we can deduce that six weeks is clearly not enough to conduct an exercise that involves first off to inform people on the area under

review in this case the management of State Corporations and their role in the society, the second thing is to consult and receive their views and feedback in relation to the State Corporation such as why do we need State Corporations and how can we improve them, the third part on public participation is to involve them in the whole process, fourth is to collaborate with them and lastly to empower them to agree to the findings and draft policy meant to streamline State Corporations in Kenya.

Public participation is a whole process that mainly educates and creates awareness and therefore you are able to get the general consensus on the way forward. Once the public is involved in the process it allows for them to hold someone accountable as they ensure that the necessary steps are taken for enactment of laws that will be beneficial to the people and protect their rights and interests in the State Corporation as they are the shareholders.

#### **5.2.4 Enactment of Mwongozo as a law**

In the foreword to the Mwongozo, His Excellency the President of the Republic of Kenya, Uhuru Muigai Kenyatta has urged the public sector to adhere to the Mwongozo. This is merely a suggestion and it has no legal ramifications if the principles of the Mwongozo are not applied.

The Mwongozo Code was published in 2015 and since then, there have been no reviews so as to update it with the best international corporate governance practices. Malaysia, South Africa and the UK have all reviewed their Codes of Corporate Governance on a regular basis. They appreciate that corporate governance is not just a passing phase but an issue that impacts on the social, economic structure and development of a country. We have to have robust governance best practices that allows and attracts investors and supports in the economic growth and development of our country.

The Mwongozo Code should first of be reviewed so as to be in line with international best practices whereby it can include proper provision on gender inclusivity which is still an issue in Kenya and has yet to be enforced in Kenya yet has been provided for in the Constitution. This can be for example through inclusion that encourages the board to have 30% women based on skill and merit and if not at least to explain the failure for lack of gender representation.

The Code should also require that the board should set targets for the State Corporations which are aimed at promoting profitability and sustainability. State Corporations should be measured on profits gained and not just output.

The Mwongozo Code after being reviewed and subjected to the proper channels of public participation should be issued as a regulation to the State Corporations Act pending the enactment of the Government Owned Entities Act.

Further, there should be a Code of Corporate Governance which should be reviewed every three years so as to update it to the changing circumstances and to be in line with other codes of corporate governance. State Corporations should undergo mandatory governance audit annually to be undertaken by the relevant authority such as the State Corporations Advisory Committee (SCAC).

The last recommendation would be the mergers of the State Corporations Advisory Committee (SCAC) and the Inspectorate of State Corporations (ISC) to have one unified body that manages all State Corporations in Kenya. The two supervisory bodies are like a dead carcass in that none of them have undertaken any governance check on state corporations, you cannot get any information on their websites and the only documents are those on the Presidential Taskforce on Parastatal Reforms in 2013. This unified regulatory body would be in-charge of reviewing performance of State Corporations, recommending the

merger/dissolving of a State Corporation, undertaking governance audits, conduct any investigations and other duties in accordance with its mandate.

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