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**COMPLIANCE WITH CAPITAL MARKETS AUTHORITY
CORPORATE GOVERNANCE GUIDELINES:
A SURVEY OF COMPANIES LISTED AT THE NAIROBI
STOCK EXCHANGE**

BY:

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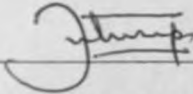
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DECLARATION

This research project is my original and has not been presented for a degree in any other university

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ACKNOWLEDGEMENTS **DEDICATION**

To my wife Angeline, daughter Enid and son Elvis, my source of inspiration

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This study has been made possible by a number of people to whom I'm indebted and would like to acknowledge their contributions.

To my family for their encouragement and support during the period of the study. My lecturers, friends, colleagues and university staff who contributed in one way or another in the course of my study and my supervisor Mr. J. L. Lishenga for his guidance throughout this project. I extend my sincere thanks

And to the almighty God for bringing me this far

ABSTRACT

In the past one and a half decades there has been a clamour for good corporate governance from investors regulatory authorities and the government aimed at ensuring proper exercise of the corporate power and safeguard shareholders interest. The clamour has further been fuelled by high profile corporate failures in the recent past. This clamour has brought about various codes and guidelines all aimed at ensuring proper corporate governance. In Kenya the Capital Markets Authority (CMA) together with other organisations have been at the forefront of ensuring good governance especially for companies quoted at the Nairobi Stock Exchange. It is in line with this that CMA in the year 2002, developed guidelines on corporate governance for companies quoted at the Nairobi Stock Exchange.

The study seeks to determine whether companies quoted at the Nairobi Stock Exchange comply with the Capital Markets Authority guidelines on corporate governance issued in the year 2002.

The data for the study was collected through the use of a self-administered questionnaire and from annual reports and accounts of the companies and publications from the Nairobi Stock Exchange. The data was analysed and presented using descriptive statistics and content analysis.

The findings of the survey are that the Capital Markets Authority corporate governance guidelines already attain a high degree of acceptance. There is no company that totally rejects the guidelines. There was however found to be a low level of compliance with regard to disclosures and there is therefore need to encourage or enforce more disclosures.

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CHAPTER 1: INTRODUCTION

1.1. Background

Corporate governance has in the past decade generated great interest from governments, regulatory authorities, investors, scholars, regional and global organisations. According to the Commonwealth Association of Corporate Governance (CACG), the interest in corporate governance has been triggered by globalisation of economies and financial investment markets in the 1990s, public attention through high profile corporate scandals and collapses; and the volatility and instability experienced in emerging markets.

Other reason why corporate governance has generated immense interest is due to the role that the corporation plays in economic development and social progress. The Global Corporate Governance Forum notes in its mission statement that:

“Corporate Governance has become an issue of worldwide importance. The Corporation has a vital role to play in promoting economic development and social progress. It is the engine of growth internationally, and increasingly responsible for providing employment, public and private services, goods and infrastructure. The efficiency and accountability of the corporation is now a matter of both private and public interest, and governance has, thereby, come to the head of the international agenda.”

The importance of corporate governance became dramatically clear in 2002. This year witnessed series of corporate meltdowns, frauds, and other catastrophes that led to the destruction of billions of dollars of shareholder wealth, the loss of thousands of jobs, the criminal investigation of thousands of executives and record-breaking bankruptcy filings. Seven of the largest bankruptcies in American history were filed in 2002 alone. Some of these corporate collapses include Enron, Tyco, Adelphia, WorldCom and Global Crossing (Monks and Minow, 2004).

Cadbury 1992 defines corporate governance as the system by which companies are directed and controlled. The Private Sector Corporate Governance Trust (PSCGT) defines corporate governance as the manner in which the power of a corporation is exercised in the stewardship of the corporation's total portfolio of assets and resources with the objective of maintaining and increasing shareholder value and satisfaction of other stakeholders in the context of its corporate mission (PSCGT, 1999).

A number of studies have been done in the area of corporate governance. Wainaina (2002) studied governance practices micro finance institutions in Kenya. The study was aimed at documenting governance practices and to establish the level of awareness on effective institutional governance in micro finance institutions in Kenya. Mucuvi (2002) conducted a survey of corporate governance practices in the motor vehicle industry in Kenya. The survey sought to identify corporate governance practices in the formal motor vehicle industry in Kenya and to establish the factors hindering implementation of good governance practices in the industry.

Mwangi (2002) conducted a survey of corporate governance practices among the insurance companies in Kenya. The survey aimed at identifying the level of governance practices in insurance companies in Kenya and to determine whether there exists a relationship between the corporate governance practices, ownership and the type of business written by the insurance companies operating in Kenya. The survey also sought to establish whether there exists a relationship between corporate governance practices and performance.

Jebet (2001) studied the corporate governance practices of companies quoted in the stock exchange. The study aimed at determining the existing governance structures in publicly quoted companies in Kenya, to identify weaknesses in these structures and to suggest improvements. The study also aimed at establishing the extent to which companies have established

audit committees as per the CMA guidelines on the establishment of audit committees issued in 1998.

Hussein (2003) examined the effect of audit committees and their composition of independent and non-executive directors on major disclosures and other non-financial characteristics of companies listed at the Nairobi Stock Exchange. The objectives of the study were to determine major disclosures and other financial characteristics of companies listed in the NSE before and after the establishment of the audit committees; to determine the perceived value of audit committees by management of the listed companies and to assess the achievement of audit committees in the listed companies.

1.2. The Capital Markets Authority

The Capital Markets Authority (CMA) was established in 1989 through an act of parliament (Capital Markets Act Cap 485A) and was constituted in January 1990. The mission of the Capital Markets Authority is “to promote the development of orderly, fair, efficient, secure, sound, just, transparent and dynamic capital markets in Kenya within a framework which facilitates innovation through an effective but flexible system of regulation for the maintenance of investor confidence and safeguards the interest of all market participants”.

The principal objectives of CMA are the development of all aspects of the capital markets with particular emphasis on the removal of impediments to, and creation of incentives for longer-term investments in productive activities. It also aims at facilitating the existence of a nationwide system of stock market and brokerage services to enable wider participation in stock market. Other objectives include creating, maintaining and regulating a market in which securities can be issued and traded in an orderly, fair and efficient manner, through the implementation of a system in which the market participants regulate themselves to the maximum practicable extent.

Protection investor interests, operating compensation fund to protect investors from financial loss arising from the failure of a licensed broker or dealer to meet his contractual obligations and developing a framework to facilitate the use of electronic commerce for the development of capital markets in Kenya are the other objectives of CMA.

The CMA is managed by a board consisting of a chairman appointed by the president on the recommendation of the Minister of Finance; six other members appointed by the minister and the Chief Executive Officer of CMA. The Chief Executive Officer serves for a four year period and eligible for re-appointment for another four-year term. Other members include the Permanent Secretary to the Treasury, the Governor of the Central Bank of Kenya, the Attorney General or persons deputy to them.

1.3. Statement of the Problem

In exercise of the powers conferred by sections 11(3) (v) and 12 of the Capital Markets Act, the Capital Markets Authority in the year 2002 issued guidelines on corporate governance practices, for observance by public listed companies in Kenya, in order to enhance corporate governance practices by such companies.

The guidelines were developed in response to the growing importance of governance issues both in emerging and developing economies and for promoting growth in domestic and regional capital markets. It was also in recognition of the role of good governance in corporate performance, capital formation, and maximization of shareholders value, as well as protection of investors' rights.

In summary, the guidelines prescribe that non-executive directors must make up a least one-third of corporate boards. These boards are required to establish appropriate board committees including an audit committee. Directors may not hold more than five directorships and must regularly

offer themselves up for re-election at annual general meetings. There should be a formal remuneration structure for directors approved by shareholders. The position of the chairman of the board and the chief executive should not be held by the same person, while directors should not be Chairman of more than two listed companies. Companies must disclose remuneration for directors and senior executives including share options in their annual report. Shareholders must approve major corporate decisions such as major asset disposals, restructurings, mergers, acquisitions and reorganisations. The boards must also provide timely and sufficient information to enable shareholder participation in annual general meetings. The board is required to present annual accounts and to ensure that the accounts are presented in line with International Accounting Standards. The board must also ensure that there is a system of internal controls. The Chief Finance Officers and the Auditors must be members of the Institute of Certified Public Accountants, and Company Secretaries must be members of the Institute of Certified Public Secretaries of Kenya.

The CMA guidelines became effective in year 2002. There has not been any study yet to determine compliance with these guidelines. The study by Jebet (2001) dealt with the compliance Capital Markets Authority guidelines on the establishment of audit committees issued in 1998. The same have been superseded by the more comprehensive guidelines on corporate governance issued in 2002.

This survey seeks to establish whether the Capital Markets Authority guidelines on corporate governance have been complied with by public companies quoted at the Nairobi Stock Exchange.

1.4. Objective of the Study

The objective of the study is to determine whether companies quoted at the Nairobi Stock Exchange have complied with the Capital Markets Authority guidelines on corporate governance.

1.5. Importance of the Study

The findings of the study will go towards filling the existing gap as regards corporate governance practices in Kenya. More specifically, it will be of importance to regulatory authorities in determining the level of compliance with the guidelines. In the event that the level of compliance is not as desired, the authorities may be required to take appropriate actions to encourage or enforce compliance

Investors will benefit in assessing whether there are mechanisms in place to ensure that their interests as shareholders are safeguarded. Potential investors will also benefit as they will be able to determine companies that are properly governed in making their investment decisions. The study will enable directors and management appreciate the importance of corporate governance practices and assist them in rating their level of compliance against those of their competitors or the entire market, and in determining whether the corporate governance practices they employ are adequate to give them a competitive edge.

The public, which includes customers, suppliers of goods and services and the community at large, would want to associate with companies that are properly governed. The study will assist the public in determining such companies and their level of interaction based on their corporate governance record.

CHAPTER 2: LITERATURE REVIEW

2.1. Overview of Corporate Governance Concept

Corporate governance is not a new concept in the world today. It is a modern expression of an issue which companies have faced for decades – that of “accountability”. At the most basic level, it is about how those entrusted with the day-to-day management of a company’s affairs are held to account to shareholders and other providers of finance; and whether the organization has the appropriate corporate structures to underpin accountability (Pricewaterhouse, 1997).

The fundamental insight from which the field of corporate governance emanates is that there are potential problems associated with the separation of power and control that is inherent in the modern corporate form of organisation. Corporate governance, then, encompasses the set of institutional and market mechanisms that induce self-interested managers (the controllers) to maximise the value of the residual cashflows of the firm on behalf of its shareholders (the owners) (Denis, 2001).

To be able to understand the corporate governance concept, we first define the term governance. The term governance is derived from the Latin word *gubernare*, meaning ‘to steer’, usually applied to ‘steering of ship’. This therefore implies that corporate governance is the function of direction rather than control. Therefore, the general definition of corporate governance *is the way in which companies are directed and controlled* (Solomon and Solomon, 2004).

Parkinson (1994) defines corporate governance as the process of supervision and control intended to ensure that the company’s management acts in accordance with the interests of shareholders. Tricker (1994) argues that governance is not concerned with the running of the business of the company *per se*, but with giving overall direction to the enterprise, with overseeing and controlling the executive actions of management and with

satisfying legitimate expectations of accountability and regulation by interests beyond the corporate boundaries.

PSCGT (1999) defines corporate governance, as the manner in which the power of a corporation is exercised in the stewardship of the corporation's total portfolio of assets and resources with the objective of maintaining and increasing shareholder value and satisfaction of other stakeholders in the context of its corporate mission. PSCGT sees corporate governance as being concerned with creating a balance between economic and social goals and between individual and communal goals while encouraging efficient use of resources, accountability in the use of power and stewardship and as far as possible to align the interests of individuals, corporations and society. It is about promoting: Fair, efficient and transparent administration of corporations to meet well-defined objectives; Systems and structures of operating and controlling corporations with a view to achieving long-term strategic goals that satisfy the owners, suppliers, customers and financiers while complying with legal and regulatory requirements and meeting environmental and society needs; An efficient process of value-creation and value adding.

Simply put, corporate governance refers to the establishment of an appropriate legal, economic and institutional environment that allows companies to thrive as institutions for advancing long-term shareholder value and maximum human-centred development while remaining conscious of their other responsibilities to stakeholders, the environment and the society in general (PSCGT, 1999).

Corporate governance should be distinguished from management. Governance is concerned with the intrinsic nature, purpose, integrity and identity of the institution, with a primary focus on the entity's relevance, continuity and fiduciary aspects. Governance involves monitoring and overseeing strategic direction, socio-economic and cultural context,

externalities, and constituencies of the institution. Management on the other hand is more of a hands-on activity. In its traditional sense, management can be characterised as conducting or supervising action with the judicious use of means to accomplish certain ends. Management primarily focuses on specific goal attainment over a definite time frame and in prescribed organisation (Tricker, 1994).

Tricker (1994) further identifies three main distinguishing characteristics of management and governance. First, governance has external focus while management is internal, secondly, governance assumes an open system while management assumes a closed system and thirdly, governance is strategy oriented while management is task oriented. Simply put, governance relates to “where the company is going”, while management relates to “getting the company there”

According to Organisation for Economic Cooperation and Development (OECD) 2004, corporate governance is one key element in improving economic efficiency and growth as well as enhancing investor confidence. Corporate governance involves a set of relationships between a company’s management, its board, its shareholders and other stakeholders. It 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.

Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders and should facilitate effective monitoring. The presence of an effective corporate governance system, within an individual company and across an economy as a whole, helps to provide a degree of confidence that is necessary for the proper functioning of a market economy. As a result, the cost of capital is lower and firms are encouraged to use resources more efficiently, thereby underpinning growth.

A company that has implemented a strong corporate governance framework allows the firm the ability to enhance their competitive advantage. In addition, it also allows the firm to be able to formulate and implement more effective strategic decisions based on accurate and objective corporate information. The execution of a comprehensive corporate governance framework also assures the shareholders a higher level of confidence about their investment decisions. A comprehensive corporate governance framework can also be a useful management tool to supervise the overall check and balance system used to evaluate the overall operations of the firm (Stanwick *et al*, 2005).

2.2. Theoretical Perspectives Applied in Corporate Governance

There are a number of theories that have evolved to explain and analyse corporate governance. Each of these theories approaches corporate governance from different ways, and views corporate governance from a different perspective arising from different disciplines. For example, the agency theory paradigm arises from the fields of finance and economics, while transaction cost theory arises from economics and organisational theory. The main theoretical frameworks include the agency theory, transaction cost theory, stakeholder theory and stewardship theory.

2.2.1. Agency Theory

The overwhelmingly dominant theoretical perspective applied in corporate governance studies is agency theory (Shleifer & Vishny, 1997). Jensen and Meckling (1976) define an agency relationship as a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf, which involves delegating some decision-making authority to the agent. If both parties to the relationship are utility maximisers, there is good reason to believe that the agent will not always act in the best interests of the principal. The principal can limit divergences from his interest by establishing appropriate incentives for the

agent and by incurring monitoring costs designed to limit the aberrant activities of the agent.

The theory argues that in the modern corporation, in which share ownership is widely held, managerial actions depart from those required to maximise shareholders returns (Berle and Means, 1932; Pratt and Zeckhauser, 1985). In agency theory terms, the owners are the principals and managers are agents. There is an agency loss, which is the extent to which returns to the residual claimants, the owners, fall below what they would be if the owners exercised direct control of the corporation. The other agency costs include monitoring expenditure of the principal and the bonding expenditure by the agent (Jensen and Meckling, 1976).

The insight into the conflict between owners and managers dates back at least as far as 1776. During that year, Adam Smith, writing about professional managers in the *Wealth of Nations*, stated that: "Being the managers of other people's money (rather than their own)... it cannot be expected that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own..."

Agency theory specifies mechanisms which reduce agency loss (Eisenhardt, 1989). These include incentives for managers which reward them for maximising shareholder interests. Such schemes typically include plans whereby senior executives obtain shares, perhaps at reduced prices, thus aligning financial interests of the executives with those of shareholders (Jensen and Meckling, 1976). Other similar schemes tie executive compensation and levels of benefits to shareholders' returns and have part of executive compensation deferred to the future to reward long-run value maximisation of the corporation and deter short-run executive action which harms corporate value.

2.2.2. Transaction Cost Theory

The transaction cost theory was initiated by Cyert and March (1963), in their work, *A Behavioural Theory of the Firm*. This was an attempt to view the firm not as an impersonal economic unit in a world of perfect markets and equilibrium but rather as an organisation comprising of people with differing views and objectives. Williamson (1996), in describing the historical development of the theory, states that transaction theory was an interdisciplinary alliance of law, economics, and organisation.

Traditional economics considers all economic agents to be rational and profit maximisation to be the primary objective of business. Conversely, transaction costs economics attempts to incorporate human behaviour in a more realistic way. In this paradigm, managers and other economic agents practise 'bounded rationality', defined by Simon (1957), as behaviour that was intentionally rational but only limitedly so. Transaction cost economists also make the assumption of 'opportunism'. This means that managers are opportunistic in nature (Solomon, 2004). The result of assuming bounded rationality and opportunism is that companies must organise transactions so as to economise on bounded rationality while simultaneously safeguarding the transactions in question against the hazards of opportunism (Williamson, 1996). There are some similarities between agency theory and transaction cost theory in that both theories present a rationale for management to be controlled by shareholders.

2.2.3. Stakeholder Theory

In defining stakeholder theory, Clarkson (1994) states that the firm is a system of stakeholders operating within the larger system of the host society that provides the necessary legal and market infrastructure for the firm's activities. The purpose of the firm is to create wealth or value for its stakeholders by converting the stakes into goods and services.

The stakeholder view considers that the investors, employees, suppliers, customers and stakeholders generally both contribute and receive benefits from a firm. In addition, other parties such as unions, trade associations, government and even political groups may be involved in relationships (Donaldson and Preston, 1995).

A basis of stakeholder theory is that companies are so large, and their impact on the society so pervasive that they should discharge accountability to many more sectors of society than their shareholders. Not only are stakeholders affected by the company but they in turn affect companies in some way. They hold a 'stake' rather than simply a 'share' in companies (Solomon and Solomon, 2004). Many writers however, refer to stakeholders as simply those who have a legitimate stake in the company in the broadest sense (Farrar and Hannigan, 1988).

2.2.4. Stewardship Theory

In stewardship theory, managers are good stewards of the corporations and diligently work to attain high levels of corporate profit and shareholders returns. Managers are principally motivated by achievement and responsibility needs (Donaldson and Davis 1994). Whereas agency theorists view executives and directors as self-serving and opportunistic, stewardship theorists describe them as frequently having interests that are isomorphic with those of shareholders. This is not to say that stewardship theorists adopt a view of executives and directors as altruistic; rather, they recognize that there are many situations in which executives conclude that serving shareholders' interests also serves their own interests (Lane, Cannella, & Lubatkin, 1998).

According to the stewardship theory, managers are good stewards of the company assets. Managers do not misappropriate corporate resources at any price because they have a range of financial motives such as the

satisfaction of successful performance, the need for achievement and recognition etc (Muth and Donaldson, 1998).

2.3. Evolution of Corporate Governance

The corporate form has existed for centuries. The East India Company, for example, was chartered in 1600 (Baskin and Miranti, 1997). One might imagine, given this long history, that the issue of how corporations should be governed would have been settled some time ago. Yet, for nearly as long as corporations have existed, there have been complaints about corporate governance and agitation to improve it. Moreover, these complaints and agitation do not seem to be purely hot air. Over the centuries, they have led to various changes in corporate law and regulation, including up to the present. Even ignoring legally imposed changes, there appear to be ongoing trends in corporate governance (Hermalin, 2005).

Corporate governance systems have evolved over centuries, often in response to corporate failures or systemic crises. The first well-documented failure of governance was the South Sea Bubble in the 1700s, which revolutionised business laws and practices in England (Iskander *et al* 2000). Iskander (2000) further notes that much of the security laws in the US were put in place following the stock market crash of 1929, the banking crisis of the 1930s in the United Kingdom and the US savings and loan debacle of the 1980s. Each crisis or major corporate failure – often as a result of incompetence, fraud or abuse – was met by new elements of an improved system of corporate governance. The takeover boom of the 1980s brought the subject of corporate governance to the front pages of the newspapers, as a revolution was mounted against the power complexes at corporate headquarters

Governance has been on the agenda in the USA for at least two decades, during which time the large institutions which dominate the US stock market have actively and publicly wrestled with the problems of exerting

control over companies which they own. In Britain, the corporate governance debate was ignited by a series of prominent corporate failures at the end of the late 1980s. The collapse of companies such as Blue Arrow, Coloroll and Polly Peck prompted company directors, institutional investors, auditors and financial advisors, supported by government to engage in collective soul searching to find ways of ensuring that such failures could not happen again. In the mid-1990s, perceived high levels of executive pay particularly in the privatised utilities gave a new lease of life to the governance debate (Pricewaterhouse, 1997).

These trends have led to investors, governments and regulatory authorities in different countries around the world to come up with mechanisms and codes of best practice to address corporate governance practices in their respective countries. The first initiative of this kind was the establishment in May 1991 of the Committee on the Financial Aspects of Corporate Governance in Britain, later to be known as the Cadbury Committee. The Commonwealth Association of Corporate Governance (CACG), founded in 1998 has also developed guidelines for the countries in the Commonwealth to address the confusion occasioned by the multiplicity of codes on corporate governance in member countries. The World Bank, through the Organization for Economic Cooperation (OECD) established the Global Corporate Governance Forum in 1999 to try and co-ordinate corporate governance practices throughout the world.

More recent efforts to improve corporate governance were the enactment of the Sarbanes-Oxley legislation of 2002 in the United States and the publishing of the Higgs Report and the Smith Report in the UK in 2003. This was in response to the collapse of Enron and other big companies in the US in 2002. The US legislation emphasised among other things, more auditor independence; attestation by chief executives and chief financial officers that financial statements meet securities and company law requirements and real time disclosure of material effects. The UK reports

emphasised more on the role of non-executive directors and recommended a greater proportion of non-executive directors and more apt remuneration.

2.4. Corporate Governance in Kenya

Corporate governance mechanisms in Kenya have for a long time been inclined towards legal and regulatory mechanisms. All listed companies in Kenya must comply with the provisions of Companies Act (derived from the UK Companies Act of 1948), the regulations of the Capital Markets Authority (CMA) and listing rules of the Nairobi Stock Exchange. All these laws and regulations are designed to ensure protection of outside investors against expropriation by insiders.

Legal corporate governance mechanisms have been described as too blunt as an instrument to handle problems of wasteful managerial behaviour effectively (Jensen, 1993). It is in realisation of this that various initiatives were formed in the 1990's to address corporate governance practices in Kenya. The Key initiators were the Nairobi Stock Exchange (NSE), Capital Markets Authority (CMA), Institute of Certified Public Accountants (ICPAK) and the Kenya Chapter of the Association of Chartered Certified Accountants (ACCA), with participation drawn from many leading corporate organisations,

These initiatives led to the creation of a committee with the mandate of doing all that was necessary to formulate a Code of Best Practice for Corporate Governance in Kenya and to coordinate, where applicable, with other efforts in the region and beyond for the purpose of improving corporate governance. The committee was also mandated to seek the establishment of a permanent organ to oversee the implementation of the code if the effort was to be sustained. This followed the formation of the Private Sector Corporate Governance Trust (now Centre for Corporate Governance) and the publication in 1999, of Principles for Corporate

Governance in Kenya and Sample Code of Best Practice for Corporate Governance.

In 2002, the Capital markets authority developed guidelines for corporate governance for all companies listed in the Nairobi Stock Exchange. The Capital Markets Authority, the Nairobi Stock Exchange and the Institute of Certified Public Accountants of Kenya have been at the forefront of ensuring effective corporate governance practices in Kenya by trying to enforce rules and regulations in their respective jurisdictions. They have also been encouraging accounting disclosures through the Financial Reporting (FiRe) awards.

The Centre for Corporate Governance has also played a role in educating the corporate directors and the public on corporate governance matters as well conducting research on best governance practices in different sectors in the country.

2.5. Corporate Governance Mechanisms

Traditional finance literature has indicated several mechanisms that help solve corporate governance problems (Fama, 1980; Fama and Jensen, 1983b; Turnbull, 1997). The first of these are mechanisms internal to the firm, such as managerial compensation, the board of directors and control by large incumbent shareholders or leverage (Jensen 1986). The other form of corporate governance mechanisms are external to the firm and include the market for managers and the markets for products and services. Market oriented systems tend to rely more on managerial compensation and the market for corporate control to solve corporate governance problems, while large-shareholder oriented systems tend to use control by large incumbent shareholders to align behaviour of managers and owners (Curevo, 2002).

Jensen (1993) outlines four basic categories of corporate governance mechanisms namely: legal and regulatory mechanisms, external control mechanisms, product market competition and internal control mechanisms.

2.5.1. Legal and Regulatory Mechanisms

The system of laws and regulations that govern the firm are the most basic corporate governance mechanisms that exist outside the firm. They are also the fundamental determinants of how a country's corporate governance structure evolves (Denis, 2001).

In different jurisdictions, rules protecting investors come from different sources, including company, security, bankruptcy, takeover, and competition laws, but also from stock exchange regulations and accounting standards. Enforcement of laws is as crucial as their contents. In most countries, laws and regulations are enforced in part by market regulators, in part by courts, and in part by market participants themselves. All outside investors be they large or small, shareholders or creditors, need to have their rights protected. In the absence of effectively enforced rights, the insiders would not have much of a reason to repay the creditors or to distribute profits to shareholders, and external financing mechanisms would tend to break down (La Porta *et al*, 2000).

Michael Jensen in his 1993 address to the American Finance Association characterized this system as being "... far too blunt as an instrument to handle problems of wasteful managerial behaviour effectively." However, research on the influence of law on corporate governance demonstrate that cross-country differences in ownership structure, capital markets, financing and dividend policies are all related to the degree to which investors are legally protected from expropriation by managers and controlling shareholders (La Porta *et al*, 2000).

2.5.2. External Control Mechanisms

External control mechanisms refer to market for corporate control. Holmstorn and Kaplan (2001) and Shleifer and Vishny (1997) discuss the corporate takeover market and review the existing evidence, that poorly performing firms are more likely to be targets for takeover attempts and that managers of poorly performing targets are likely to be fired. The mere threat of losing control in the external marketplace provides some managers with the incentive not to deviate too far from value-maximizing behaviour.

The market for corporate control is expensive and requires large deviations from appropriate behaviour by managers in order to function properly, while being further subject to deficiencies in form of anti-takeover measures that protect incumbent managers (Jensen 1993).

2.5.3. Product Market Competition

Jensen (1993) suggests that the product market competition is at best a blunt instrument in the fight for effective corporate governance. A firm must produce products that people want with cost structure that allows them to sell at a competitive price. Management wastefulness and/or inefficiency interfere with the ability to do so and will reflect in poor performance in its product markets.

Shleifer and Vishny (1997) agree that product market competition is probably the most powerful force towards economic efficiency in the world. They are however sceptical that it cannot solve the problem of corporate governance. They argue that market competition may reduce the returns on capital and hence cut the amounts that managers can possibly expropriate, but it does not prevent managers from expropriating the competitive return after capital is sunk. Thus solving the corporate governance problem requires more than product market competition.

2.6. Internal Control Mechanisms

Internal control mechanisms of a firm consist of the functions and processes established to oversee and influence the actions of the firm's management. The role of these mechanisms in relation to financial reporting is to ensure compliance with mandated reporting requirements and to maintain the credibility of a firm's financial statements (Dechow *et al.*, 1995). The mechanisms revolve around shareholders, board of directors, the audit committee and the internal audit function. These mechanisms are discussed in details in here below.

2.6.1. Shareholders

Members or shareholders (as owners) of the corporation play an active role in ensuring effective corporate governance. They preserve and actively exercise the supreme authority of the corporation in general meetings. They have a duty, jointly and severally, to exercise that supreme authority of the corporation to ensure that only competent and reliable persons, who can add value, are elected or appointed to the board of directors; ensure that the board is constantly held accountable and responsible for the efficient and effective governance of the corporation so as to achieve corporate objectives, prosperity and sustainability; change the composition of a board that does not perform to expectation or in accordance with the mandate of the corporation (PSCGT, 1999).

Institutional investors especially, are a powerful corporate governance mechanism that can monitor company management, as their influence on company management can be substantial and can be used to align management interests with those of the shareholder group. The monitoring role of institutional investors is increasingly important, as they have grown so large and influential, at the same time gaining significant ownership concentration. Indeed, ownership concentration has been acknowledged as an important mechanism, which controls agency problems and improves protection (Shleifer and Vishny, 1997).

The role of institutional investors in corporate governance received significant attention in the Cadbury Report (1992). The report stated:

Given the weight of their votes, the way in which institutional shareholders use their power to influence the standards of corporate governance is of fundamental importance. Their readiness to do this turns on the degree to which they see it as their responsibility as owners, and in the interest of those whose money they are investing, to bring about changes in companies when necessary, rather than selling their shares." (The Cadbury Report, 1992, p 50)

2.6.2. Board of Directors

The board of directors is the team appointed by the shareholders to run the business on their behalf. The board is required to exercise leadership, enterprise, integrity and judgment in directing the corporation so as to achieve continuing prosperity and to act in the best interest of the enterprise in a manner based on transparency accountability and responsibility (PSCGT, 1999).

Recent scandals have again put the spotlight on the board of directors. In the wake of corporate failures, numerous suggestions have been made about how to improve the governance of companies in order to rebuild trust. These corporate governance reforms focus primarily on the makeup and working of the board (Van den Berge and Levrau, 2004). According to Cadbury (1992), this is understandable given the fact that boards of directors are the bridge between the shareholders and the management in charge of running the company. Fama and Jensen (1983a, b) recognise the board as the most important control mechanism available because it forms the apex of a firm's internal governance structure.

Directors' activities can be broadly classified into two categories; namely performance roles and conformance roles. Performance roles relate to the

board focusing on strategic and policy issues for the future, setting the corporate direction and contributing to the performance of the business. Conformance roles entail ensuring that the company is conforming to policies, procedures and plans laid down by the board and being properly accountable for its activities (Tricker, 1994).

Board activities can be split into four components – formulating strategy, setting policies, supervising executive management and providing accountability. Figure 1 below depicts these necessary orientations of the board. They revolve around, looking at matters both in the long term and the short term; focusing externally on the environment in which the company is operating and internally on the operations of the business itself.

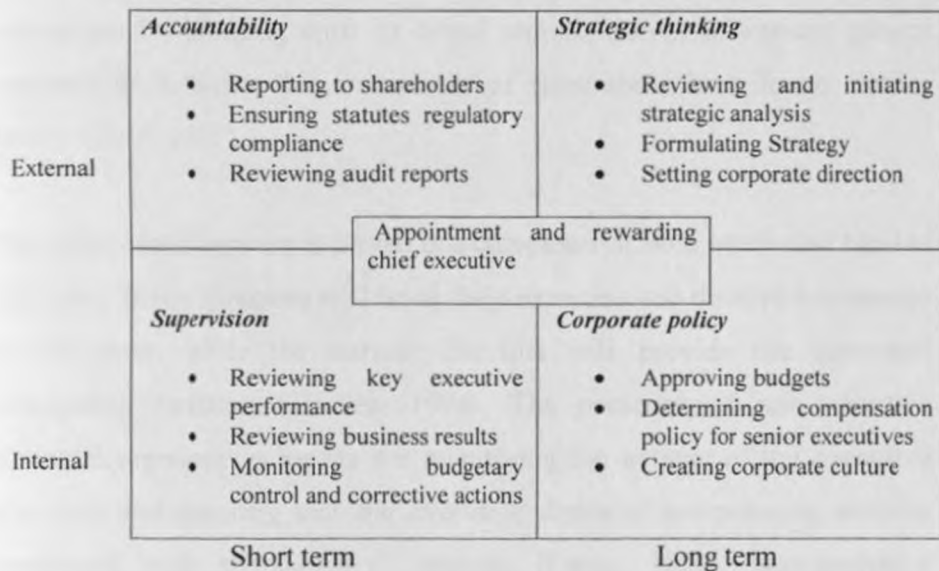


Figure 1: Range of board functions

Source: Tricker B. (1994), *Corporate Governance: Readings and Cases*

These activities can be grouped, on the left and side of Figure 1, showing boards involvement on the one hand in contributing to the company's performance, through strategy formulation and policy making, and on the other hand with ensuring conformance to required results and with maintaining accountability to the shareholders and others with legitimate interests in the company. As seen from the diagram the selection of the

chief executive and the planning for his/her succession is one of the most critical board tasks and cuts across all the four dimensions.

Central to the effectiveness of any board of directors is the composition of its membership. The problem has many facets – size, the number of inside and outside director, the age and retirement of members, individual qualifications, compensation and other incentives. All these elements of board composition present difficult problems in practice (Koontz, 1967).

The main questions here are as to what constitutes an “ideal” board and whether the composition of the board really matters. Studies of the composition of corporate boards date as far back as 1949 when Selznick observed that the Tennessee Valley Authority was able to reduce opposition by bringing onto its board representatives of various groups opposed to it. Since then, a number of researchers have found similar results (Zald, 1967)

The ideal board appears to be the one composed of both inside and outside directors. Inside directors will bring their expertise and detailed knowledge of the firm, while the outside directors will provide the important monitoring function (Tricker, 1994). The presence of non-executive directors represents a means for monitoring the actions of the executive directors and ensuring that the executive directors are pursuing policies consistent with shareholders’ interests (Fama, 1980). Non-executive directors possess two characteristics that enable them to fulfil their monitoring function. First their independence (Cadbury, 1992) and second, they are concerned to maintain their reputation in the external market (Fama and Jensen, 1983).

Board composition with regard to size is one of the well-studied board characteristics from two different perspectives. First, the number of directors may influence the board functioning and hence corporate

performance. Yermack (1996) found a negative relationship between board size and firm value. Second, researchers have studied board of directors as decision-making groups by integrating the literature of group dynamics and workgroup effectiveness. Hence board size can have both positive and negative effects on board performance. Expanding the number of directors provides an increased pool of expertise because the larger boards are likely to have more knowledge and skills at their disposal. Besides larger boards may be able to draw on a variety of perspectives on corporate strategy and may reduce domination by the chief executive officer (Forbes and Milliken, 1999; Goodstein *et al.*, 1994).

However, increasing the board size might significantly inhibit board processes due to the potential group dynamics associated with large groups. Larger boards are more difficult to coordinate and may experience problems with communication and organisation. Furthermore, larger boards may face decreased levels of motivation and participation and are prone to develop factions and coalitions. The boards may also have difficulties to further cohesiveness and may suffer from diffusion of responsibility or “social loafing” often found in large groups. Consequently, these group dynamic problems may put a barrier on the ability of the board to control management (Forbes and Milliken, 1999; Goodstein *et al.*, 1994).

Van den Berge and De Ridder (2002) in their study on how to optimise the working of the board of directors maintain that a minimum number of directors are needed to guarantee the required countervailing power and diversity. The latter can express itself in different ways such as the need for a balanced representation of multiple stakeholder groups, the need for non-domestic directors in multinational companies and the need for sufficient expertise in diversified groups.

One of the threats to the exercise of independent judgement by the board of directors is the dual role of chief executive officer as board chairperson.

Here the top managerial officer of the corporation simultaneously serves as the chairperson of the board, which has the responsibility of monitoring and evaluating management. This dual role would seem to suggest a certain conflict of interest as the very person to be evaluated is the head of the evaluation team (Tricker, 1994).

The agency model argues that boards dominated by executive directors are more difficult to control, a situation that would clearly apply to duality (Fama and Jensen, 1983). The theory further argues that the separation provides essential checks and balances over the exercise of the executive function. Without such independent oversight, the chief executive would tend to be motivated by self-interest, reflecting the interests of the incumbent top management rather than those of various other stakeholders.

2.6.3. Transparency and Accountability

Transparency is defined as the as the accessibility of information to stakeholders of institutions, regarding matters that affect their interests (Tapscott, 2004). Bushman *et al* (2004) define transparency as the availability of specific information to those outside publicly traded firms. To be accountable for one's activities is to explicate the reasons for them and to supply the normative grounds whereby they may be justified. Transparency and accountability are essential characteristics of good leadership because without these, leaders cannot and will not be trusted to the ultimate disadvantage and demise of a country's economy (CACG, 1999).

Corporate disclosure to stakeholders is the principle means by which companies can become transparent. Without a structured system of disclosure, and in particular financial reporting, it would be difficult for shareholders to obtain appropriate and reliable information on their investee companies. Such information asymmetry leads to moral hazard and adverse selection problem. By ensuring frequent and relevant

disclosure, shareholders are in a better position to monitor company management (Solomon, 2004).

Disclosure quality is an important element of corporate governance and is critical to the functioning of an efficient capital market. The lifeblood of markets is information and barriers to the flow of relevant information represent imperfections in the market. The more the activities of the company are transparent, the more accurately their securities will be valued. An open approach to the disclosure of information contributes to the efficient working of the market economy, prompts boards to take effective action and allows shareholders and others to scrutinize companies more thoroughly (Cadbury 1992).

Shareholders and potential investors require access to regular, reliable and comparable information in sufficient detail for them to assess the stewardship of management to enable them to make informed investment decisions. Insufficient or unclear information will affect confidence in the corporation, its board and management and may result in the increase of the cost of capital to the corporation and hamper efficient allocation of resources. Effective communication and disclosure will also help improve public understanding of the structure and objectives of the business enterprises, its corporate policies, and relationships with its shareholders and other stakeholders (CACG, 1999).

The accounting function is an essential aspect of a well functioning corporate governance system. Bushman and Smith (2001) describe the role of financial accounting information in corporate governance, arguing that the use of externally reported financial accounting data in control mechanisms promotes the efficient governance of companies. However there is need to stress that this relates to the quality of the information disclosed, as in accounting terms it needs to be relevant and reliable. La Porta *et al*, (1998), argue that accounting standards play an important role

in corporate governance by informing investors and by making contracts more verifiable. However, simple adoption of International Accounting Standards is not sufficient to resolve the transparency problems (Ho and Wong, 2001). Whether the quality of the actual corporate disclosures satisfies investors' information needs is more central. Mandatory disclosure rules ensure equal access to basic information (Lev, 1992), but this information need to be augmented by firms' voluntary disclosures and information production intermediaries (Ho and Wong, 2001).

2.6.4. Internal Control and Audit

A company's system of internal controls represents another corporate governance mechanism that can be used to align the interests of managers and shareholders (Solomon, 2004). Internal control system has been defined as the whole system of controls, financial or otherwise, established in order to provide reasonable assurance of: effective and efficient operations; internal financial control; and compliance with laws and regulations (Rutteman Working Group, 1994).

Without an effective system of internal control, companies can undergo substantial financial losses as a result of unanticipated disasters. Failure of Enron's system of internal control has been cited as part of the reasons for the company's failure. Smith (1996) discussed a number of cases of corporate failure and explained how inadequate systems of internal control, as well as investors' inadequate analysis of disclosed information led to collapses of companies such as Coloroll and Polly Peck. Companies need to establish a system for internal control so that they can manage risk effectively, thereby increasing transparency (Solomon, 2004).

The external audit represents one of the most indispensable corporate governance checks and balances that help to monitor company's management activities, thereby increasing transparency. The Cadbury report emphasises annual audit as one of the cornerstones of corporate

governance. The audit provides the external and objective check on the way in which the financial statements have been prepared and presented (Cadbury, 1992)

The auditor's primary duty is to express an opinion on the financial statements. In addition, from the analysis and other testing performed, the auditor should report to the management any risks identified, both internal and external and offer suggestions for managing those risks. It is likely that the auditor can identify strengths and opportunities from the audit that the organisation may consider in its longer term strategic planning (Wallace and Zinkin, 2005).

2.6.5. Audit Committees

Audit committees assume the important responsibility of representing boards of directors on oversight matters related to financial reporting, auditing and overall corporate governance. As a corporate governance mechanism, audit committees monitor management, the external auditor and the internal auditor in an effort to protect shareholder's interests (DeZoort, 1997). While all directors have a duty to act in the interest of the company, the audit committee has a particular role, acting independently from executive to ensure that the interests of shareholders are properly protected in relation to financial reporting and internal control. (Smith, 2003)

According to Wallace and Zinkin, (2005), Audit committees are designed to assist boards and individual directors discharge their duties, particularly in relation to internal company controls, reported financial information and corporate standards of behaviour. An audit committee should be able to understand the fundamental accounting issues facing the company and be able to advise the board on the impact of these issues. The objectives set for a committee will vary, but will generally include improving the quality of financial reporting; ensuring that the board makes informed decisions

regarding accounting policies, practices, and disclosures; reviewing the scope and outcome of internal and external audits; and overseeing the financial reporting process

The Blue Ribbon Commission and the National Association of Corporate Directors (NACD, 1999) suggest that audit committees are likely to be more effective in protecting the credibility of the firm's financial reporting if committee members are independent of management. The Cadbury report argued that that audit committees were an additional control mechanism that ensured that shareholder interests were being safeguarded. This was achieved by promoting the effective financial management of the company and increasing accountability (Cadbury, 1992). An effective audit committee should bring a number of benefits. These include helping the board to meet its statutory and fiduciary responsibilities by improving links between the board and the external and internal auditors. Audit committees should therefore improve the credibility of financial statements, something that benefits shareholders and other users of the information (Collier, 1997).

2.7. CMA Corporate Governance Guidelines

The Capital Markets Authority has identified a number of principles and guidelines that are essential for good corporate governance practices, representing critical foundation and virtues of good corporate governance practices.

The guidelines have been developed taking into account the work which has been undertaken extensively by several jurisdictions through many task forces and committees including but not limited to the United Kingdom, Malaysia, South Africa, Organization for Economic Cooperation and Development (OECD) and the Commonwealth Association for Corporate Governance (CACG). The objective of these guidelines is to strengthen corporate governance practices by public listed companies in Kenya and to

promote the standards of self-regulation to bring the level of governance in line with international trends.

These guidelines are mainly centred on board of directors, shareholders, accountability and audit. The guidelines, summarised below, are applicable to all public companies quoted at the Nairobi Stock Exchange and became effective from the year 2002.

2.7.1. Board of Directors

The CMA guidelines set out that, every public listed company should be headed by an effective board to offer strategic guidance, lead and control the company and be accountable to its shareholders. The guideline further elaborates on the roles of board and board committees, directors' remuneration, supply of information to directors, board balance, appointments to the board, multiple directorships, election of directors, resignation of directors and the role of chairman and chief executive.

The CMA recommends that the structure of the board should comprise a number of directors, which fairly reflects the company's shareholding structure. The board composition should not be biased towards representation by a substantial shareholder but should reflect the company's broad shareholding structure. The composition of the board should also provide a mechanism for representation of the minority shareholders without undermining the collective responsibility of the directors. (CMA, 2002)

2.7.2. Shareholders

The CMA guidelines emphasise shareholders participation in major decisions of the company. The board is therefore required to provide the shareholders with information on matters that include but are not limited to major disposal of the company's assets, restructuring, takeovers, mergers, acquisitions or reorganisation. The CMA further issues guidelines on the

convening of the annual general meetings that will ensure effective attendance and participation in the business of the annual general meeting.

2.7.3. Accountability and Audit

The board is required to present an objective and understandable assessment of the company's operating position and prospects. The board is also required to ensure that accounts are presented in line with International Accounting Standards. The board should maintain a sound system of internal control to safeguard the shareholders investments and assets. In addition, there should be a formal and transparent arrangement for shareholders to effect the appointment of independent auditors at each annual general meeting and that the relationship with auditors should be a formal and transparent arrangement for maintaining a professional interaction with the company's auditors.

2.7.4. General Provisions

This covers public disclosure in respect of any management or business agreements entered into between the company and its related companies, which may result in a conflict of interest. Other issues covered here include the qualifications of the chief financial officers, company secretaries and auditors of public listed companies.

CHAPTER 3: RESEARCH METHODOLOGY

3.1. Population and Sample

The population for this study consisted of all forty-eight (48) companies listed in the Nairobi Stock Exchange as at 31 December 2004.

3.2. Data Collection

Both primary and secondary data was used in the survey. Primary data was collected using a self-administered questionnaire consisting of both open-ended and closed ended questions. The questionnaire was mailed or dropped to the respondents. The questionnaire was used to elicit information on aspects that are not subject to disclosure or those that cannot be objectively obtained from the annual reports or from the Nairobi Stock Exchange. The respondents were mainly the company secretaries of the listed companies. The reason for using the company secretaries is because, according to the Institute of Certified Public Secretaries of Kenya, they have been trained to understand the full range of the underpinning operations of an organisation including, compliance and regulations; corporate finance; shareholders' relationships; corporate governance issues; management practice; corporate taxation; corporate resources and corporate law. (ICPSK)

Primary data collected included information on the effectiveness of the board in discharging its responsibilities; information on committees established by the board, their mandates and their composition in terms of executive and non-executive directors; information on the structure of remuneration of directors; relevance and timeliness of information supplied to the board; board balance in terms of qualifications and mix between executive and non-executive directors; procedure for appointment and re-election of directors to the board; directors holding multiple directorships within the Nairobi Stock Exchange; resignations of directors; and whether the role of the chairman and the chief executive officer are held by different persons.

Other primary data included information on shareholders participation in major company decisions; whether the company supplies the shareholders with relevant and timely information regarding the general meeting; convenience of the venues of the annual general meetings to the shareholders and whether shareholders are given adequate time to ask questions or seek explanations in the annual general meeting; internal controls systems; appointment of auditors and the relationship that exists between the auditors and the management and the qualifications and professional memberships of the chief financial officers, company secretaries.

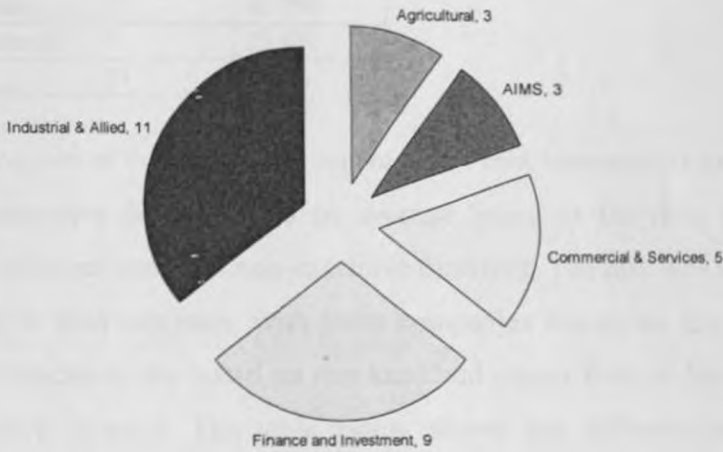
Secondary data was obtained from the annual accounts and reports of listed companies and from Nairobi Stock Exchange publications mainly relating to the aspects disclosure prescribed by the guidelines. These include disclosure in the annual reports on the quantum and components of directors remuneration; disclosure of the ten major shareholders; aggregate directors loans; share options given or to be given as compensation to the directors; resignations of directors and the circumstances necessitating resignations; examining the various auditors report and ascertaining whether the accounts are presented in line with the International Accounting Standards and whether the auditors of the company are certified public accountants.

3.3. Data Analysis

Data relating to the number of directors, proportion of executive and non-executive directors was analysed using descriptive statistics. Descriptive statistics ^{will} also be used in analysing the data such as companies that have complied with the various disclosure aspects of the guidelines. Some of the data relating to directors, shareholders, internal control and audit, which is of qualitative nature, was analysed using content analysis.

CHAPTER 4: DATA ANALYSIS AND FINDINGS

Thirty-one companies out of a total population of 48 companies responded to the questionnaire representing a 64 % response rate. The chart below represents the distribution of the respondents per sector



4.1. Board of Directors

The CMA corporate governance guidelines outline the role of directors as providing strategic direction, accountability to shareholders, leadership and control. The table below summarises the role directors of the various respondent companies. The four major roles outlined in the guideline featured prominently with the highest being strategy at 84% and leadership scoring lowest at 55%. Other roles include compliance, review of company performance, risk management, growth and profitability with a combined score of 68%

Role of directors	No. of Responses	Percentage of Responses	Percentage of Respondents
Strategy	26	25%	83.87%
Accountability to Shareholder	20	19%	64.52%
Control	21	20%	67.74%
Leadership	17	16%	54.84%
Other	21	20%	67.74%

The average board size was found to be nine directors. The minimum number of directors was four and the maximum twelve. The table below summarises the distribution of the number of directors.

	Frequency	Percentage
1-5 Directors	3	9.7%
6-10 Directors	21	67.7%
11-15 Directors	7	22.6%
Total	31	100%

The composition of the board with regard to the mix between the executive and non-executive directors was on average found in the ratio of 26% executive directors and 75% non-executive directors. The mix was found to be skewed in both extremes, with some companies having as few as one executive director in the board on one hand and others with as few as one non-executive director. The table below shows the different ratios of executive and non-executive directors

Ratio	Frequency	% of Executive	Frequency	% of Non-Executive
1-10%	3	10%	0	0%
11-20%	13	42%	1	3%
21-30%	9	29%	0	0%
31-40%	0	0%	1	3%
41-50%	3	10%	1	3%
51-60%	2	6%	3	10%
61-70%	0	0%	2	6%
71-80%	0	0%	10	32%
81-90%	1	3%	12	39%
91-100%	0	0%	1	3%
Total	31	100%	31	100%

There was found to exist diverse professional qualifications among the directors of the respondent companies. Professional qualifications were

observed to be inclined more towards the professional qualifications in line with the company operations. In the financial services sector, for example, banking and insurance professionals were more dominant than any other profession.

All the companies with the exception of one admitted to having an audit committee. The mandate of the audit committees was found to include review of financial information, annual financial statements, compliance with accounting standards, liaison with external auditors, remuneration of internal auditors, overseeing the internal control systems and risk management processes. Other committees that featured prominently include the nomination and remuneration committee, responsible for recommending directors for nomination to the board, assessing the effectiveness of the board of directors, the chief executive officer and senior management as well as managing the recruitment and appointment of senior management. Companies were also found to form committees specific to the company core business. For example, credit and advances committee for financial institutions, editorial committees for media companies.

68% of the companies appoint the directors to the board through a nomination process, mainly to fill casual vacancies and subsequently through an election at the annual general meeting. The remaining 32% appointed the directors through election at the annual general meeting. All the companies require their executive directors have a fixed service contract whose renewal is subject to performance appraisal and shareholders approval. They are also required to submit themselves for re-election, 74% every 3 years, 7% every one year while 19% did not indicate any specific interval.

Thirty companies representing 97% of the respondents did not have any directors approaching their seventieth birthday during the year under study.

Only one company had and disclosed directors approaching their seventieth birthday. All companies disclose the resignations of directors in their annual accounts. However, none of the companies disclosed the circumstances necessitating their resignation.

There was found to be clear separation of the role of the chairman of the board and the chief executive officer in 30 companies, representing 97% of the total respondents. Only one company had the chairman and the chief executive officer positions being held by one person. None the companies had any of its directors serving as directors of more than five other companies quoted at the Nairobi Stock Exchange. Three companies representing 10% of the respondents had their chairman holding the same position in two other companies quoted at the Nairobi Stock Exchange.

100% of the respondent companies have their executive directors remuneration linked to performance. The shareholders approve the remuneration of directors in the annual general meeting. This was found to be one of the agenda of the annual general meeting. It was however observed that none of the companies disclosed the directors' remuneration policies. The only disclosure observed was only the quantum of the remuneration as part of the management expenses of the companies. With regard to disclosure on any share options and other form of executive compensation, 29 companies representing 93.5% did not disclose whether or not such forms of compensation exist while two companies representing 6.5% disclosed having no such forms of compensation.

Regarding the supply of information to directors and the frequency at which directors are supplied with information to enable them discharge their responsibilities and the how soon after the period in question, such information is received; 68% of the companies supply information to the board on a monthly basis, while the remaining 32% supply the information

as required. 58% supply information to directors within a fortnight, 7% within a month, 3% within a week and 32% as is required.

The CMA guidelines require the disclosure of ten major shareholders. Twenty-seven companies representing 87% of the respondents disclosed this. Twenty-four companies representing 77% of the companies disclosed the aggregate loans to directors. Directors of four companies representing 19% had no loans, while one company representing 3% of the respondents had no disclosures on whether or not there were any loans to directors.

4.2. Shareholders

Only two companies representing 6% had, during the period of study, major company decisions that required shareholders approval. One of them required shareholders to approve the increase in share capital and the other involved approval of a merger and conversion of shares class. In both instances, the shareholders were required to approve by way of passing a special resolution.

Other than participating in major decisions, the shareholders were seen to participate in other company decisions through their attendance of the general meetings. It was observed that the board provided to its shareholders timely information concerning the date location agenda and issues to be decided in the annual general meetings. The notice to the annual general meeting averaged 31 days, with the minimum notice period being 21 days. With regard to the convenience of the venues for the annual general meetings, 68% indicated that the venues were convenient, 13% as very convenient and 19% as convenient. 77% indicated having allocated adequate time to shareholders at the annual general meeting for questions on matters pertaining to the company performance and other matters of their concern. 13% gave more than adequate time while 10% fairly average time.

4.3. Accountability and Audit

All companies present an assessment of the company's operations in the annual accounts and reports. This is in the form of the profit and loss account, the balance sheet the cashflow statement and the other disclosures as prescribed by the accounting standards and statutes. The company's future prospects are captured in the chairmen and or the chief executive officers reports.

A number of internal control mechanisms exist to safeguard the shareholders investments and assets. The most prominent mechanisms adopted by respondent companies include adherence of documented policies and procedures; authority for major financial transactions, compliance with rules and regulations; physical security of company assets and periodic review of systems of control.

All the companies in the survey confirmed that the shareholders appoint the auditors at each annual general meeting. This was observed as one of the agenda contained in the notice of the annual general meeting of all the companies in the survey. All the respondents indicated that their interaction with the external auditors is formal and transparent.

4.4. Other Provisions

Twenty-five companies representing 81% of the respondents indicated that their chief financial officers are members of ICPAK. One company had their chief financial officer who is a member of Chartered Accountants of South Africa, while five companies representing 13% of the respondents did not disclose the membership of their chief financial officer. All companies indicated that their company secretaries are members of ICPSK, and their auditors are members of the ICPAK. The accounts of all the companies in the survey are prepared in accordance with international accounting standards. The directors in the statement of directors' responsibilities and the auditors report attest this.

CHAPTER 5: SUMMARY AND CONCLUSION

5.1. Conclusions

To sum up the outcomes of our study, it was found that the Capital Markets Authority corporate governance guidelines already attain a high degree of acceptance. There is no company that totally rejects the guidelines.

Board roles and responsibilities were found to be in line with the guidelines as is the composition of the board in terms of the mix between executive directors and non-executive directors and professional qualifications. Whereas there are some companies that do not strictly adhere to the ratio of executive and non-executive directors prescribed by the CMA, the overall ratio conforms to the guidelines.

The board of directors were found to have committees dealing with various aspects of the company operations. The requirement to have an audit committee was complied with by 97% of the companies. This is consistent with the findings Riro (2005), who observed 93% compliance. The mandates of the committees were found to be consistent with the findings by Hussein (2003). The role of the chairman of the board and that of the chief executive officers are distinct. Supply of information was found to be regular and timely and shareholders played their role in corporate governance by exercising their rights in the annual general meeting and in approving major company decisions.

All companies had their accounts prepared and presented in accordance with the International Accounting Standards. However, there is minimal disclosure on most of aspects that the CMA guidelines require to be disclosed. The depth of the disclosures was found to be low and only on matters specifically required by the statutes or the accounting standards. Voluntary disclosure was minimal. This is consistent with the findings of Muguchia (2005) who observed low compliance on disclosures at 71.95%.

All the companies have complied with the requirement to establish internal control mechanisms and their interaction with the auditors is formal and transparent. 84% of the chief accounting officers of the companies are members of the Institute of Certified Public Accountants (ICPAK) or bodies equivalent to ICPAK as well as their auditors. The company secretaries are also members of the Institute of Certified Public Secretaries

5.2. Limitations of the Study

The study encountered a number of limitations one of which being that out of the 48 companies listed in the Nairobi Stock Exchange, only 31 responded to the questionnaire. A better response rate would have resulted in better generalisation. The data for the study was obtained from officers of the companies, annual accounts and other publications of the Nairobi Stock Exchange. The perceptions of the shareholders as to whether the companies are compliant or not were not taken into account. The study, being empirical in nature had a broad coverage but shallow depth. An in-depth study would be required.

5.3. Recommendations

There is commitment by the all the stakeholders in corporate governance to adhere to good corporate governance practices as evidenced by the level of compliance with the CMA guidelines. There are however some areas that require more indulgence from all concerned in order to achieve the highest level of corporate governance. One of these areas is the disclosure of information. Companies should be encouraged or compelled to provide more disclosures and not necessarily disclose in order to comply with certain legal requirements or standards.

The CMA guidelines should be more specific in order to ensure there is no ambiguity in interpretation, which would subsequently lead to poor compliance. The CMA should have mechanisms to address low levels of compliance and failure to comply. There should be continuous education on corporate governance targeted at the company boards and management

to enable them understand and appreciate the need for good corporate governance. Similar training should be extended to shareholders to enable them demand good governance practices in organisations where they have invested.

5.4. Suggestions for Further Research

Various studies have been carried out on the relationship between performance and some aspects of the guidelines such as board composition. A study to determine whether there is any relationship between compliance with all the CMA guidelines and performance or the market price of the shares would create more understanding the role of corporate governance in company performance.

The study did not capture the perceptions of the shareholders as to whether the companies are compliant with the CMA guidelines. A survey on the shareholders perceptions would shed more light on the levels compliance with the guidelines.

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APPENDICES

Appendix 1: Questionnaire

Company Information

Company Name: _____

Sector: _____

Respondent: _____ Position: _____

Board of Directors

1. What are the roles of the board of directors?

2. (a) What committees have been established by the board? What are their delegated mandates.

(b) Has the board established an audit committee? YES [] NO []

What is its delegated mandate?

3. Is executive directors' remuneration linked to performance? YES [] NO []

4. Is the directors' remuneration structure approved by the shareholders? YES [] NO []

5. How often is the board supplied with relevant information to enable it discharge its duties?

Weekly [] Fortnightly [] Monthly []

Other [] Please Specify: _____

6. How soon after the period in question is the information provided to the board?

Week [] Fortnight [] Month []

Other [] Please Specify: _____

7. Does the board disclose in its annual report, its remuneration policies? YES [] NO []

8. Does the board disclose in its annual report, the ten major shareholders of the company? YES [] NO []
9. Does the board disclose in its annual report, any share options and other form of executive compensation made or have to be made during the course of the financial year? YES [] NO []
10. Does the board disclose in its annual report, the aggregate directors loans? YES [] NO []
11. What is the total number of directors _____
- Number of executive directors _____
 - Number of non-executive directors _____
12. What is the composition of the board in terms of professional qualification? (give number)
- Accountants []
 - Lawyers []
 - Banking and finance specialists []
 - Engineers []
 - Economists []
 - Other professions [please list and give numbers]
13. What is the procedure for appointing directors to the board
14. Are there any directors who are also directors of more than five other companies quoted in the Nairobi Stock Exchange? YES [] NO []
- If answer is YES, how many _____
15. Do executive directors have a fixed service contract? YES [] NO []
16. Are directors required to submit themselves for re-election at regular intervals? YES [] NO []
- If Yes, at what intervals? [] years
17. Is the renewal of service contracts subject to:
- Regular performance appraisal YES [] NO []
 - Shareholders approval YES [] NO []

18. Is there disclosure in the annual reports or at the annual general meeting of all directors approaching their seventieth (70th) birthday in that respective year? YES [] NO []
19. Is there disclosure in the annual reports of resignations by a serving director and details of circumstances necessitating the resignation? YES [] NO []
20. Is there clear separation of the role and responsibilities of the chairman and the CEO YES [] NO []
21. Does the board chairperson hold such other positions in more than two public listed companies in the Nairobi Stock Exchange? YES [] NO []

Shareholders

22. Were any of these decisions made in the course of the year?
- | | | |
|---|---------|--------|
| a. Mergers | YES [] | NO [] |
| b. Acquisitions | YES [] | NO [] |
| c. Disposal of major company assets | YES [] | NO [] |
| d. Restructuring/Re-organisation | YES [] | NO [] |
| e. Take-overs | YES [] | NO [] |
| f. Other major decisions (please specify) | YES [] | NO [] |

If answer to any of the above questions is "YES", how were shareholders involved?

23. What was the length of notice the past annual general meeting _____
24. Was the notice of the meeting accompanied by full information regarding issues to be decided in the annual general meeting? YES [] NO []
25. What was the venue of the last annual general meeting?

26. How convenient are the venues for the annual general meetings to shareholders?
- Very convenient [] Convenient [] Fairly convenient [] Not convenient []
27. How adequate is the time allowed to shareholders for questions on matters pertaining to the company's performance and other issues of their concern?
- More than adequate [] Adequate [] Fairly adequate [] Not adequate []

Accountability and Audit

28. Does the board present an objective and assessment of the company's operating positions and prospects in the annual accounts and reports YES [] NO []
29. Are the accounts presented in line with International Accounting Standards? YES [] NO []
30. What internal control systems are in place to safeguard the shareholders investments and assets?

31. Are the company auditors appointed by shareholders at each annual general meeting? YES [] NO []
32. Is the interaction of the auditors and management formal and transparent? YES [] NO []

General

33. Is there disclosure on any related company transactions likely to result in a conflict of interest YES [] NO []
34. Is the chief financial officer of the company a member of Institute of Certified Public Accountants of Kenya (ICPAK)? YES [] NO []

If not, what professional body is he a member of?

35. Are the company secretaries members of the Institute of Certified Public Secretaries of Kenya (ICPSK)? YES [] NO []
36. Are the company auditors members of the Institute of Certified Public Accountants of Kenya (ICPAK)? YES [] NO []
37. Is the audit of the company in compliance with the International Auditing Standards? YES [] NO []

Appendix 1: Companies Comprising the Population

AGRICULTURAL SECTOR

1. Unilever Tea Kenya Ltd
2. Kakuzi Ltd
3. Rea Vipingo Plantations Ltd
4. Sasini Tea & Coffee Ltd

COMMERCIAL AND SERVICES SECTOR

5. Car & General (K) Ltd
6. CMC Holdings Ltd
7. Hutchings Biemer Ltd
8. Kenya Airways Ltd
9. Marshalls (E.A.) Ltd
10. Nation Media Group
11. TPS Eastern Africa (Serena) Ltd
12. Uchumi Supermarket Ltd

FINANCE AND INVESTMENT SECTOR

13. Barclays Bank Ltd
14. C.F.C Bank Ltd
15. Diamond Trust Bank Kenya Ltd
16. Housing Finance Co Ltd
17. I.C.D.C Investments Co Ltd
18. Jubilee Holdings Ltd
19. Kenya Commercial Bank Ltd
20. National Bank of Kenya Ltd
21. NIC Bank Ltd
22. Pan Africa Insurance Holdings Ltd
23. Standard Chartered Bank Ltd

INDUSTRIAL AND ALLIED SECTOR

24. Athi River Mining
25. B.O.C Kenya Ltd
26. Bamburi Cement Ltd
27. British American Tobacco Kenya Ltd
28. Carbacid Investments Ltd
29. Crown Berger Ltd
30. East African Cables Ltd
31. East African Portland Cement Ltd
32. East African Breweries Ltd
33. Kenya Oil Co Ltd
34. Kenya Power & Lighting Ltd
35. Mumias Sugar Co. Ltd
36. Olympia Capital Holdings Ltd
37. Sameer Africa Ltd
38. Total Kenya Ltd
39. Unga Group Ltd

ALTERNATIVE INVESTMENT MARKET SEGMENT

40. A Baumann & Co. Ltd
41. City Trust Ltd
42. Eaagads Ltd
43. Express Ltd
44. Williamson Tea Kenya Ltd
45. Kapchorua Tea Co. Ltd
46. Kenya Orchards Ltd
47. Limuru Tea Co. Ltd
48. Standard Group Ltd