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CORPORATE FAILURE OF THE SUGAR INDUSTRY IN KENYA: A STUDY OF MUMIAS SUGAR COMPANY.

BY

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DECLARATION

I **SIMIYU MILDRED NAFULA**, declare that this is my original work and the same has not been presented to any institution of higher learning for the award of a Diploma, Degree or Post Graduate qualifications.

Signature **Date** **24th November, 2021**

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

Signature……………………………………Date……November 24, 2021**……………………………….**

PROFESSOR KIARIE MWAURA

DEDICATION

To everyone who toil quietly but steadily.

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LIST OF ABBREVIATIONS

- AGM Annual General Meeting.
- CCGC Centre for Corporate Governance.
- CEO Chief Executive Officer.
- CFO Chief Financial Officer.
- CMA Capital Markets Authority.
- COMESA Common Market for Eastern and Southern Africa.
- EAC East African Community.
- EMCA Environmental Management and Coordination Act.
- KERSREF Kenya Sugar Research Foundation.
- KESGA Kenya Sugar Cane Growers Association.
- KSA Kenya Sugar Authority.
- KSB Kenya Sugar Board.
- MOCO Mumias Outgrowers Company.
- MSC Mumias Sugar Company.
- SCA State Corporation Act.
- SCAC State Corporations Advisory Committee.
- SONY South Nyanza Sugar Company.
- SOX Sarbanes Oxley Act.
- WTO World Trade Organization.

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- Capital Markets Act CAP 485A (Revised 2016).
- Companies Act (No 17 of 2015).
- Companies Act CAP 486 (repealed).
- Crops Act, (No. 16 of 2013).
- England Companies Act, 1948.
- Ethics and Anti-corruption Commission Act (No 22 of 2011).
- Land Act, (No. 2 of 2012).
- Leadership and Integrity Act (No 19 of 2012).
- Official Secrets Act CAP 187 (Revised (2016).
- Public Finance Management Act No 18 (2012).
- Public Officer Ethics Act No 4 (2013).
- The Constitution of Kenya, 2010.
- The Public Audit Act (No 34 of 2015).

- The State Corporations Act Cap 446 (Revised 2019).
- Witness Protection Act (No. 79 of 2006 (Revised 2012).

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- Report No. 1887-KE Kenya Sugar Rehabilitation Project Appraisal Report Volume I November 17, 1978: Published by World Bank. http/documents.worldbank.org/curated/en/400221468044989548/pdf/multi-page.pdf.
- Sample Code of Best Practices for Corporate Governance, Private Sector Initiative for Corporate Governance.

ABSTRACT

Corporate governance is central to the success of any business entity, irrespective of its legal formation. This is because corporate governance encompasses the processes, practices and a system of rules that anchors the interests of all shareholders and stakeholders hence, good decision making. In the recent times, corporations have focused on corporate governance to avoid corporate failure after the collapse of major corporations both globally and locally. One of the major foci in the aftermath of major corporate failure in corporations has been the efficacy of the legal and regulatory framework in anchoring corporate governance in corporations. In Kenya, the sugar industry is currently insolvent yet it is an industry that played a major role in the economic and social development in Kenya and supported the livelihood of its citizens before and after independence in 1963.

This study endeavoured to prove that corporate failure is detrimental to the social and economic growth of a country, a conduit of devastating losses of investment by the shareholders and stakeholders and a core factor for a myriad of social effects such as school dropout, rise in crime rate which emanates from unemployment and loss of a livelihood. The major factor that has contributed to the collapse of the sugar industry is the lack of proper corporate governance mechanisms majorly; improper ownership structure, the improper composition of board of directors and lack of optimum internal controls and disclosure mechanisms. The study was therefore conceived to analyse these and their contribution to the collapse of the sugar industry in Kenya with particular reference to Mumias Sugar Company which began as a state-owned entity in 1973 and privatized in 2002.

The study revealed that the minority shareholders who collectively hold the majority shareholder are not satisfactorily protected by the existing legal and regulatory basis to make a significant contribution to the control and the decision-making process of the company. The composition of the board of directors has also hurt the performance of the industry due to lack of diversity, improper board size and lack of board independence influenced by political patronage. Additionally, the research examined the effect of internal control disclosure mechanism in the sugar industry *vis a vis* the sufficiency of the legal framework. To strengthen the study, the researcher analysed the Indian sugar industry to import some lessons for the Kenyan sugar industry.

The study relied on the agency theory, the stakeholder's theory and resource dependency to advance this thesis. The three theories were necessitated by the shift of business from the focus of profit maximization for the shareholder to the current focus on a wide range of investors for instance customers, suppliers, employees, and the local community in which the corporations operate, while the resource dependency was necessary since the sugar industry relies on external resources to operate. To achieve the objective of the study, both doctrinal and non-doctrinal research methodologies and supplemented with interviews of both shareholders and stakeholders. This study recommended *inter alia* a need for privatization of the sugar industry with the government holding minority shares if any, a dispersed ownership structure in publicly listed companies, a board composition with the proper size, diversity and independence and, transparent internal control and disclosure mechanisms. Furthermore, the study recommended a robust legal and regulatory framework that anchors an efficient corporate governance system that can revitalize and sustain the sugar industry in Kenya.

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

Corporate failure is a global phenomenon that causes a lot of anxiety to investors due to losses incurred when corporations collapse with their investments. The emerging markets are increasingly turning to good corporate governance mechanisms to boost the performance of organizations, increase the shareholders' value and attract new investments. The sugar industry in Kenya is one of the sectors that has immensely contributed to the national Gross Domestic Product (GDP) and supported the economic and social wellbeing of about six million people, both directly and indirectly.[1] The failure of the sugar sector in Kenya has therefore, adversely affected the country's economy, the sector's trading relationships, capital investment, and the social and economic wellbeing of the community that depended on it. One of the employees who also doubled up as a farmer indicated as follows to the researcher during the interview:

> I was employed by Mumias Sugar Company in 2001 when Booker TAE was still managing the company. I was however retrenched in 2015. Besides being employed, I was also a sugarcane farmer on my two-acre plot. In 2004, we received very good dividends from cane farming and as an employee, we also got very good bonus however, when the company began to record losses, we were retrenched, we lost our good dividends as shareholders of the company, we lacked school fees for our children and now most people have uprooted the cane plantations and are majorly engaging in alcohol drinking (S. Makokha, 13/10/2019).

The history of the sugar sector in Kenya is traced to colonial era when the first commercial sugar mills; Victoria Nyanza Sugar Company and Ramisi Sugar Company were established.[2] These companies were privately owned and managed by the Hindoch Family and Madhavan Group, respectively.[3] Their performance was impeccable such that upon attaining independence in 1963, the government of Kenya got directly involved in the sugar industry, through the enablement of

[1]Kenya National Bureau of Statistics, Economic Survey (2018) p.18.

[2]Ordinance No 1 of 1923, February 7, 1923 Colony and Protectorate of Kenya.

[3] Peter Wanyande, 'Management Politics in Kenya's Sugar Industry: Towards an Effective Framework' (2001) 6 (1) African Association of Political Science 123 at 124.

Sessional Paper No. 10 of 1965. The aim of government direct involvement in the sugar sector was to ensure that the country attained self-sufficiency in the production of sugar and also, improve the welfare of its people through job creation and income generation from sugarcane cultivation.[4] Subsequently, and following the economic blueprint of the Sessional paper 10 of 1965, the government established several state-owned sugar corporations; South Nyanza, Chemelil, Muhoroni, Nzoia, South Nyanza and Mumias Sugar Companies.

The post-independence sugar industry was managed through contracts with foreigners due to lack of skilled manpower.[5] The industry experienced incredible growth, with about 40,000 small-scale farmers cultivating sugarcane.[6] These trends improved the livelihood of the communities living around the sugar companies and induced regional socio-economic development through employment, better transport and communication network, as well as better schools and hospitals. To stimulate further growth of the industry and the macroeconomic of the country, the government of Kenya undertook liberalization of the economy in the early 1980s under the structural adjustment program; however, the desired outcomes were never realized due to unclear liberalization policies.[7]

Nevertheless, Mumias Sugar Company (MSC) was successfully privatized and listed on the stock exchange market in 2001.[8] At the time of privatization, Mumias Sugar Company was manufacturing about 250,000 metric tonnes of the projected annual national output of 600,000 metric tonnes. Nonetheless, the ownership structure of MSC was unconventionally controlled by the government of Kenya holding a substantial share of the company even after the entity was

[4] Part II, African Socialism and its Application to Planning in Kenya (1965) p.18.
[5] African Socialism and its Application to Planning in Kenya (1965) p.48.
[6]https:/www.booker-tate.co.uk/project/mumias-sugar-company-kenya/accessed on May 26, 2019.
[7]Gurushri Swamy, *Kenya: Structural Adjustment in the 1980s* (World Bank Publications, 1994) p.27.
[8]Robert Shaw, What is going on in the sugar industry (Monday October 3 2016)<http/www.nation.co.ke/oped/opinion/what-is-going-on-in-the-sugar-industry> accessed on May, 26 2019.

privatized.[9] The substantial shareholding by the government was a major symptom of bad governance since the government of Kenya as a substantial shareholder continued to have enormous effect on the management and control of the corporation.

Being a substantial stockholder, the government influenced the board of directors' composition so much, to an extent that the board of directors lacked independence due to political interests and influences. Their diversity in knowledge and skills, age and tribal inclination was compromised to accommodate all the political interests and influences while the board size was constantly large even after Mumias Sugar Company became technically insolvent in 2018. Conflicts of interest and inconsistencies in the internal control and disclosure mechanisms made it difficult for the stakeholders to make informed decisions on investments since they were not represented on the board and only relied on audited accounts to measure the stability of their investments.

In 2004, the company recorded the first highest sugar production and profit margins since its inception. With this impressive performance, the management of the Mumias Sugar Company undertook to refurbish the factory to attain enhanced factory capacity such as supplying 2MW of electricity to the national grid through Kenya Power.[10] This blissful profit-making and rapid expansion programmes went on until 2015 when the public was given a pointer to the factors that led to the corporate failure of Mumias Sugar Company.[11]

Globally, several other catastrophic corporate failures had been witnessed through whose lenses Mumias Sugar Company had blinded itself from. For instance, Enron, the once largest energy

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[9] Justus Wanga, Troubled Mumias Set to Face Shareholders (15 November 2014) <http/www.nation.co.ke/oped/opinion/troubled mumias set to face shareholders> accessed on May, 26 2019.

[10] http://www.mumias-sugar.com/products accessed on May 4, 2019.

[11] Standard Team, Report puts Mumias Mess on Evans Kidero's Doorstep. https://www.standardmedia.co.ke/article/2000152424/report-puts-mumias-mess-on-evans-kidero-s-doorstep# accessed on May 4, 2019.

company globally and publicly traded company in the United States of America had seen the worst corporate failure in 2001. Enron's failure had been attributed to a combined collapse of several corporate governance mechanisms insufficiently anchored in the legal and regulatory framework with attention on accounting and auditing issues.[12] The subsequent changes in response to the corporate failure inscribed in the Public Company Accounting Reform and Investor Protection Act (SOX) were skewed towards rules and regulations that would hold the firm's auditors more accountable by establishing stricter criminal penalties for securities fraud in corporations.[13] The swift and sudden business failures made investors to also focus on the composition of board of directors. In the United Kingdom, the enactment of Companies Act, 2006 placed a lot of responsibility on the board of directors whose composition is key in achieving firms' objectives.

The collapsed sugar industry in Kenya is largely state-owned and its board of directors are appointed in line with the State Corporations Act, Cap 446 except for Mumias Sugar Company which was privatized in 2002. This meant that it ought to have relied on the Companies Act, 2015. Arguably, the composition of the board of directors in state-owned entities do not normally achieve the scrutiny standards for the directors applied in listed companies.[14] However, Mumias Sugar Company which was a listed company that was subject to the Companies Act, 2015, and rules and regulations of Capital Markets Authority continued to operate as if it was still a state-owned entity. As a result of the peculiar ownership structure where the government of Kenya held the majority shares, there was a substantial influence on the board of directors' composition that was unnecessarily large, lacked independence and diversity due to political allegiance, interests and influences from the government.

[12] George Benson & Al Hartgraves, Al, Enron: 'What Happened and what we can Learn from it' (2002) Journal of Accounting and Public Policy. 21. 105 at 108.
[13]SOX Act 2002, s302, 404 and 802.
[14] Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015.

1.1.1 Effects of Corporate Failure of the Sugar Industry in Kenya

The fall of the sugar industry brought serious economic and social dislocation to the government, shareholders and its stakeholders. These dislocations include loss of revenue in terms of taxes for public spending hence poor infrastructure, loss of investment by the shareholders and stakeholders who include the government, loss of livelihood and income through job losses and a chain of business failure that depended on the sugar industry. The investor confidence reached its lowest point when the small scale farmers uprooted their sugarcane plantations.

The social impacts due to the collapse of the sugar industry have been insurmountable. These impacts range from increased crime rates, addiction to illicit drugs to major school dropouts by the youth due to lack of fees. Presently, Mumias Sugar Company is technically insolvent contrary to the government's vision at independence.[15] All the other state-owned sugar entities are now unable to conform to the envisioned strategic path of growth and development as well as attain the intended economic growth.[16]

Notably, corporate failure is not unique to the sugar industry in Kenya since other economic powerhouse entities have also fallen prey to the phenomenon. For instance, Uchumi and Nakumatt Supermarkets, Chase Bank Imperial Bank, and Deacons East Africa have also experienced corporate failure. In the wake of these failures, there is therefore, a need for institutionalization of a robust corporate governance mechanism anchored in an efficient legal and regulatory framework that ensures an optimum ownership structure, a well-constituted board of directors in terms of size, independence and diversity and, proper internal control and disclosure mechanisms that enhance shareholders and stakeholders confidence investment in companies.

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[15]Republic of Kenya, *African Socialism and its Application to Planning in Kenya* (Nairobi, Government Printer, 1965).

[16]David O. Mbati and Eyo I Eyo, 'Corporate Failure: Causes and Remedies' (2013) 2 (4) Business and Management Research 19 at 21.

1.2 Statement of the Problem

Ramifications of the failure of the sugar industry in Kenya have impacted negatively the social and economic wellbeing of its shareholders and stakeholders, who include the government, industry, employees, creditors, and the communities from which the industries operate. These negative impacts of corporate failure include loss of investments through declined sales and exports of sugar products**,** loss of livelihood due to the collapse of the employment system and income generation for thousands of small-scale farmers, employees, customers, suppliers and other investors who depended on the sugar industry either directly or indirectly. Moreover, the collapsed sugar industry has failed to pay off the debts owed to many creditors**,** such as banks and suppliers; hence, a chain of business failures and a significant increase in the unemployment rate. Conspicuously, societies around the collapsed sugar industries are now experiencing rampant school dropouts, increased crime rates due to idleness, and illicit drug addiction.

In 2001, when Mumias Sugar Company was privatized, and became a public company, it retained the government of Kenya as its major shareholder. Although a controlling shareholder is capable of taking a long term perspective to maximize the interests of the investors, it is also a source of bad governance resulting from abuse of power, disregard of minority shareholders' interests, pursuing of pet projects and misuse of resources for personal gains.[17] These problems have been prevalent at Mumias Sugar Company, Chemilil, Muhoroni, Miwani, Nzoia and SONY Sugar Companies, which are now illiquid.

The audited accounts of Mumias Sugar Company of the 2017/2018 financial year indicated that the company's liabilities stood at Ksh.30 billion, while its assets' base was Ksh.15 billion. These dwindling fortunes are largely attributed to a lot of controlling power by the government and its

[17] Ronald Gibson, 'Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy, 119 Harv. L. Rev. 1641 at 1643 and 1644.

invasion of the board composition. Invariably, the board lacks the autonomy to make decisions, knowledge, and skills to run the sector. Instead, the board of directors perform to achieve their political appointees' interests and demands; hence, managerial inefficiency.

Moreover, Mumias Sugar Company does not exhibit transparent internal controls and disclosure mechanisms. Consequently, there is a trace of inflated raw material prices, procurement malpractices, pilferages by the managers and deceptive profit declarations. This makes it hard for shareholders and stakeholders to reach sound investment decisions and monitor the financial stability and growth of the company. Furthermore, the lukewarm approach adopted by codes issued by Capital Markets Authority has compounded the inefficacy of corporate governance mechanisms in public listed companies since the codes only demand an ***apply or explain*** approach.

1.3 Statement of Objectives

1.3.1 Main Objective

This thesis shall review, analyse, and identify the impact of ownership structure, board of directors' composition and effects of improper internal controls and disclosure mechanisms on the performance of the sugar industry in Kenya.

1.3.2 Specific Objectives

(i) To review the historical account of the sugar industry in Kenya and analyse the extent to which it has formed the basis of the current corporate failure of the industry.

(ii) To analyse the impact of ownership structure on the performance of the sugar industry in Kenya.

(iii) To identify the effects of the board of directors composition on the performance of the sugar industry in Kenya.

(iv) To analyse the contribution of internal controls and disclosure mechanisms to the failure of the sugar industry in Kenya.

1.3.3 Research Questions

(i) To what extent has the historical account of the sugar industry in Kenya formed the basis of current corporate failure?

(ii) What is the impact of ownership structure on the performance of the sugar industry in Kenya?

(iii) What is the effect of board of directors' composition on the performance of the sugar industry in Kenya?

(iv) Has the internal control and disclosure mechanisms contributed to the failure of the sugar industry in Kenya?

1.4 Hypothesis

The thesis proceeds on the premise that there is a substantial association between corporate failure in the sugar industry in Kenya and a legal and regulatory framework that is not robust in embodying ownership structure, board composition, and internal controls and disclosures mechanisms in the sugar industry in Kenya.

1.5 Literature Review

This study reviewed different sets of literature to trace the historical development of governance of the sugar industry in Kenya, the impact of ownership structure on the performance of the sugar industry, the composition of the board and its contribution to corporate failure of the sugar sector and the implications of insufficient internal controls and disclosure mechanisms in corporations.

1.5.1 Historical Development and Governance of the Sugar Industry in Kenya

Sugarcane is an indigenous crop that was grown in Kenya long before the colonial era. It was mainly cultivated and chewed as food and its juice was used in the making of traditional brews.[18] Its development and governance tentacles began in earnest during the colonial period. Peter Wanyande connects the history and growth of Kenya's sugar business to the Asian Agricultural Settlement, which was built at the same time as the East African Railway line.[19] The land issue, which was then a retained prerogative of the European settler, was important to the growing of sugarcane. As a result, land was a barrier to the sugar industry's growth.[20] When Miwani Sugar Mills was established in 1922 in the then Kisumu District of Nyanza Province, now Kisumu County, followed by Ramisi Sugar Company in the Coastal region, the Asians overcame the obstacle and began to engage in retail cane cultivation before and eventually, they began to cultivate it commercially.[21]

Before attainment of self-rule in 1963, the sugar industry was privately governed and controlled. However, upon independence, the government began to participate directly in the sugar industry to boost production and make the country self-sufficient in sugar production.[22] The government therefore became the controlling investor in the sugar industry, dominating it through state-owned entities. The Centre for Governance and Development is a non-profit organization that promotes good governance and identifies several causes of poor performance by state-owned enterprises, which include inadequate corporate governance structures and mechanisms, as well as weak legal

[18]R.B. Ogendo and J.C.A. Obiero, 'The East African Sugar Industry' (1978) 2 (4) Geo Journal 343.p.344.
[19]Wanyande (n 3) at 124
[20] Patricia Kameri-Mbote et al., *Ours by Right* (Strathmore University Press, 2013) p.9.
[21]Wanyande (n 3) at 125.
[22]Ibid.

systems and excessive control from the executive branch of government.[23] In their analysis, the Centre for Governance and Development enlists mismanagement of public resources, abuse of power and inefficiency of managers as the main sources of corporate failures. The centre, therefore, advocates for legal reforms in the ownership structure of state-owned entities.

It is against this backdrop that Wanyande states that the fall of the industry was obvious from the beginning due to the ownership structure that was characterised by direct involvement by the government in the sector. It witnessed unpleasant political intrusions in the constitution of management and governance boards with a preference for foreign managers and the political undertones evident in 1966 between the then Vice President and President of the Republic of Kenya. In his analysis, Wanyande fails to demonstrate what sustained the sugar industry before independence and the reasons for its success.

In Kenya, Corporate governance discourse began earnestly with economic liberalization, but privatization of state-owned sugar entities remains largely unpopular due to a delusion that privatization is not ideal for the sugar sector both in conception and performance.[24] Some of the essential benefits associated with privatization of entities include the eagerness with which the public subscribes to boost the capital base of corporations as was the case with Mumias Sugar Company. Unfortunately, most state-owned sugar corporations are yet to be privatized and yet they are technically insolvent. This non-realization of privatization is not because of lack of a proper legal framework to anchor the process but it is due to political intrusion and resistance towards privatization.

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[23]Centre for Governance and Development, A Decade of Parastatal Waste, A Study of the Audited Accounts of State Corporations over the Period from 1993 to 2002, www.cgd.or.ke/documents/Parastatal%20 Waste.pdf accessed on May 30, 2019.

[24] ibid.

The sugar sector shareholders and stakeholders have over time identified the ills that bedevil the industry, through various forums and drafting of various policies and sectorial papers, for example, the ***Strategy for Revitalization of Agriculture, Sugar Industry Task Force 2003***. Nevertheless, the responses to the recommendation by sectorial policy formulators have been painfully slow. The regulatory system in the industry has failed to robustly guide the sector. For instance, the now-defunct Kenya Sugar Authority (KSA) that was recognized through the Kenya Order of 1973 is also ill equipped in managing the corporate governance mechanisms in the industry since its board lacked the necessary knowledge and skills, diversity and autonomy, due to political interferences.[25] The subsequent repeal of the Kenya Order of 1973 by the Sugar Act, 2001 that created Kenya Sugar Board is also handicapped in responding to the sector's corporate governance challenges since its functionalities; management and governance are not any different from the defunct Kenya Sugar Authority.

1.5.2 Impact of Ownership Structure of the Sugar Industry in Kenya.

The sugar sector in Kenya comprises of several forms of business entities that mainly include state-owned companies, privately owned corporations and public corporations. Although formation and ownership structures differ, these companies converge within mechanisms that describe the interrelations amongst the stakeholders, board of directors, company management, and the shareholders.

Machuki and Rasowa in analysing the performance of the sugar sector in Kenya, acknowledge that the ownership structure of the sugar industry is complex and therefore poses a lot of challenges that

[25] Wanyande (n 3) at 129.

have resulted in disparities in the level of performance.[26] Machuki and Rasowa, fail to articulate the position of small-scale farmers, who are central to the success of the sugar industry. Machuki and Rasowa also, aver that the state-owned entities are barely surviving or are insolvent while the privately owned entities are flourishing because they have explored and implemented good corporate governance mechanisms. However, they do not expound on how the corporate governance mechanisms have been implemented and if the implementation is a result of a robust legal and regulatory framework. Shleifer and Vishny, assert that the success of corporations is dependent on ownership structure; however, they argue that a concentrated ownership structure gives the majority shareholders the controlling power to damage the interests of the minority shareholders.[27] Pistor highlights the effectiveness and influence of legal requirements on ownership structure and shareholders rights, hence extending Shleifer and Vishny's argument.[28]

Most of the sugar Corporations in Kenya have a unique ownership structure that meanders between blocked and dispersed ownership. While the government of Kenya is the predominant shareholder in the sugar industry, other institutions and individuals hold dispersed shares of the sector. As for the private sector, it is largely governed and managed as family business entities with block ownership. In studying the impact of ownership on performance, Tam and Tan establish that ownership structures impact performance in diverse ways.

While Tam and Tan contend that state-owned entities have the highest block ownership whose governance and management is separated, private businesses with similar holdings have greater incentives for personally getting involved in the administration and management; hence, distorting

[26]V.N Machuki and J. O. Rasowo, 'Corporate Governance and Performance: An Empirical Investigation of Sugar Production Companies in Kenya' (2018)14(31) European Scientific Journal 240 at 243.

[27]Andrei Shleifer and Robert Vishny, 'A Survey of Corporate Governance' (1997) 52 (2) The Journal of Finance. 737 at 751.

[28] Katharina Pistor, Martin Raiser and Stanisla Gelfer, 'Law and Finance in Transition Economies' (2000) 8 (2) Economics of Transition 325 at 356.

the concept of separation of ownership and control.[29] This, therefore means, private companies are likely to perform better than state-owned companies. However, these two ownership structures have no provision for the involvement of the minority shareholders or stakeholders. This case is resonated in the sugar sector in Kenya where the legal and regulatory framework does not adequately provide for the participation of the small-scale farmer and the stakeholders of the sector at large.

Vagliasindi also scrutinizes the notion of ownership and control of state corporations and observes the different layers of principal/agent relations results in multiple objectives.[30] Therefore, the likelihood of objectives clashing is high leading to company failure. These various objects are a result of various legal requirements pursued by various layers of agents and principals. For example, while the government, through the Ministry of Treasury, attempted to save Mumias Sugar Company to support the country's economic development, the Kenya Revenue Authority demanded accrued taxes since 2012.[31] Interest struggles amongst the various government entities made Koech, Namusonge and Mugambi conclude that state corporations were not established to maximize profits but to fulfil the state's social objectives.[32]

In a similar vein, a study by Ndiba evaluates the connection between the structure of corporate governance and the fiscal performance of the Kenyan sugar industry.[33] According to Ndiba, it is

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[29] On Kit Tam and Monica Guo-Sze Tan, 'Ownership, Governance and Firm Performance in Malaysia' (2007) 15 (2) Corporate Governance: An International Review 208 at 210.

[30]Vagliasindi M, "Governance Arrangements for State-owned Corporations," Policy Research Working Paper 4542, Sustainable Development Network, The World Bank, p.4.

[31]Benson Amadala, "KRA descends on Mumias over KSh 10bn tax arrears" (Monday September 2 2019) https://www.nation.co.ke/business/KRA-descends-Mumias-over-Sh10bn-tax-arrears/996-5257578-15l1 accessed on June 2, 2019.

[32]Peris Koech, Gregory Namusonge and Fred Mugambi, Board Characteristics as a Determinant of Effectiveness of Corporate Governance in State Corporation in Kenya, (2016) 5(04) International Journal of Business and Commerce.37 at 41.

[33] Caroline Ndiba, *The Effect of Ownership Structure on Financial Performance of Sugar Manufacturing Firms in Kenya* (Doctoral dissertation, University of Nairobi, 2016). p.13

usually considered that privately managed enterprises record better performances than state-owned firms, which applies to the Kenyan sugar industry.[34] Deriving from this, Ndiba's study illustrates that majority of the sugar manufacturing industries owned by the state have experienced a decline in their economic performances.

With a focus on general corporate governance, Ongore's literature sheds light on the impact of ownership in two-fold; encompassing ownership concentration and ownership identity.[35] Before delving into the crux of the discourse, Ongore is cautious to note the significant pieces of literature on ownership concentration overly inclined towards owners' ability to oversee managerial discretion while ignoring the investment priorities of the owners.[36] Critically, Ongore is of the view that ownership concentration triggers better monitoring incentives hence, better performances.[37] To this end, one must discover whether the owner is a manager, a private person, an institution, a financial or non-financial institution.[38] The rationale behind the choice is that owners or investors vary in respect to risk aversion, wealth and attachment of priorities towards shareholders' views.[39] Deducing from the preceding, Thomsen and Pedersen state that ownership concentration becomes more material against the backdrop of the identity of the large or controlling shareholders.[40]

[34] Ibid p.8.
[35] Vincent Okoth Ongore, 'The Relationship between Ownership Structure and Firm Performance: An Empirical Analysis of Listed Companies in Kenya' (2011) 5 (6) African Journal of Business Management 2120 at 2121
[36] Ibid at 2121.
[37] Ibid.
[38] Ongore (n 35) at 2122.
[39] Ibid.
[40] Steen Thomsen and Torben Pedersen, 'Ownership Structure and Economic Performance in the Largest European Companies' (2000) 21 (6) Strategic Management Journal 689 at 690.

1.5.3 Composition of Board of Directors

A large number of literature reviews have analysed the relations between successful organization and board composition. The general conclusion is that the board of directors is the central focus for the maximization of the shareholder value and therefore the composition of the board is key. Corporate failure is a result of the board's use of ineffective corporate governance mechanisms. Honesty, openness, and transparency, as well as fairness, ethical behaviour, and accountability, are required for effective corporate governance mechanisms. These mechanisms may be as strong as they appear; however, practice is more important than simply adhering to these mechanisms. These mechanisms also increase investor confidence in the corporation and reduce the risk of financial embezzlement.

Corporate failure affects more than just a company's shareholders and stakeholders. The consequences of such failures are felt throughout the country's economy. Garratt[41] argues that business failure is a common occurrence. He links business failure in state corporations to a misunderstanding of the board of directors' responsibilities, largely nominated by politicians. As a result, he contends that corporations will continue to perform poorly and lose investors' trust unless the board of directors properly understand the scope of their responsibilities and roles.

Although Grant thesis points to factors that have led to improper board composition, and it is the view of this study that corporate failure in organizations undoubtedly begins and ends with the board of directors, the focus of reforms is on what the configured board of directors ought to do within the legal and regulatory framework and not what they are capable of doing to avert corporate failure. This is evident in Section 142 of Companies Act, 2015 that reiterates the proper purpose

[41]Garratt K, Corporate Governance and Compliance Law.www.bryancave.com/awards/Award Detail.aspx?award=3162 accessed on June 2,2019.

doctrine. This Section limits the Director who must be keen not to engage in any collateral purpose even though it is in good faith and interest of the corporation.

Most of the sugar companies in Kenya are state-owned entities, hence the board of directors are appointed by the executive under the State Corporations Act. On the other hand, Mumias Sugar Company is a public company although the government is the controlling shareholder whose corporate failure is attributed to the government's meddling in the governance affairs of the company and lack of independence by the board. Ndiba discusses the composition of board of directors in his study, which significantly relies on the literature by Dalton, Daily, Ellstrand and Johnson.[42] At the outset, his literature concedes that the board of directors' confirmation or its leadership has little connection with a firm's performance. Nonetheless, Ndiba states that where the board, particularly its chairman acts independently, there is a likelihood of better performance by the firm.[43]

One of the most important characteristics of board composition is the size of the board. The emphasis on smaller boards by many scholars is evidenced by the negative effects of large board sizes which have weaknesses in communication and are relatively hard to coordinate. Although there is no optimum size of the board for all due to diversity in the businesses and functions organizations engage in, Mwongozo advises that an optimum board should be between seven and nine members.[44] The small board size offers members the highest degree of interest in the functions and mandate of the business since smaller boards call for devotion to work.

Critical to an effective corporate governance framework lies a wide range of board members who have multiple views in the decision-making process. These multiple views call for diversity in

[42] Ndiba (n 33) at p.5.
[43] Ibid at p.5.
[44] The Code of Governance for State Corporations, (2015) p. 1

knowledge, skills, age, race, cultural background and even religion.[45] As Lena Eisenstein puts it, a good corporate governance framework calls for diversity that can elicit a robust discussion and reflect the real world of business. She recognizes that boards attain a comfortable level to the business agenda if multiple perspectives result in strategic decisions.

Jeneffer Hill posited that Enron Corporation and World Com failure reflected a global portent that eventually led to regulatory reactions to cushion corporate governance mechanisms.[46] However, she is of the view that these responses do not balance guidelines and laws on one hand and composition of the board on the other hand. Moreover, she argues that although board composition issues are common in nature worldwide, the reforms undertaken after the corporate scandals are tied to only the national corporate scandals and not the global common issues, yet the corporate world is now international.

In analysing these studies, the researcher is of the view that globalization has a significant effect on corporate governance yet there is no sufficient literature on the global convergence of corporate governance mechanisms that ensures optimum board composition. The import of lessons from organizations in other jurisdictions is therefore not practical given the different approaches to corporate governance.

1.5.4 Internal Controls and Disclosure

To effectively manage risks, sufficient internal control and disclosure mechanisms are inevitable. These mechanisms work to enhance reliable financial reporting that are compliant with the applicable laws and regulations and also, efficient and effective internal operations. Fan and Wong have indicated in their study that the relationship between board composition and ownership

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[45] Lena Eisenstein, 'The Importance of Diversity on Boards (2019) https://www.boardeffect.com/blog/importance-diversity-boards/ accessed on 6th June, 2020.

[46] Jennifer G. Hill, 'Regulatory Responses to Global Corporate Scandals' (2006) 23 Wisconsin International Law Journal 367 at 369.

structure is likely to encourage financial manipulations in a corporation and concealment of information to eliminate potential competition.[47] While this is true to the extent of their research, Fan and Wong do not have a lasting solution that is anchored in a legal and regulatory framework.

Mwaura believes that if control of corporations is left to Chief Executives who are employed competitively and granted sufficient independence to act, then initiatives can be adopted to make corporations more efficient.[48] Unfortunately, this is not the case with parastatals and therefore, Mwaura asserts that monitoring and evaluation mechanisms must be effective and realistic. He further argues that there is a need for rationalization of multiple regulations governing state-owned enterprises and raising standards of corporate governance for prudent management of privatized services, an argument which this study agrees with.

Vera-Munos discloses that the monitoring reforms that have risen after the rampant corporate scandals are generally intended to redefine and re-emphasize the duties of those responsible for financial reporting.[49] In her opinion, the reforms have strengthened the analysis of the audit committees and ensured their effectiveness. Additionally, she examines the need for corporate governance re-organisations, more so, the place of whistle-blowers provisions in the wake of the ensuing corporate scandals. Unfortunately, she does articulate the roles of stakeholders in propelling robust internal controls such as internal audit and disclosures mechanisms.

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[47]Joseph P.H. Fan and Tak Jun Wong, 'Corporate Ownership Structure and the Informativeness of Accounting Earnings in East Asia (2002) 33 (3) Journal of Accounting and Economics 401 at 403.

[48] Kiarie Mwaura, 'The Failure of Corporate Governance in State Owned Enterprises and the Need for Restructured Governance in Fully and Partially Privatized Enterprises: The Case of Kenya' (2007) 30 (1) Fordham International Law Journal 34 at 36.

[49] Sandra C Vera-Munoz, 'Corporate Governance Redefined Expectations of Audit Committee Responsibilities and Effectiveness' (2005) 62 (2) Journal of Business Ethics 115 at 126.

Aguilera avers that corporate governance re-organisations worldwide are copiously ongoing to avoid the risks that exist where some stakeholders exert too much influence in the corporation.[50] Aguilera postulates that corporate control guides managerial performance and conduct towards national legislation such as Sarbanes Oxley Act, 2002 enacted at the peak of corporate failures in the United States of America. The Act makes compulsory some responsibilities on corporate managers and directors, audit firms and corporate boards to resolve conflicts of interest and also, enhance accountability. But Aguilera did not recognize that cost of implementing these reorganisations is massive.

Fomburn and Foss acknowledge that business scandals have extensive repercussions on the part of investors and as a result of such repercussions, ethical questions have been raised.[51] Some of the ethical issues have far-reaching inferences which Fomburn and Foss aver those responses should be founded on ethical principles instilled by different corporate cultures, ethical officers in the corporations and implementation of strict ethical rules and strategies or codes of conduct. However, Branson is of the view that although these codes of conduct had been around for long, Enron Corporation and other mega business scandals happened. [52] Nonetheless, Branson goes ahead and agrees that these codes have served to raise the ethical behaviour and standards within organizations. He also believes that the codes can only serve optimally if their implementation is robust. He further fears that although there are legislative frameworks in place in many jurisdictions within which corporations operate, the age-old actions hold against attempts to decree morality. The assertion can only be to the extent of his conviction, but the synchronicity of law and

[50]Ruth V. Aguilera, 'Corporate Governance and Director Accountability: An Institutional Comparative Perspective' (2005) 16 British Journal of Management 39 at 44 and 49.

[51]Charles Fomburn and Christopher Foss, 'Business Ethics: Corporate Responses to Scandal' (2004) 7 (3) Corporate Reputation Review 284 at 285 and 286.

[52]Douglas M Branson, 'Enron-When All Systems Fail: Creative Destruction or Roadmap to Corporate Governance Reform' (2003) 48 Villanova Law Review 989 at 1008.

morality is progressively becoming relevant in modern days, especially with a decay of the societal moral fabric that leads to immoral and unlawful actions in the business realm.

1.6 Theoretical Framework

There exist several theoretical frameworks underpinning corporate governance in modern corporations. These theories include Agency, Stakeholders, Stewardship, Resource Dependency and Transaction Theories.[53] However, this study shall rely on the Stakeholders, Agency and Resource Dependency theories in advancing the thesis on the corporate failure of the sugar sector in Kenya.

1.6.1 Agency Theory

Agency theory assumes a connection between a company's managers and shareholders of a company. The separation of business ownership from control and/or management is the central feature of Agency theory. This feature has sparked a debate about its effectiveness in aligning the interests of a company's managers and owners to avoid conflicts between principals in corporations and their agents. Adam Smith examined the agency theory with agency/principal conflict as early as 1776 and concluded that separation of ownership and control did not incentivize agents to act in the interest of the principal while managing their investment; hence, the agents could not be expected to watch over the principal's investments as anxiously as the owners would.[54]

Principal/agency conflict, according to Berle and Means, arises from the separation of ownership and control. They argued, similarly to Adam Smith, that agency/principal conflicts are a

[53]Ghulam Abid et al., 'Theoretical Perspective of Corporate Governance' (2015) 3 (4) Bulletin for Business and Economics 166. 953 at 956.
[54]Modern Corporation and Private Property, 1932 New York, Macmillan Company https://archive.org/details/moderncorporatio00berl/page 13>accessed on May28,2019.

misunderstanding of poor incentives for managers to operate the company efficiently.[55] Berle and Means looked at the principal as nearly powerless when dealing with the substance of their property, as a significant part of ownership is entrusted with a different person who manages it hence raising agency costs.

Jensen and Meckling's proposal on firm agency theory was based on the modern corporation, which combines various aspects of property rights and finance to create an ownership structure.[56] They also defined agency costs to include principal monitoring costs, economic bonding, and residual economic loss. According to this theory, the principal-agent relationship is a legal fiction and a nexus of contracts for individuals and institutions, and thus agency costs are unavoidable. They do, however, suggest that to reduce agency costs, a corporation should create incentives to limit divergent behaviour and mitigate aberrant activities of the agent, in this case, the board of directors. As a result, the composition of the board of directors should take into account knowledge and skills, diversity, and autonomy to achieve the firm's objectives.

1.6.1.1 Effects of Agency Theory on Ownership Structure

A look at the Kenyan sugar sector reveals that it is structured on a network of agents and stockholders. They include the government as owners of state-owned firms, private investors, shareholders who are largely small-scale farmers, the Board of Directors, industry managers, Cooperative Societies, and even intermediaries found in the sugar industry chain in cross-border trading. The conundrum that arises with several levels of principal and layers in the sector is determining who is the rightful principal and/or agent in the sugar trade chain. This quandary is

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[55] Modern Corporation and Private Property, 1932 New York, Macmillan Company https://archive.org/details/moderncorporatio00berl/page/n13. p. viii. accessed on May 28, 2019.

[56] Michael C Jensen and William H Meckling, 'Theory of The Firm: Managerial Behaviour, Agency costs and ownership structure' (1976) 3 (4) *Journal of Financial Economics*, 305 at 308.

exacerbated by the fact that the ownership structure of most sugar firms in Kenya, the government being the main stakeholder, does not acknowledge the role of small-scale farmers in the sector's governance, despite small scale farmers constituting the majority of true shareholders. Furthermore, the government's direct control over public companies such as Mumias Sugar Company and other State-Owned Sugar Companies makes it difficult for management to devise methods to improve shareholder participation without the approval of the government. Most of the time, these managers are swayed by government officials or lobbyists to put strategies in the interest of the government without necessarily considering the views of the minority shareholder.

Besides, the liberalized sugar market which has allowed cross-border trading on regional markets such as COMESA has compounded the complication in determining the rightful principal and/ or agents. The rightful shareholders in the sugar trade chain are at the mercy of their agents. To bridge the gap and protect the investment by the shareholders, the government of Kenya introduced mechanisms to bridge the ownership and control gap through a performance contract signed by managers of state-owned enterprises. However, the performance contracts, have so far failed to yield any meaningful results. As Mwaura puts it, unless performance contracts are redesigned with a specific target, they are another tool that unnecessarily increases costs of operations.[57] Therefore, to achieve an effective ownership structure that is designed to minimise the agency problems as well as reduce agency costs, improved monitoring and evaluation mechanisms must be put in place, and provision of incentives that bring the interests of shareholders and agents closer to each other.

[57]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 at 52.

1.6.1.2 Agency Theory on Board Composition

As already mentioned, agency theory explains the distinctive relationship that exists between the principal and the agents. While the board of directors are the agents of the shareholders, their main function is to monitor on behalf of the shareholders the activities of the company. To optimally carry out the monitoring function, the composition of the board in line with the size of the board, board independence and diversity play a key role in bridging the gap between the shareholder and the members of the board. These board composition tenets have over time evolved to mitigate agency conflicts; thus, ensuring that investors get a return on their investment.[58]

Mumias Sugar Company being a public limited company had a functional board whose demographics as shall be demonstrated later in this study were adversely affected by the agency theory in its performance that eventually led to the failure of the company. Some of the effects included: the board being too large to effectively bridge the gap between the shareholders and the company, increased operational costs and the inability of the board to operate independently due to political interference from the government, which was also, the main shareholder in the company.

1.6.1.3 Impact of Agency Theory on Internal Controls and Disclosure

Lopsided information is an agency problem that emanates from separation of ownership and control. While the agents control the firm through some internal mechanisms and can only disclose the financial accounting to the owners through annual financial records, this study explores the gaps that were prevalent in the sugar industry as a result of incompetent internal control mechanisms that resulted in either distorted information about the performance of the sugar industry and particularly

[58] Andrei Shleifer and Robert Vishny, 'A Survey of Corporate Governance' (1997) 52 (2) The Journal of Finance 734 at 746.

Mumias Sugar Company, concealment of information or a complete nondisclosure of information that eventually led to the collapse of the sugar industry in Kenya.

1.6.2 Stakeholders Theory

Stakeholder theory is an alternative governance model designed to improve corporate interactions.[59] The model is often linked to the Japanese and German Models that require supervisory boards to have at least half of the seats occupied by the workforce representatives, bankers and large block shareholders among other stakeholders.[60] This theory demands that a corporation should strike a balance between the interests of various stakeholders as well as ensure some degree of satisfaction to all.[61] It has also created the idea that an organization has a moral relationship with persons who are not shareholders but are involved in the corporation's activities.[62]

Its origin can be traced to Edward Freeman who described stakeholders as a group or individuals affected or can be affected by the success of the corporation's purpose.[63] According to Freeman, companies cannot be properly managed if they act against the interests of stakeholders who form a critical component of the corporation. He based his arguments on an examination of the firm's goals and management's responsibility to stakeholders. He also believes that if the stakeholders are dissatisfied and elect to withdraw from the organization, either whole or part, the corporation would fail. As a result, Friedman's traditional idea that a corporation's social obligation is meant to use its resources to promote profits is becoming obsolete.[64]

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[59] Elaine Sternberg, 'The Defects of Stakeholder Theory' (1997) 5 (1) An International Review 3 at 4.

[60] Shleifer and Vishny (n 25).

[61] Frank W. Abrams, '*Management's Responsibilities in a Complex World'* (1951) 29 Harvard Business Review 29 at 31.

[62] G.P. Stapeldon, 'The Hampel Report on Corporate Governance' (1998) 16 Companies and Securities Law Journal 408 at 410.

[63] R. Edward Freeman, Andrew C Wicks and Bidhan Parmar, 'Stakeholder Theory and The Corporate Objective Revisited' (2004) 15 (3) Organization Science 364 at 364 and 365.

[64] Milton Friedman, "The Social Responsibility of Business is to Increase its Profits." In *Corporate Ethics and Corporate Governance* (pp. 173-178) (Springer, Berlin, Heidelberg, 2007) p.173. and 174.

Stakeholder theory is increasingly becoming a key determinant of a corporation's worth through its strategic contact with stakeholders, and these interactions, connections, and networks, in turn, are determining the financial score card and the influence of companies on the environment. To a considerable part, stakeholder theory has decreased the inherent hazard of managers focusing on short-term plans with higher risks, which eventually leads to company disasters such as Enron Corporation. Companies are no longer the property of shareholders, but rather partners to the society, with the new obligation to guarantee that corporations enhance the environment in which they operate. [65]

1.6.2.1 Ownership Structure and the Stakeholders Theory

The sugar industry as currently constituted has a shareholding structure, majorly concentrated in government and, which adopts the traditional interface of shareholders on one side and the managers of the company on the other side. While the agency theory only recognizes the shareholders, the Stakeholder theory is increasingly advocating for the inclusion of stakeholders as a pertinent part of the company who invest in organizations to create value for their investment. As a multifaceted business with complex relationships, the sugar industry has gradually embraced the stakeholders' model in recognition of the various stakeholders such as the bankers, the employees, the various suppliers and the community living around the companies. Unfortunately, they are still not represented within the ownership structure since it is still concentrated in government. Even though the corporate failure of the sugar industry has affected both the stakeholders and the shareholders in equal measure, the greatest losers are the stakeholders who may not have options to diversify their interests as the government does. For instance, the community living around Mumias Sugar Company have lost their livelihood due to their dependency on the operation of the

[65] Kiarie Mwaura, 'Constitutionalism of Environmental Governance: Towards Sustainable Corporate Responses to Environmental Degradation' (2018) 2 Jomo Kenyatta University of Agriculture and Technology Law Journal 27 at 36.

company. There is also a rise in unemployment that has been witnessed in Mumias town since most residents depended on the factory either directly or indirectly to support their social and economic affairs. The stakeholders' theory assisted this study to advance the contribution of stakeholders in the ownership structure of the sugar industry in Kenya.

1.6.2.2 Board of Directors Composition and the Stakeholder's Theory

The stakeholder's theory questions the board of directors' composition in terms of size, diversity and independence and questions the non-representation of the stakeholders on the board of directors. This theory articulates the need to broaden the domain of board composition beyond the shareholders' representatives to include the stakeholders within the composition of the board to participate in decision making within the firm and keenly observe the performance of the corporation on behalf of the stakeholders such as suppliers, banks, employees and the community. This would eventually lead to mitigation of corporate failure of the company since the interests of the stakeholders who are in most need of the survival of the company are represented. For instance, if Mumias Sugar Company had had a representation of stakeholders within the board, the monitoring aspect of the company's performance would have been more robust than it was. Additionally, the decision-making processes would have taken into consideration the interests of the stakeholders.

1.6.2.3 Stakeholders Theory on Internal Controls and Disclosure mechanisms.

Internal control and disclosure mechanisms are essential elements of corporate governance approaches in an organization. This theory was used to understand how the stakeholders use the disclosed information that emanates from a competent internal control system in making informed business decisions when dealing with the organization. If the information is improper, untimely and inaccurate, then the stakeholders make uninformed decisions in an entity that is not a going concern as was the case with Mumias Sugar Company.

1.6.3 Resource Dependence Theory

The Resource Dependency Theory connects the corporation with its external resources for survival.[66] This theory was suggested by Jeffrey Pfeffer and Gerald Salancik as a technique to explain organizational behaviour by examining internal controls and disclosure systems, as well as the overall operations of the company.[67] The idea recognizes the significance of all stakeholders, as well as the shareholders' assurance of access to resources and firm knowledge via affiliation.[68] The sugar sector in Kenya is significantly reliant on external resources, such as external auditors who are in charge of providing audited financial information to the public. As a result, the sector is impacted by a variety of external factors, putting the management at the centre of acting in a way that guarantees that all disclosures are truthful and allows the shareholders to closely monitor the company's performance. The focus of this idea is on the board of directors' ability to manage internal systems as a resource within the organization, as well as its ability to connect external networks with the firm. As such, the composition of the board of directors is key in ensuring the firm's success and therefore, reduce business uncertainties and failures.[69]

1.6.4 Conclusion

All of these theories serve to ingrain corporate governance mechanisms in corporations, but there is an increasing need for convergence of these theories into one comprehensive theory that

[66] Jeffrey Pfeffer, 'Size and Composition of Corporate Board of Directors: The Organization and its Environment' (1972) 17 (2) Administrative Science Quarterly 218 at 222.

[67] Jeffrey Pfeffer and Gerald R Salancik, *The External Control of Organizations: A Resource Dependence Perspective* (Stanford University Press, 2003) p.xii.

[68] Bello Lawal, 'Board Dynamics and Corporate Performance: Review of Literature, and Empirical Challenges' (2012) 4 (1) International Journal of Economics and Finance 22 at 24.

[69] Amy J. Hillman, Albert A Cannella and Ramona L Paetzold, 'The Resource Dependency Role of Corporate Directors: Strategic Adaptation of Board Composition in Response to Environmental Change' (2000) 37 (2) Journal of Management Studies 235 at 237.

encompasses all of the components that include wealth creation for shareholders, fiduciary responsibility to stakeholders, as well as being aware of societal needs. Furthermore, there is a growing paradigm shift among investors from passively watching stock market behaviour to shareholder activism, necessitating a rethinking of organizational ownership structures.

1.7 Justification of the Study

This study seeks to establish the causes of corporate failure despite the existence of a legal and regulatory framework that supports corporate governance mechanisms related to the ownership structure of corporations, configuration of the board of directors, internal controls and disclosure mechanisms. It is also conceivable that the findings of this study shall improve the efficiency and implementation mechanisms of the legal and regulatory framework of the sugar industry in relation to corporate governance.

This study will assist in establishing whether the government should continue to engage in the sugar industry and/ or privatize the entire sugar sector to allow its growth and development, as is the case with private companies. The study is also valuable to corporate governance policy formulators in the state-owned entities, public companies and private companies not only in the sugar industry but in all sectors in the Kenyan economy. Further, the findings of this study will contribute to strategic measures to be undertaken for the revitalization of the sugar industry in Kenya and enable the sector to contribute to the wellbeing of society by not only generating capital but also employment thus eliminate the negative social effects such as addiction to illicit drugs, increase in criminal acts and school dropouts.

1.8 Research Methodology

1.8.1 Research Strategy and Method

The study used doctrinal and non-doctrinal research methods. The doctrinal research method entailed a study of the international, regional and domestic legal and regulatory framework that governs corporate governance, published reports, newspaper articles, published reports, case laws, scholarly articles from online sources such as Hien and books from the internet sources and the library.

The study was initially conceived to review the literature and secondary data; however, it became inevitable to complement the study with a field study to Mumias Sugar Company and its zones situated in Kakamega County. The field study was necessitated by absence of up-to-date data on corporate governance practices in the sugar sector. It was therefore plausible to interview both the shareholders and stakeholders in the sugar industry.

1.8.2 Data Collection Methods and Design

Data was collected by way of structured interview guidelines that addressed the research questions of this study. Where necessary prior appointment was secured, however, most of the interviews were conducted whenever it was possible to do so while in the field. The interview guidelines were specific for every target category of respondents.

1.8.2.1 Category of Respondents

There were four major categories of respondents targeted were the 2 County Officials, 9 Company Employees, 13 Farmers and 5 Company Senior Managers.

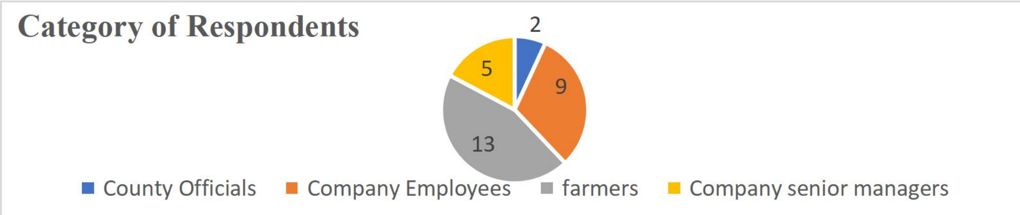

Figure 1.8.3.1: Category of Respondents

1.8.2.2 Response Rate

The response was 85% as indicated in the chart below with eleven (11) of thirteen (13) farmers being interviewed, all the nine (9) employees were interviewed, two (2) out of two (2) County officials interviewed and three (3) out five (5) Company Senior Managers.

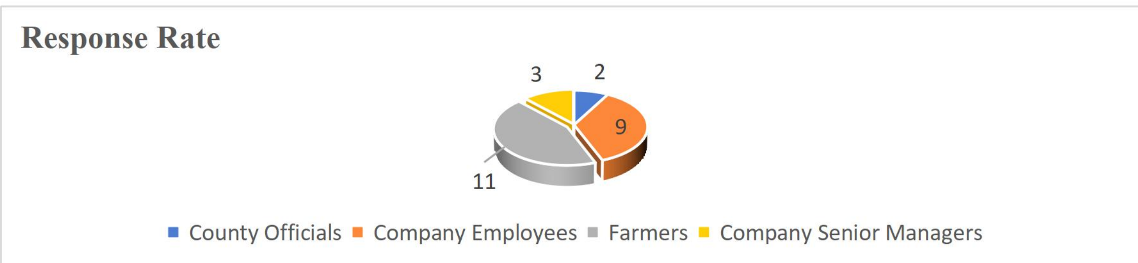

Figure 1.8.3.2

The local government administration included Agriculture officers at the Ministry of Agriculture, Livestock, Cooperatives & Fisheries, Kakamega County. Upon securing an interview appointment, two officials at the Ministry of Agriculture, Livestock Cooperatives and Fisheries, Kakamega County were interviewed. In securing an appointment, the respondents were able to allocate reasonable time for the interview and, avail additional data and documentation on the finding of county government on the sugar crisis in Mumias Sugar Company.

1.8.2.3 Data Analysis

The collected data was analysed using content analysis. It was summarized under s: - Historical background of the sugar industry, Ownership structure of the sugar industry, Board Composition, Internal controls and Disclosure mechanisms and recommendations for each category.

1.8.4 Ethical Consideration

Before the field research, a study permit was obtained from the National Commission for Science and Technology and Innovation (NACOSTI). Additionally, interview respondents were not subjected to harm in any way; their dignity was respected and consent was sought from the respondents with an assurance of privacy and anonymity.

1.9 Chapter Breakdown

The research project is divided into seven chapters as follows:

Chapter One: Introduction

This is an introductory chapter of the study. It provides a background to the study, statement of the problem, research objectives and questions, hypothesis and justification of the study. The chapter also provides literature review, theoretical framework, study methodology, as well as the scope and limitation of the study.

Chapter Two: The Historical Development and Governance of the Sugar Industry in Kenya

The chapter offers an analysis of the evolution of the governance of the sugar sector. It traces developments in the sugar industry from colonial times to the current day. The chapter also evaluates the transformations of ownership structure and composition of sugar corporate entities to provide a chronology of failed corporate governance in the sector.

Chapter Three: The Impact of Ownership Structure on the Sugar Industry in Kenya

The chapter examines the impact of the ownership structure on the sugar industry in Kenya. Further, the chapter interrogates the existing legal and regulatory framework on the ownership structure of sugar corporate entities.

Chapter Four: Effect of Board of Directors Composition on the Sugar Industry in Kenya

This chapter evaluates the impact of the board composition on the corporate performance of the sugar industry in Kenya. However, the analysis is limited to public limited sugar companies and how their board compositions have impacted their performance. Moreover, the chapter also analyses the Companies Act, 2015, as far as board composition is concerned.

Chapter Five: Internal Controls and Disclosure in the Sugar Industry in Kenya.

The chapter examines the effect of internal controls and disclosure mechanisms in the sugar sector in Kenya. To this extent, the chapter focuses on the adequacy of existing legal and regulatory frameworks that shape the internal controls and requirements of disclosure in the corporate governance of the sugar industry.

Chapter Six: Lessons from India: A Case Study of E.I.D. Parry (India) Limited

This chapter provides a comparative study of Indian sugar industry *vis* a *vis* the situation in Kenya. The Indian Sugar Industry is preferred for the study because it is the second largest producer of sugar worldwide due to good corporate governance. The chapter also provides the lessons that Kenya would borrow from the Indian sugar industry.

Chapter Seven: Findings, Conclusion and Recommendations

This chapter of the study is divided into three sections. The first section provides a summary of the study findings while the conclusion section offers a recap of the entire study. The final section provides the recommendations critical in enhancing corporate governance as a way to strengthen the sugar industry in Kenya.

CHAPTER TWO: THE HISTORICAL DEVELOPMENT AND GOVERNANCE OF THE SUGAR INDUSTRY IN KENYA

2.1 Introduction

This chapter analyses the historical development and governance of the sugar industry in Kenya during colonial period, post-colonial period and the current state of governance of the sugar sector. It interrogates the effects of the ownership structure, the composition of board of directors in relation to the early sugar industry, and the internal controls and disclosure mechanisms that were employed. This enables the researcher to trace the genesis of the current corporate failure of the sugar sector in Kenya.

2.2 The Colonial Period 1900–1963: Overview of the Kenyan Sugar Sector

The Kenyan sugar industry is concentrated in Western, Nyanza, and to some extent, the coastal regions of Kenya. Its introduction is linked to the construction of the East African railway line in 1900 and the settlement of construction labourers, mostly Asians.[70] As they settled, the Asians engaged in commercial sugarcane farming to supplement their income even though land was not readily available to them due to the colonial policies.[71] However, the Asians persisted with sugar cane farming until the colonial government recognized it as an avenue for revenue provision.[72] The colonial government then embraced sugarcane farming and allocated the Asians land in Kibos and Muhoroni area to continue with cane cultivation along the Kenya Uganda railway.[73]

Land was a central factor for development of the sugar sector in Kenya. However, it was discriminately allocated to the detrimental growth of the sugar industry. The passing of numerous

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[70]Jeckonia Otieno, "Kenya's Railway History and its Indian roots" (12th July, 2016) accessed through www.standardmedia.co.ke/article/2000208362 June 19, 2019.

[71]Wanyande (n 3) at 124.

[72] Zarina Patel, *Challenges to Colonialism: the Struggle of Alibhai Mulla Jeevanjee for Equal Rights in Kenya* (Z and Graphics, 1997) p.5.

[73] Bill Freund, *Sana Aiyar. Indians in Kenya: The Politics of Diaspora* (New York Harvard University Press, 2015) p.24.

laws and concessions, for instance, Crown Lands Ordinance of 1902 and Crown Lands Ordinance of 1915, did not ease land allocations but isolated the indigenous people and Asians from their land and any acquisition of land, respectively. It became a continuous source of conflict between natives and foreigners since landholding brought by the British could not consider the natives' traditional norms, expectations, and practices. However, in 1912, some Asian farmers acquired substantial pieces of highlands through sales by the white settlers in the Kibos-Muhoroni area to enlarge their agricultural activities.[74]This led to structured commercial cane cultivation, with the first sugar mill being established in Kisumu District in 1927.[75]

Through the enablement of the Commonwealth of Australia and the Companies Act, 1915, Victoria Nyanza Sugar Company was established but later renamed Miwani Sugar Company. It was primarily owned and managed privately by the Hindoch Family.[76] Subsequently, Ramisi Sugar Company Limited was formed in 1927 and was also primarily owned and managed privately by Madhavani Group International of India.[77] Although historical accounts of composition of the board of directors, internal controls and disclosure mechanisms are scanty, the early commercial sugar industry performed well. This then led the colonial government to rethink its stand on the industry. In 1954, the colonial government decided to boost the sugar manufacture and other agricultural divisions through the adoption of the strategic policy paper, Swynnerton Plan, whose objective was to increase the residents' commercial crop cultivation, improve the marketplaces and infrastructure, supply suitable inputs, and assure steady alliance and inclusion in landholdings.

[74]Peter Anyang' Nyong'o, 'The Development of a Middle Peasantry in Nyanza' (1981) 8 (20) Review of African Political Economy 108 at 112.

[75] John Ernest Odada, 'A Critical Evaluation of the Structure of Kenya's Sugar Industry' (1987) 1 The Accountant 21 at 23.

[76]Ordinance No 1 of 1923, February 7, 1923 Colony and Protectorate of Kenya.

[77]Wanyande, (n 3) at 124.

2.3 Governance of the Sugar Industry in Kenya during the Colonial Era

The historical governance of the sugar industry was based on a primarily private ownership structure. The structure lacked the fundamental principles of corporate governance that establish mechanisms, and procedures, and relations by which corporations are managed and run, transparent internal controls, and disclosure mechanisms.[78] These mechanisms were also not embodied in any legal and regulatory framework. Moreover, the trade was premised on a land disparity branded by abuse and biased economic control by colonial government. Given the abuse and economic control of land by colonial government and the subsequent eviction of the natives to pave way for the development of the sugar industry, the sector did not contribute to any social and economic wellbeing of the natives. Instead, the natives remained in perpetual poverty and lacked a stable livelihood after the meagre compensation following eviction from their original land.[79]

Further, as a privately owned industry, the regulatory framework was overlooked. This is because there was no separation of ownership and control of industry; hence, absence of the regulator. The private ownership structure did not also provide for sufficient internal control systems and disclosure mechanisms since they were not being monitored by any external shareholders or stakeholders. Due to the travesties of the industry to the economic and social wellbeing of the natives, the indigenous people decided to form an association to front their grievances to the owners and governors of the sugar industry.[80] The first prominent association was the Kibos Planters Association formed in 1920 to articulate planters' grievances and act as a disclosure mechanism of the industry during the colonial period.[81]

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[78] Sample Code of Best Practices for Corporate Governance, Private Sector Initiative for Corporate Governance P.9.
[79] Nyong'o (n.77) at 110.
[80] R. McGill, *Defining Institutional Development* (London, Palgrave Macmillan, 1996) p. 1-4.
[81] Joshia Otieno Osamba, 'The Forgotten Minority: The Origins of the Asian-Owned Sugar Plantation Agriculture in Kisumu County, Kenya' (2016) 4 (6A) Scholars Journal of Arts, Humanities and Social Sciences 617 at 620.

2.4 The Post-Colonial Period 1963 - 1980: Governance of Sugar Sector in Kenya

In 1963, Kenya got its independence, marking the enthusiasm for the social and economic development of the country.[82] The belief by government officials was that the state was the only single entity that could foster an effective social and economic development than the private sector leading to the establishment of parastatals in all economic sectors.[83] This, therefore, marked the beginning of the direct government involvement in the governance of the sugar sector in Kenya.

2.4.1 Direct Government Involvement in the Sugar Industry

The government's direct involvement in management and governance of the sugar industry aimed at ensuring the social and economic drivers of the country achieved the much needed and vital import substitution plan and, also, earned the country the much-needed foreign exchange and improved the infrastructural development.[84] This direct involvement in the sugar sector marked the end of privately-owned sugar industry and opened up an era of state-owned entities involved in the sugar industry as guided by the provisions of the Swynnerton Plan of 1954 and the African Sessional Paper No 10 of 1965.

2.4.1.1 The Swynnerton Plan of 1954

This Plan was instrumental in the expansion of the commercial crop production and cultivation in Kenya through enhanced markets, infrastructure, and supply of suitable inputs, with a steady distribution of landholdings.[85] According to this plan, comprehensive agricultural growth was reliant upon a land tenure that availed to the African farmer a component of land with an

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[82] Great Britain Colonial Office, Kenya Independence Conference 1963 (Command 2156). His Majesty's Stationary Office. p 17.

[83] 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) 30 (1) Fordham International Law Journal 34 at 36.

[84] Republic of Kenya, *African Socialism and its Application to Planning in Kenya* (Nairobi, Government Printer, 1965).

[85] Roger JM Swynnerton, "A plan to intensify the development of African agriculture in Kenya" *A plan to intensify the development of African agriculture in Kenya* (Nairobi, Government Printer, 1955) Preface.

arrangement of cultivation that would support families.[86] The plan also advocated for the security of land tenancy through titles with security against financial credits for farmers. Further, it permitted Africans to plant profitable export crops which had been previously a reserve for white settlers and Asians.[87] The government of Kenya, therefore, looked for ways of fast-tracking land consolidation after independence based on the provisions of the Swynnerton Plan of 1954 and the Land Adjudication Act of 1968, hence ascertaining and recording rights and interest in Trust Land that propelled the growth of the sugar industry in Kenya.

> We used to live in a communal land which my grandfather had obtained a title immediately after independence. Originally the land had no titles and so we lived as a community and cultivated anywhere as long as it was in the territory of our grandfather.
> (Mumia, 13/10/2019).

2.4.1.2 Sessional Paper No. 10 of 1965

The Sessional Paper No. 10 of 1965 on African Socialism and its Application to Planning in Kenya, was used to marshal resources to attain quick economic growth to the advantage of citizens and afford them a voice in the management of the natural resources in the country.[88] The policy paper sought to achieve social fairness, political equality, and human dignity, freedom from want, freedom of belief, sickness, and the provision of equal possibilities for higher and evenly distributed per capita income.[89]

To meet the goals of Session Paper No. 10 of 1965, the Kenyan government devised a strategy that would allow the economy and public resources to be Africanized.[90] Given the shortage of resources, including local currency, trained labour, and foreign exchange, the government invested heavily in

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[86] Ibid.
[87] Adhola Migot, *Rural Development Policy and Equality*, (Nairobi, Heinemann Kenya, 1984) p.203.
[88] Ibid (n 84).
[89] Ibid (n.84) Section 4.
[90] Mwongozo 2015, Statement by the President.

the sugar industry.[91] Its involvement in the industry was intended to ensure that local resources like land, water, and potential employment possibilities were used skilfully and aggressively without requiring major foreign help.[92] Agriculture was therefore essential to Kenya's Africanization, with the government establishing its countrymen on land previously controlled by Europeans.[93] Concurrently, the government formed state-owned sugar organizations and acquired major stakes in the established sugar corporations.

2.4.2 Establishment and Governance of the Sugar Companies Post Independence

In pursuance of the social objective for the direct involvement of government in the sugar sector, the government acquired land in East Muhoroni and North Muhoroni in 1964. It established schemes that were controlled by the Ministry of Agriculture. The land was also partly alienated to establish Muhoroni Sugar Company Limited although its operations began in 1966.[94] Further, in 1965 when Chemilil Sugar Company was founded through British and German aid, the government of Kenya was allotted shares in the privately formed company but the company was changed in 1974 into a parastatal.[95] At the time of its formation, the major shareholder was UKETA Ltd, which was a part of the Mehta Group of Companies but later on, the government through Agricultural Development Corporation (ADC) acquired majority shareholding at 83%.[96] Subsequently, the government contracted Booker Agriculture and Technical Services to carry out a feasibility study on the possibility of cultivating cane in Mumias in 1967.[97] At the time, the area around Mumias,

[91] Ibid, Part II.
[92] Ibid Section 70.
[93] The Constitution of Kenya (Amendment) Act 1965, Article 6(7).
[94] http://musco.co.ke/ accessed on June14, 2019.
[95] www.chemsugar.co.ke/chemelil/chemelil-sugar-company...accessed on June 14, 2019.
[96] Report No. 1887-KE Kenya Sugar Rehabilitation Project Appraisal Report Volume I November 17, 1978: Published by World Bank.http#documents.worldbank.org/curated/en/400221468044989548/pdf/multi-page.pdf accessed on June 14, 2019.
[97] www.mumias-sugar.com, accessed on June 14, 2019.

the present Kakamega County was underdeveloped, had poor road and communication networks while large chunks of land lay idle.[98]

> I was a teenager when Mumias Sugar Company was built in the early 1970s. We used to cultivate only foodstuff such as groundnuts on my grandfather's land and consumed everything as a family (Imbusi 13/10/2019).

Booker Agriculture and Technical Services, therefore, found the establishment of the sugar industry in Mumias viable due to the availability of land and hence, the potential supply of sugarcane would be from out-grower farmers and nucleus estate. In 1971, the government facilitated the incorporation of Mumias Sugar Company and held majority shares at 71% and the rest of the interests in the company were owned by Commonwealth Development Corporation at 17%, Kenya Commercial Finance Company held 5%, Booker McConnell held 4% and the East African Development Bank held 3%.[99] To strengthen its grip in the sugar sector, the government of Kenya further formed Nzoia Sugar Company in 1978 followed by the establishment of South Nyanza Sugar Company (SONY) in 1979.[100]

> My community was relocated from our original land in Shibale where we used to live together as a community to pave way for the construction of Mumias Sugar Company. Although we are a part of the Wanga clan, we were nicknamed ***Abahuyi*** meaning "movers" in Luhya dialect.

In line with the Sessional Paper No 10 of 1965, the management and governance of the post-colonial sugar industry were by foreigners in a partnership with the private capital. For example, Muhoroni Sugar Company was managed by Mehta Group International. Chemelil and Mumias on the other hand were both managed by Booker Tate International. Booker Tate International was further assigned with the formation and subsequent administration of Mumias Sugar Company.[101]

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[98] Ibid.
[99] www.mumias-sugar.com, accessed on June 14, 2019.
[100] https://www.businessdailyafrica.com/news/Seven-new-firms-get-sugar-milling-licence/accessed on June 14,2019.
[101] www.booker-tate.co.uk/.../mumias-sugar-company-kenya accessed on June 14, 2019.

The composition of the board that governed and managed the companies was therefore primarily foreign. This led to an over-reliance on foreign experts leading to lack of diversity in terms of the board or the management of the company to the detriment of harnessing local human resource capitation. Besides, appointment of foreign management companies was influenced by political interests since the selection was solely done by the government. Nevertheless, the sugar industry continued to grow so much, that Mumias Sugar Company, for example, led in the production of sugar in the East African Region and was also the most profitable company under the management of Booker Tate whose contract expired in 2013.[102]

> I worked in Mumias Sugar Company for thirty years between 1978 and 2008. I have therefore known Mumias Sugar Company when it was being managed by Booker Tate and when the local managers came in. I rose through the ranks to be a shop manager. During Booker Tate's time, we were earning very little but the pay was sustained. The pay plan favoured the foreign managers who were on a tax-free basis. Booker Tate therefore made us work very hard because all they focused on was their returns. Booker Tate never trained us, or even made us do their work. So, upon their departure, we were all not sure if we were doing the right thing and that led to the government deciding to sell the company and employ someone from outside the company. That is how we got the first African manager (Anonymous, former employee 15/10/2019).

After the exit of Booker Tate, Mumias Sugar Company continued to thrive not for so long before it began to experience severe financial woes under the locally appointed managers. The imminent fall of Mumias Sugar Company was attributed to:

2.4.2.1 Ownership Structure

Mumias Sugar Company was predominantly owned by the Government of Kenya, which, as already mentioned, held 71% of the shares. The management of the company was left to the foreign managers, that is, Booker Tate International. With the concentrated nature of ownership structure, the agency problems associated with ownership and control were inevitable. That meant

[102] Ibid.

that incentives to monitor the management and influence sound decision making became a part of the expense incurred by the government of Kenya through hefty salary payments. That notwithstanding, the concentrated ownership structure also did not consider the contribution of the minority shareholder who formed part of the outgrower farmers; hence, their expropriation. The government acted in its interest and exerted power in running state-owned sugar companies to their benefit and objectives but overlooked the interests of the minority stakeholders.

2.4.2.2 Board of Directors Composition

The reliance on foreign expertise by government did not bring about diversity in the board of directors' composition. Therefore, the local expertise was not capacitated to take over the industry's management and governance upon the departure of the foreign managers. With the foreigners managing the sugar sector, the government had direct control over the management decisions, which were more often than not detrimental to the industry's growth.[103] This is because the foreign managers could not independently make their decisions, but relied on the government for guidance. This, therefore, led to the industry's slow growth attributable to innumerable challenges that most State Corporations experience, such as too much state and political involvement, hence a focus of mismanagement, managerial inefficiencies and ineffectiveness, corruption and industry bureaucracies and wastages.[104]

[103]Stephen G. Marks, 'The Separation of Ownership and Control' (1999) Encyclopaedia of Law & Economics 692 at 696.
[104]Peris Koech, et al., 'Board Characteristics as A Determinant of Effectiveness of Corporate Governance In State Corporation In Kenya' (2006) 5 (4) International Journal of Business and Commerce 37 at 41.

2.4.2.3 Internal Controls and Disclosure Mechanisms.

Internal control and disclosure mechanisms revolve around safeguarding investors' interests, minimizing errors and risks, and promoting efficiency in the management of a business entity. To realize the sugar industry's objectives as envisioned at independence, the internal control and disclosure mechanisms were inevitable. However, there was a lacuna in the framework embodying the corporate governance in the sugar sector. The Kenya Order of 1973 created the Kenya Sugar Authority. Still, this authority was ill-equipped in dealing with the challenges associated with internal controls and disclosure mechanisms. It was an entity that was an extension of the government and lacked the autonomy in regulating and monitoring the sector.

> I knew the Kenya Sugar board and its officials; it was headed by former MPs one from Tiriki and the other came from Webuye. They only worked to please the government and not us. We were therefore not aware of anything that was happening to the company other than being told what the government was working to improve the company through other people. We relied on rumours (Sakwa, 14/10/2019).

2.4.3 Liberalization of the Economy in Kenya

The World Bank noted the ills in the Kenyan public sector that led to massive public sector ownership, in activities the utilities and transport sector, and the distribution and manufacturing industry.[105]These state corporations were informally protected by their domination in the trades, higher rates, and exclusions on competing importations and ad hoc duty exceptions on raw resources.[106] The World Bank, hence, called for transparent property rights and improved implementation of competition laws.[107] The government of Kenya then began routing economic restructurings through Structural Adjustment Programmes in collaboration with the World Bank. This marked the commencement of economic liberalization in Kenya to guide economic reforms.

[105]Gurushri Swamy, *Kenya Structural Adjustment in the 1980s* (World Bank Publications, 1994). p.7
[106] Ibid.
[107]Ibid.

The anticipated benefits of denationalization of entities were industry growth as well as development of the effective system; competitiveness of resources and subjection of more products to market forces.[108] To optimally achieve the benefits of privatization, a study to restructure the sugar sector was flagged off in 1994 to identify options for restructuring the industry. The review believed that government would enable institutional and policy restructurings through legislation and manage the progression of privatization. A new body to substitute Kenya Sugar Authority was suggested.[109] A policy paper on reforms in the public sector listed all state-owned sugar companies for privatization. In 2002 the first phase of the privatization programme ended but the sugar sector had not realized the expected privatization milestone. To date, the government of Kenya is either the largest shareholder or still owns most of the sugar corporations in Kenya.[110] However, Mumias Sugar Company was successfully privatized in 2001.[111]

2.5 Sugar Industry in Kenya After 2000

After the total liberalization of the sugar industry failed, the sugar sector's stroll to the brink of collapse began in earnest despite the industry producing more sugar against an increased demand and consumption, thereby necessitating the government to import the deficit.[112] There was also a need to reform the legal and regulatory framework under the Kenya Sugar Authority Order (Cap 318), 1973. The Order had established the Kenya Sugar Authority. Still, it was found inefficient in promoting the sugar industry due to emerging challenges of managerial inefficiency and ineffectiveness of the sector due to government interference.

[108] www.pc.go.ke/*background* information on state corporation reforms accessed on June 16, 2019.
[109] Ibid.
[110] Gurushri (n. 105).
[111] https://www.nse.co.ke accessed on June 16, 2019.
[112] KSB Investment Guide, 2006.

The Sugar Act, 2001(now repealed), was therefore enacted. However, shortly after its enactment, it became apparent that the Act was ill-equipped to deal with the sugar sector's challenges. Even though the Act established a regulatory body that is, the Kenya Sugar Board (now defunct) and tasked it with the responsibility of promoting and regulating the sugar industry, the board could not carry out its mandate due to political interferences. The Kenya Sugar Board became a mere springboard to political stardom or as a backdoor to the political realm previously lost. The board's managers served their interests or those of their appointers and not the shareholders and the sugar sector stakeholders. On the other hand, the Sugar Act was not robust enough to resolve the industry challenges such as the insufficient internal control and disclosure mechanisms, efficacy in the board composition and the ills of the ownership structure of the sector. Despite the identification of the gaps in the legal and regulatory instrument by the stakeholders such as Sugar Campaign for Change (SUCAM) and the development of several consultative documents such as the ***Report on The Task Force for Sugar Industry Crisis***, the policy formulation process was painfully slow due to the overlapping roles played by the different government agents, for instance, the Ministry of Agriculture and the Kenya Sugar Board.

The industry was also affected by the interference from government officials with a lot of pilferages through exploitation and hence the industry was indeed collapsing. Most of the companies were closing down or were insolvent.[113] By 2015, survival of the sugar sector in Kenya was doubtful. Six sugar companies in being choked with a debt of Ksh.6 billion.[114]In 2018, the government injected Ksh.3.2 billion into Mumias Sugar Company to bail it out of debts.[115] Although the government tried to salvage Mumias Sugar Company from debts, very little improvement was realized in capital

[113], as was Chemilil Sugar Company and Muhoroni Sugar Company.
[114]Paul Wafula, Politics of Sugar: Huge Debts, Lack of Cane Kill once Thriving Sector. Available at<https://www.standardmedia.co.ke/article/2001275224> accessed on June 17, 2019.
[115]ibid.

positions and earnings.[116] Muhoroni Sugar Company was also choking with a debt of Ksh8 billion, while Miwani had debts of over Ksh3 billion, SONY and Chemelil were each beholden Ksh.1 billion each.[117] Nzoia Sugar owed the state and defunct Kenya Sugar Board Ksh.28 billion.[118] There was no doubt the sugar industry had experienced corporate failure when Mumias Sugar Company closed down the factory in 2018.

Currently, the sugar industry is regulated by the Sugar Directorate of Agriculture and Food Authority through the enablement of the Agriculture and Food Act.[119] This directorate lacks the robustness that was exhibited by the defunct Kenya Sugar Board. Its visibility in the sugar industry has not been felt. The stakeholders of the sugar industry have therefore proposed an enactment of sugar specific act since the repealing of the Sugar Act 2001. Although the Bill was formulated, it has stuck in Parliament since 2019 yet it seeks to reinstate the roles of the Kenya Sugar Board (KSB) for the regulations, development and promotion and reinstate the Sugar Act that was repealed upon enactment of the Crops Act 2013. This Bill recognizes that Agriculture is a devolved function, and therefore proposes the composition of the Kenya Sugar Board to comprise of five representatives elected by growers, the Principal Secretaries for the Ministry of Agriculture and the Treasury, one representative elected by millers, one person nominated by the Council of Governors and the non-executive chairperson coming from among the representatives of growers on the board. Still, this composition will be profoundly predisposed towards the supply side, it will resolve improper board composition while facilitating proper internal controls and disclosure mechanisms. Furthermore, the diversity in the composition of the board may influence a dispersed ownership structure. The bill also proposes that the role of Chief Executive Officer should not be

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[116]Ibid.
[117] Ibid.
[118]Ibid.
[119] Agriculture and Food Act,2013 Section 11.

pegged on experience in management only but professional competence. This proposal will be instrumental in curing the lack of professionalism in the composition of boards and eliminate political appointees in the process.

2.6 Conclusion

The chapter examined the historical development and control of Kenya's sugar sector from colonial times to the present. The chapter also revealed that throughout the colonial period, the sugar business lacked a strong legal and regulatory framework for creating corporate governance processes. Furthermore, it has been proved that the problems confronting the sugar business were caused by bad sector management, which was exacerbated by political meddling. Over time, the sugar sector suffocated due to a lack of corporate governance mechanisms as a result of ownership structure, which served as the foundation for political interference, an ineffective board of directors' composition, resulting in managerial inefficacy and ineffectiveness, as well as insufficient internal control strategies and disclosure mechanisms.

CHAPTER THREE: THE IMPACT OF OWNERSHIP STRUCTURE ON THE SUGAR INDUSTRY IN KENYA

3.1 Introduction

This chapter studied the influence of ownership structure on the performance of the sugar sector in Kenya. It scrutinizes robustness of the legal and regulatory framework anchoring ownership structure in different typologies of organizations involved in the sugar sector. In this exposition, this study recognizes the dynamism of the industry since its inception in early 1900 resulting from renewed and divergent interests of the investors.

3.2 Characteristics of Ownership Structure in the Sugar Industry in Kenya.

As previously stated in chapter two of this research, the commercial sector of the sugar industry began as a privately owned industry in 1922. Soon after independence, the government of Kenya got involved and dominated the sector through state-owned entities. The domination of the government of Kenya in the sugar sector continued until the year 2001 when Mumias Sugar Company was privatized. Currently, most of the entities in the sugar sector are state-owned and anchored on the provisions of the State Corporations Act.[120] Other entities in the sugar sector are either private or public limited companies as provided by Companies Act, 2015.[121] These entities whether state-owned, privately owned or publicly owned have a common feature of existence that is independent of the membership. [122]

In Kenya, the only public limited corporation in the sugar industry is Mumias Sugar Company.[123] The Company enjoys corporate personality which is subject to exceptions that are either statutory or judicial. For example, statutory exceptions under the Companies Act 2015 provide that, where

[120] State Corporation Act Cap 446, s3.
[121] Companies Act, 2015,s5, 9 &10.
[122]*Salomon v Salomon & Co* (1987) AC 22.
[123] Companies Act, 2015, s9.

there is an intention to commit fraud through the corporation, then the corporate veil may be lifted.[124] Further, the Insolvency Act, 2015, provides that directors can personally be held liable for debts of limited companies and make contributions to assets in liquidation where a fraudulent trading or improper use of the company's name is detected.[125] However, the establishment of such fraudulent acts has been left to the courts to determine without specific procedures. As such, these open-ended rules provide an avenue for a different analysis of the doctrine of veil lifting in corporations for different sets of facts or circumstances. It is no wonder then, that the courts have not been able to find any of the directors of Mumias Sugar Company culpable of any fraudulent actions towards the corporate failure of the company.[126]

3.3 The Influence of Ownership Structure on the Performance of the Sugar Industry in Kenya

Ownership structure of corporations is determined by the level and number of equity holders' rights. Depending on the level of equity holders, the ownership structure can be concentrated or dispersed.

3.3.1 Effects of Concentrated Ownership on Performance of the Sugar Industry in Kenya.

Concentrated ownership is a structure with a controlling or absolute shareholder.[127] Most of the private companies and state-owned entities have concentrated ownership structures hence active involvement in the control and management of the organization. [128] As already explained in Chapter Two of this study, Mumias Sugar Company began as a state corporation before it changed

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[124]Companies Act, 2015, s1002.
[125] Insolvency Act, 2015, s632.
[126] Dzuya Walter, Kidero Wants Court to Stop Accounts Probe during Mumias Tenure https://citizentv.co.ke/news/kidero-wants-court-to-stop-his-accounts-probe-during-mumias-tenure-171604/ accessed on 28/10/2020.
[127] Ronald Gilson, Controlling Shareholders and Corporate Governance: Complicating the Comparative Tazony, (2006) 119 Harv. L. Rev. 1641 at 1643.
[128] Randall Morck, Andrei Shleifer & Robert Vishny, 'Management Ownership and Market Valuation (19988) 20 J. Fin Econ. 293 at 307.

into a public company in 2001. The government of Kenya continued to hold the largest shares singularly. For instance, the 2014/2015 audited annual reports indicate that the government of Kenya held the highest shares at 20% while the other shares were distributed amongst other shareholders, mostly small-scale farmers. This shareholding structure at Mumias Sugar Company was therefore concentrated and hence, paved the way for expropriation of minority shareholders permeated with domination of government's interests to the detriment of the small-scale farmers who were the minority shareholders and stakeholders.

> I used to own shares in Mumias Sugar Company and although we used to have Annual General Meetings, we were only told what the government had decided to do. It got to a point where I did not want to attend those meetings because it was a forum for being told what the government is doing and has decided to do. At some point, when they stopped paying us regularly, most of us (the shareholders) could not afford to travel to the Annual General meeting which we rarely attended because they would hold them in Kisumu yet we did not have the means to get to Kisumu (Nabongo, 13/9/2019).

Ultimately, the dominance of the government of Kenya in the decision making, monitoring, management and governance of Mumias Sugar Company determined the company value that the atomistic shareholding by individual shareholders largely depended on. [129] There was, therefore no incentive for any of the minority shareholders to monitor the management of the corporation since such monitoring would only be possible through the Annual General Meeting or Special Annual General Meeting whose attendance was costly to the minority shareholders in terms of travelling costs to the venue of the meetings. As a result, the government of Kenya would be left as the ultimate decision-maker during the meetings. The non-participation of the small-scale farmers and the stakeholders created agency problems that resulted in conflicts of interest from the company managers and increased operational costs to close the gap of communication between the company and minority shareholders.

[129]Susan P. Shapiro, 'Agency Theory' (2005) 31 Annual Review of Sociology 263 at 275.

While the Companies Act, 2015 has provided an avenue for the shareholders to pass resolutions and vote at the Annual General Meetings, the stakeholders have been excluded and do not feature in the ownership structure of the firm. [130] This does not automatically presume that shareholders have a greater right over corporation affairs than other investors. Certainly, the stakeholders determine the value of the company and must therefore be involved and represented during the Annual General Meetings or similarly apportioned rights just as the shareholders. Regrettably, the legal and regulatory framework in the sugar sector fails to envision participation of stakeholders in the governances and management of the sugar sector in Kenya.

Company law recognizes the majority rule thereby preventing multiplicity of legal proceedings.[131] However, the minority shareholders should also be protected further, by an efficient legal and regulatory that allows them to bring derivative actions when there is neglect, omissions, breach of duty or trust and default.[132] Minority shareholders should further be protected from actions which are oppressive and unfair.[133] Even though the Companies Act, 2015 has outlined these provisions, the sugar industry minority shareholders are still incapable of accessing these rights. This is because derivative actions are limiting for the small-scale farmers to demonstrate. They also have no access to information about the sugar corporations traded with given the numerous layers of representatives engaged in the trade chain. As such, minority shareholders are left with no choice but to speak up their discontent through the sale of shares and/ or stop the cane farming altogether.

Although the sugar business environment is dynamic and therefore the necessity for frequent appraisal of the legal and regulatory framework to keep pace with the changing drifts, the recent amendments to the Companies Act, 2015 inexplicably endanger the gains of minority shareholders

[130]Companies Act, 2015, s756, 769, 770.
[131]*Foss v Harbottle* (1843)2 Hare 461.
[132]Companies Act, 2015, s238.
[133] Ibid, s780.

protection during takeovers.[134] These changes apply to public and private corporations where a bidder is required to attain a threshold of 50% compared to the previous threshold of 90% to buy minority shareholders out in a takeover.[135]As much as some of the minority shareholders do not understand the complexities of such transactions and it may take time for them to understand these transactions, the low threshold is a more accessible avenue for the bidder to force out any dissenting shareholders as long as their 50% threshold is achieved.

> We heard recently that the bank took over the management of the Mumias Sugar Company, we have no idea what even happened to our shares because we have not sold them although we uprooted the sugarcane plantation and we no longer supply anything to them (Nabongo, 13/10/2019)

Other amendments to the Companies Act 2015 that entails undisputed agreement from the shareholders for the admission of fresh members are inhibitions to those companies seeking capital to improve their investment particularly the failed sugar corporations in Kenya.[136]The provision further fashions unnecessary obstruction in share assignments and subscriptions, yet the law is ought to ease business transactions. Furthermore, the changes to the Companies Act, 2015 require corporations to retain a directory of beneficial owners and the nature of control.[137] Whilst this is a transparency move and a mechanism that is instrumental in tracing money laundering missions, it is unfortunate that small-farmers/minority shareholders may never access this information.

3.3.2 Ownership Structure and Separation of Ownership

The extent of principal-agent relationship is determined by the ownership structure of the corporation. This relationship expects that while one entity is appointed to legally act on behalf of the other, there ought to be no conflict of interests in the relationship. The presence of conflict of

[134] Statutory (Miscellaneous Amendment) Act No. 12, 2019.
[135] Companies Act, 2015, s611.
[136] Ibid, s91A.
[137] Ibid, s93 A.

interest gives rise to agency problems which in the long run affect the performance of a corporation. The nature of public limited companies embraces separation of ownership and control, a rare feature in most of the private limited companies that are managed and controlled as family businesses. In some instances, employers of these private companies play a dual role of management and control of the corporations. This, therefore, puts them at a disadvantage of benefitting from business sustainability by a professional team of managers with diverse knowledge and skills to facilitate effective management through capital maximization. Similarly, in the presence of a controlling shareholder such as the case of Mumias Sugar Company where decisions are reached for the benefit of the majority shareholder, the corporation may be denied the benefit of professional management depending on the decision made by the controlling shareholder.

However, separation of ownership and control does not offer flexibility and agility for decision making due to multiple layers of agents and principals. Mumias Sugar Company as a public limited entity is controlled separately by the managers from its shareholders and stakeholders. Managers who are agents of the shareholders are appointed based on their skills and knowledge, however, their decision making must go through a certain bureaucracy as a result of different preferences and goals by the management and the shareholders/stakeholders.[138] The managers' interests with those of the members of the company, including the government, the small-scale farmers, creditors, employees and other stakeholders are usually not aligned, hence a surge in operations costs.[139] These conflicts of interests resulted in inefficient and ineffective management leading to the corporate failure at Mumias Sugar Company that has since 2018 been unable to

[138]Frank H. Easterbrook & Daniel R. Fischel, 'The Corporate Contract' (1989) 7 Columbia Law Review 1416 at 1427.
[139]Ibid at 1421.

operate or meet its legal obligations such as payment of dues for services and goods delivered and/ or payment of dividends to shareholders effectively.[140]

Mumias Sugar Company being a public limited company is also interposed with multiple layers of principals and agents, thus existence multiple agency contracts. For instance, MSC was monitored and accountable to policies, rules and regulations by various government ministries such as Ministries in charge of Agriculture, Finances, Industry and Trade. While the Ministry of Finance is concerned with importation levies and taxes in all sectors including the sugar industry, the Ministry of Agriculture concerns itself with agriculture that includes policies that regulate cultivation of crops such as sugarcane and the Ministry of Trade, Industry and Cooperatives, on the other hand, is concerned with negotiating terms for the sugar sector on the international market and also, marketing the cane products. The major problem is lack of clear rules and a robust legal and regulatory framework that is capable of synching the policies, guidelines, rules and regulations in the sugar industry. Although the Sugar Directorate is under the Agriculture and Food Authority, it is invisible and unable to coordinate all the roles of government ministries.

> There is very little that can change in terms of what the Directorate of Sugar can do for the industry as long as it remains answerable to the government through the Ministry of Agriculture. This is because all the decisions of the Directorate must be approved by the Ministry of Agriculture. I say this because I was once a chairperson of the defunct Kenya Sugar Board and the bureaucracies that we experienced in the discharge of our duties was way beyond acceptable limits. At some point, we would be caught up with issues that were beyond our remedy for instance the importation of sugar by cartels that had got approval from either the Ministry or other powerful politicians (S. Busolo, 14/10/2019).

Furthermore, upon being privatized, Mumias Sugar Company continued to be operated as if it was state-owned property because the government was the controlling shareholder. Characteristic of

[140] Julius Otieno, Court halts leasing of cash-strapped state-owned sugar companies, the Star Newspaper (12th October, 2020) **https://www.the-star.co.ke/business/kenya/2020-10-12-court-halts-leasing-of-cash-strapped-state-owned-sugar-companies/** accessed on 28/10/2020.

state-owned entities, MSC operated with a notion of improving the economic and social welfare of the residents and not necessarily to make profits; thus, the laxity with which the managers operated MSC.[141] It is, therefore, no wonder that most of the state-owned entities in Kenya have suffered from total corporate failure and it has been the view of most technocrats and stakeholders in the sugar industry to privatize all the sugar companies through the procedures outlined by the Privatization Act, 2005.

The Privatization Commission indeed framed and passed the privatization plan for Nzoia, Miwani South Nyanza, Muhoroni and Chemilil Sugar Companies. However, there was lack of stakeholders and pollical will to conclude the privatization course. An attempt by the government to lease some sugar mills owned by the state indicated in Gazette Notice No 5473 and 6437 of 2020 was temporarily stopped by the High Court of Kenya sitting in Eldoret due to lack of public participation or consultation with the stakeholders of the industry.[142] The political class had also lamented that the planned leasing was going to be undertaken without public participation by the local stakeholders in the sugar belts. Further, the Labour Relations Court in Kisumu suspended the leasing of state-owned sugar factories until the workers' issues, including Ksh.4 billion salary arrears were addressed.[143] Presently, the long-term lease to assign the right of use of insolvent state-owned entities to the lessee, that is, Nzoia, Miwani South Nyanza, Muhoroni and Chemilil Sugar Companies is temporarily halted by the court.

[141] Ravi Ramamurti, 'Performance Evaluation of State-Owned Enterprises in Theory and Practice' (1987) 33 (7) Management Science 876 at 883.

[142] Julius Otieno, 'Court halts leasing of cash-strapped state-owned sugar companies', the Star Newspaper (12th October, 2020) https://www.the-star.co.ke/business/kenya/2020-10-12-court-halts-leasing-of-cash-strapped-state-owned-sugar-companies accessed on 28/10/2020.

[143] Faith Matete, 'Court suspends leasing of state-owned sugar mills', the Star Newspaper (14 August 2020) https://www.the-star.co.ke/counties/nyanza/2020-08-14-court-suspends-leasing-of-state-owned-sugar-mills accessed on 28/10/2020.

The only operational sugar companies in the Kenyan industry presently are privately owned corporations.[144] Undeniably, the sugar sector has had transformed over the years and gone back to its state as it were during the pre-independence period when all the sugar industries were privately owned. The ownership structure of privately owned sugar corporations is limited to the shares as envisioned by the Companies Act, 2015. Nonetheless, there is little if any semblance of separation of ownership and control but very minimal focus of managerial inefficacies and ineffectiveness, as experienced in public and state-owned corporations.

3.4 Conclusion

The Chapter's main thesis has demonstrated that the sugar industry in Kenya has generally concentrated ownership which is a sign of bad governance because the substantial shareholder has continuously dominated the industry for their interests with no regard for minority shareholders. Furthermore, the substantial shareholder has used its muzzle as the government to infringe rights of the minority shareholders despite the existence of a legal and regulatory framework. This infringement has been achieved through arbitrary decision making by the government on the issues affecting the sugar industry without the involvement of the minority shareholder or the stakeholders of the industry.

This chapter has also exposed the inadequacies of the legal and regulatory framework in anchoring concentrated ownership of the sugar industry in Kenya. The chapter established that although there is a continuous improvement of the existing statutes such as the Companies Act, 2015, implementation is which key is lacking. Moreover, the chapter underscores the need for speedy privatization of the state-owned sugar entities to control and freeze the government's shareholding in public companies thereby, revitalizing and sustaining the profitability of the sugar industry. A

[144] Companies Act, 2015, s5.

regulatory body that is efficient in implementing its policies, rules and regulations should be institutionalized through a sector-specific Act. This would give the sugar sector the robustness of the legal and regulatory framework that it deserves thereby; avoid the perennial corporate failure of the sugar sector.

CHAPTER FOUR: EFFECTS OF BOARD OF DIRECTORS' COMPOSITION ON THE SUGAR INDUSTRY IN KENYA

4.1 Introduction

The board of directors is a body of individuals that represent absentee owners of an organization. They actualize the corporate personality of the organization, make decisions, monitor and manage the corporation's activities and expectations of the shareholders as well as stakeholders. Hence, the centrality of board of directors in corporate governance of an organization that must function and perform their roles efficiently to influence the firm performance.

The board structure in Kenya embraces a unitary system where both the executive directors and non-executive directors serve the same board but the non-executive directors are not engaged in the daily operations of a corporation. As a result of this unitary system, the influence of the board of directors varies substantially dictated by the legal region the company adopts. For instance, the private limited companies managed as family businesses have their board members who play dual responsibilities as board members and employees of the association.

The emphasis of this chapter however, is on public limited sugar companies and the influence the board composition has had on its performance. This chapter demystifies the elements of board composition provided by the Companies Act, 2015 and the guidelines, rules and regulations of stock market.[145] It focuses on three board composition variables: board size, independence and diversity.

4.2 Board of Directors Composition

The composition of the board of directors has come under scrutiny following mega-corporate failures that have been witnessed both globally and nationally. For example, the corporate failure of

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[145] Company Act, 2015 and the Code or Corporate Governance Practices for Issuers of Securities to Public, 2015.

Enron and WorldCom in the global arena and the sugar industry in Kenya. These corporate failures have been weighted against incompetent boards of directors that were either too large to execute their mandate efficiently, lacked the necessary independence or did not embrace the diversity of knowledge, skills and gender to function resourcefully.

The legal reforms have responded to a myriad of issues related to an incompetently configured board. For instance, United States of America responded to the failures of WorldCom and Enron by enacting Sarbanes-Oxley Act in 2002. The Kenyan legal regime has also responded to myriad instances of corporate failures by enacting Companies Act, 2015 and regulations of stock market by the Capital Markets Authority. These legal reforms are skewed towards institutionalization of good tenets of corporate governance in organizations. However, the efficiency of these legal reforms and particularly the Code[146] is wanting in implementation. It has adopted the lukewarm approach of ***apply or explain.*** The ***apply or explain*** model of governance calls upon shareholders to enforce the code. While it sounds ideal since the shareholders are perceived to own the corporation it disadvantages small shareholders who are unable to access the annual general meetings as was the case in Mumias Sugar Company.

The King III Report endorses that the board ought to have majority of non-executive directors who should also be independent bringing about objectivity in the execution of their roles.[147] Similarly, the public limited companies' boards in Kenya are expected to comprise of directors that fairly reflect the shareholding structure of the corporation and ought not to favour a certain substantial shareholder.[148]

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[146] Code or Corporate Governance Practices for Issuers of Securities to Public, 2015.
[147] King Report on Governance for South Africa, Institute of Directors in South Africa, 2009. p.38
[148] The Code or Corporate Governance Practices for Issuers of Securities to Public, 2015.

Furthermore, the public limited company boards of directors in Kenya are advised to provide mechanisms for minority shareholder representation as well as manage any conflicts that may arise between the management and the board. No doubt, Mumias Sugar Company had a board that had relatively embraced the provisions of the code as guided by the Capital Markets Authority. From the Annual Reports and Financial Statements for the years 2003 through to 2019, the board of directors were either twelve members or thirteen who comprised both the executive directors and non-executive directors.

> I was an employee of Mumias Sugar Company and was also a shop steward until 2016. We did not know the composition of the board members since a list of names came from Nairobi and the most, they could do was to read the names for us. Most of those that were being appointed were affiliated with some politicians. Some could resign and their replacement was done and only reported to us during Annual General Meetings (Chitayi, 14/10/2019).

As already mentioned, the government of Kenya was a substantial shareholder in Mumias Sugar Company and hence, was a part of the body of the board of directors. Consequently, it was instrumental in the implementation of policies and strategies that were in its favour. The government representative did not take cognizance of the composition of the board that represented other shareholders but instead approached their roles as if Mumias Sugar Company was still a state-owned entity. For instance, the government of Kenya adopted a protectionist approach towards the sugar industry by seeking limited sugar imports from other Common Market for Eastern and Southern Africa (COMESA) countries yet, it is instrumental in creating healthy competition under secure trading environment.[149] Although the safeguards sought by the government are generally positively viewed by the shareholders and stakeholders in the industry, these safeguards are indeed

[149] Allan Olingo, 'Kenya bags COMESA sugar safeguards for another two years' *East African Newspaper* (July 21, 2018) Accessed through www.eastafricas.com on July 4, 2019.

the key causes of inefficacies adopted by board of directors due to the isolation of Kenyan sugar sector from the regional market[150]

A critical analysis of these safeguards reveals that they prevent the local sector from world-wide growth while creating importation cartels that are endorsed by board of directors.[151] From the foregoing, the protectionist approach adopted for the sugar industry is not aiding its development and growth but has instead created an environment for government bureaucrats and by extension the board of directors to act arbitrarily. Furthermore, the Mumias Sugar Company board as configured could not collectively perform its roles and effectively monitor the performance of the company since the government offered them financial bailouts that did not necessarily resolve the major issues that affected corporate governance in corporations. Therefore, in analysing board of directors' composition at Mumias Sugar Company, this study focuses on the size, independence and diversity of the board in determining the degree of its influence and contribution to the corporate failure of the sugar industry.

4.2.1 Size of the Board

Board size is one of the common measures of board composition that has increasingly attracted attention in the wake of corporate failures. Although there is no optimal board size recognised universally, various factors such as legal regimes, the business of the organization and the desire of investors influence the sizes. The Code of Corporate Governance Practices for Issuers of Securities to the Public 2015 expects public limited companies to have a board of directors whose

[150] K.B. Kipruto, 'Effect of Trade Protectionism on the Efficiency of the Sugar Industry in Kenya." 'In *proceedings of the 12th KARI Biennial Scientific Conference 1279-1283* (Nairobi Kenya, 2010).p.1281

[151] Paul Wafula, "Mastery of Loads of Sugar Sneaked in within Days" (June 24, 2018) <https://www.standardmedia.co.ke/article/2001285265/mystery-of-loads-of-sugar-sneaked-in-within-days.> accessed on July 14, 2019.

composition is sufficient in size and quality in the size of board members ought to ensure as opposed to quantity.

The Code of Corporate Governance for Issuers of Securities to the public, 2015 fails in demarcating the parameters board sizes as opposed to what the Mwongozo provides. Mwongozo has defined the parameter and states that each state-owned entity should not be more than nine members or less than seven members. The non-demarcation of board sizes for public companies is a risky inclination. This is because a substantial shareholder may decide to dictate the number of board members, some of whom are merely ceremonial or represent the interests and aspirations of the substantial shareholder.

Mumias Sugar Company had a significantly large board compared to other public listed companies sampled from the Nairobi Stock Exchange website. For instance, Limuru Tea Company and Car & General (K) Ltd had eight (8) directors each, while NCBA Group Plc and Sameer Africa Group had nine (9) directors each and Crown Paints Co. Ltd had only five (5) directors. Going by their annual financial statements, these companies recorded good performances attributed to the smaller boards in the sampled companies. This is because, smaller boards can facilitate quick and better decision making due to their commitment, ownership of the board discussion and are fully engaged in the board deliberations. It is also relatively easy and cost-effective to organize a board meeting for small boards since schedules of different members can easily be synchronized. Besides, the cost of maintaining and remunerating the board of directors is relatively low.

Research carried out by GMI Ratings in 2014 for the Wall Street Journal supports small boards which are effective than huge boards.[152] For purposes of that study, GMI Ratings defined small

[152] https://www.wsj.com/articles/smaller-boards-get-bigger-returns-1409078628 accessed on 1st June, 2020.

boards as comprising a membership of 9.5 while the large board, 14 or more directors.[153] This study averred that the large boards had less time to give issues the necessary in-depth attention they required and hence, the board's decisions varied. Moreover, scheduling board meetings for such large numbers of board members was not cost-effective since the schedules of the members could not be easily synchronized. No wonder, General Electric Company decided to reduce the directors to provide for effective board size.[154]

Mumias Sugar Company had a unique shareholding structure; hence, the justification for the large board. However, attention should have been paid to the dwindling performance of the corporation between 2013 and 2019 for it to take strategic steps towards reducing the board size through attrition. Perhaps the board would have taken advantage of the small size boards to engage fully and own the decisions in revamping the company to profitability and therefore avoid corporate failure.

Mumias Sugar Company Board Size vs Financial Trend from 2013 to 2018

No of Directors	**Financial year**	**Loss (000,000)**
13	2013	1,670
13	2014	2,741
13	2015	4,645
12	2016	4,757
12	2017	6,774
12	2018	15,142

Source: **Mumias Sugar Company Annual Financial Reports**

[153] Ibid

[154] 2019 Notice of annual meeting and Proxy Statement. 56. Accessed through https://www.sec.gov/Archives/edgar/data/40545/000120677419000903/ge3496121def14a.htm#reduction_mim_number on 1st June, 2020.

It was incumbent upon the shareholders to vote to reduce the number of directors as a result of the dwindling fortunes of the company. However, such a decision could not be reached with the shareholding structure of Mumias Sugar Company due to the controlling power of the government of Kenya which was a substantial shareholder.

4.2.2 Diversity in Board Composition

Diversity in board composition has been moulded and enhanced by globalization and technological advancements. That notwithstanding, the diversity in board composition is also orchestrated alongside academic qualification, skills and industry knowledge, gender balance, age, ethnicity, religious beliefs and cultural background.[155] Further, the Constitution of Kenya, 2010 obligates the state to take necessary affirmative and legislative actions, policies and programmes that address diversity in race, sex, age, disability, religion or culture.[156] The fused diversity is fostered on all fronts of business to ensure a homogenous environment that raises innovativeness and creativity resulting in investments interests. Therefore, the board of directors in its diversity is projected to work jointly to warrant that management of the company is as per the interests of investors; hence, the need to undertake with reasonable care, skills and diligence.[157]

Section 142, the Companies Act, 2015 reaffirms the proper purpose doctrine formulated by Lord Green MR in Re Smith & Fawcett Limited (1982). It follows that if certainly, the directors in their diversity should exercise their authority for the proper purpose, it should be in good faith as stated in Section 143 of the Companies Act 2015. However, there is tension between two provisions such that any director who acts for the interest of the company in good faith but for a collateral purpose, permeated to be improper, the director may be guilty of abuse of office and or power. Furthermore,

[155] Thomas R Roosevelt, Beyond Race and Gender: Unleashing the Power of your Total Workforce by Managing Diversity AMACOM, New York 1991 at p. 15.
[156] Constitution of Kenya, 2010, Article 27(4).
[157] Companies Act, 2015, Part IX.

the obligation to advance the success of the corporation takes into account the interests of stakeholders affected by the corporation relations and performance and therefore, the directors must be keen not to engage in any collateral purpose even though it is in good faith and the interest of the corporation. Nonetheless, the predicament lies with the way the directors ought to conduct themselves with the creditors in the event of insolvency when they are also required to ensure sound decision making to keep the company afloat.

From the Annual Reports and Financial Statements of 2011, Mumias Sugar Company commenced the construction of the Ethanol Distillery at a contract sum of USD 41,869,344.54 and a Water Bottling plant at a sum of USD 3,448,000.00 which were both commissioned in 2012. However, the company had been experiencing the lowest crushed tonnes of cane since 2002. In the same year, the then Managing Director left to join competitive politics.

From the records at Mumias Sugar Company, the production of sugarcane was averagely the same until 2011 when it began nose-diving before 2015 when it worsened. It is recorded that the worsening productivity was due to shortage of cane and hence, idle time and less utilization of the factory. The diversification of business was meant to cover the idle time the sugar mill was not running. However, there was no indication of return on investment realized from these mega projects. This diversification was therefore not the proper purpose for the investment but a cover-up of the façade of profitability that had been perpetrated by the former regime of governance. It was evident that the managing director and the former regime of governance had not acted for the proper purpose.

When the National Assembly Committee on Agriculture, Livestock and Cooperatives investigated the crisis that was facing the sugar sector in Kenya in 2013, it established a massive false statement in the importation of sugar originating from Madagascar, a non-COMESA country. Another non disclosed 10,000 metric tons had been brought in by Msahle Commodities Ltd and Stutwave Limited while records at Mumias Sugar Company gave varying figures of these imports. [158] Interestingly, a former director moved the court and stopped the publication of any material or article that was linked to the forensic investigation at Mumias Sugar Company.[159]

A relatively authoritative and modern view of the board of directors' composition is diversity and mastery of numerous aspects of knowledge and skills of the industry. It is therefore expected that the fusion of expertise, skills and knowledge from the members of the board enables them to act and exhibit reasonable care, skill and diligence. This maxim was initially embedded in common law case of Donoghue vs Stevenson (1932) UKHL 100.[160]

The Companies Act, 2015 has also codified the above duty, but the composition of the board of directors in Kenya appear to function within the old framework of engaging directors based on social standing in societies and who more often than not, are neither skilled nor knowledgeable but have the necessary political standing or are former retirees from public service.[161] For instance, none of the 2018 members of the board at Mumias Sugar Company was a financial, agricultural or investments expert. Their reliance on skills, knowledge and expertise in these areas was on the members of the executive who could easily take advantage of the lack of the knowledge to advise the board for their interests leading to the continued corporate failure.

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[158]Report of The Departmental Committee on Agriculture, Livestock and Cooperatives, "The Crisis Facing the Sugar Industry in Kenya" (Kenya National Assembly, 2015) p. 10.

[159] https://www.businessdailyafrica.com/bd/corporate/companies/kidero-gets-order-to-stop-circulation-of-kpmg-report-on-mumias-sugar-2099374 accessed on 1st July 2019.

[160]Companies Act, 2015, s145.

[161]*Re Cardiff Savings Bank* (1892)2 Ch 100.

4.2.3 Independence in the Board of Directors

Board of directors' independence is one of the crucial aspects of directors' composition in public limited companies. Since the board of directors bears the responsibility of monitoring the activities of the corporation, the code recommends that boards should have more non-executive board members than executive board members. The presence of non-executive board members is aimed at making boards more independent in decision making which counterbalances the selfish interests of the executive board members. As such, the Companies Act, 2015 guides the initial directors of either private or public corporations.[162] The successive directors are appointed by members at an Annual General Meeting and their names are transmitted to the Registrar of Companies vide a notice of appointment.[163] Still, members of the company can resolve to remove a director before expiry of a term through an ordinary resolution during a meeting[164]

Public listed companies are subjects of the Codes provided by the Capital Markets Authority on the directors' appointment. [165] The Code of Corporate Governance for Issuers of Securities to the Public, 2016, however, has a lukewarm method of ***Apply or Explain*** which requires the shareholders to implement it. Given the shareholding design in the sugar sector in the Kenyan public corporation that is, Mumias Sugar Company, where the government of Kenya holds majority shares it largely influences and/ or controls the appointment of the directors detrimental to minority shareholders.

The effect of these controls is that the government appoints board members who may not be independent in executing their duties since they serve the interests of the government. The appointed directors may not be qualified or experienced in the governance of the sugar sector but

[162]Companies Act 2015, s128.
[163] Ibid, s138.
[164] Ibid, s139.
[165]Code of Corporate Governance for Issuers of Securities to the Public, 2016.

due to their affiliation to the political elites, they lack the necessary independence; hence, conflict of interests. For instance, it was reported that members of board of directors at Mumias Sugar Company Board of Directors together with the management had on some occasions exhibited conflicts of interest that indeed undermined the efforts of saving the company.[166]

The lack of guidelines on the retirement of board members is a thorn in the independence of the board of directors. Although the code limits multiple directorships, it is not clear when a board member should retire. For instance, the records at Mumias Sugar Company indicate that one member of the board served between 2013 until 2019. There is no new skill, expertise or knowledge that this member brought on the board and alongside her service, she lost her independence and was more likely an allowance seeker than an independent board member. Other members of the board and particularly a former managing director who served between 2003 until 2012 used the company as a political springboard; hence, lacked independence.

4.2 Conclusion

This chapter has demonstrated that Board composition is central to success of a corporation since they are central to decision making and are paramount to effective monitoring of the activities of the company on behalf of the shareholders. To function efficiently, board composition should be rooted in a robust legal and regulatory system that facilitates strategic and desirable initiatives in increasing the organization investment capital. These aspects are achievable through optimal board sizes and enhanced director independence and diversity that fuses knowledge, skills and expertise, which were majorly lacking at Mumias Sugar Company. Furthermore, the failure of these aspects was accelerated political interferences that hindered the strategic board of directors' composition to achieve good corporate governance leading to corporate failure. Furthermore, the legal and

[166]<https://www.the-star.co.ke/siasa/2015-01-17-mumias-sugar-on-its-deathbed/>accessed on July 19 2019.

regulatory framework is lukewarm and inefficient, not in its form but its implementation mechanisms on the size, diversity and independence of board of directors in public listed companies such as Mumias Sugar Company.

CHAPTER FIVE: THE EFFECT OF INTERNAL CONTROLS AND DISCLOSURE MECHANISMS IN THE SUGAR INDUSTRY IN KENYA.

5.1 Introduction

Internal controls and disclosure mechanisms have rapidly evolved in organizations due to rampant corporate failure. These mechanisms have evolved through modification or enactment of new laws skewed to avert financial and accounting scandals. More so, the legal and regulatory framework is being modelled to ensure that investors have confidence in corporations through provision of accurate information that facilitates sound investment decisions.

The provision of accurate and specific information to investors is embedded in the antiquity of 1929 stock market crash in the United States of America. At the time, the United States of America passed the Securities Act 1933 and the Securities Exchange Act, 1934. These Acts require that security issuers disclose specific information to investors. Furthermore, the Sarbanes-Oxley Act, 2002 was enacted to increase the accurateness of financial reporting, with specific provisions for internal control mechanisms.[167] Similarly, the Company Act requires that directors of each corporation prepare an individual fiscal statement for the corporation for every financial year.[168] Further, Capital Markets Authority requires that all listed companies on the Nairobi Stock Exchange disclose their financial results under the issuers' rules.[169]

This chapter examines the internal control and disclosure mechanisms in the sugar industry and its contribution to the corporate failure experienced by the sector. The chapter also examines the efficiency of internal control and disclosure mechanisms as anchored in the current legal and regulatory framework.

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[167] SOX, Section 4.
[168] Companies Act, 2015, Section 635.
[169] The Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations, 2002.

5.2 Internal Control Mechanisms

Internal control mechanisms are specific procedures designed by an organization to enhance efficiency in their operations, financial reporting and adherence to policies rules and regulations of the industry. Further, the internal control mechanisms warrant that there is a reliable form of fiscal reporting, risk assessment and appropriate response on the attainment of planned goals, compliance with regulations and laws. These controls are usually designed to fit the size of the organization, the complexity of its structure, the assessed risks and the attainment of the company's objectives. The rate of global corporate failure and in particular, the sugar industry in Kenya has awakened the attention of corporate governance practitioners in assessing ways in which the internal control mechanisms can be achieved.

The critical part of achieving these optimal internal control mechanisms is through awareness of the responsibilities assigned either by the legal and regulatory mechanisms or the internal control procedures. For instance, the members of the organization and specifically the audit committee of board of directors ought to understand their responsibilities or roles for internal controls from the onset and during the induction period, internalize the audit procedure and trails and the audit board committee charter. If these responsibilities are intentionally or accidentally overlooked, then the internal control systems failure results in corporate failure.

The Companies Act 2015 recognises the role played by corporations' gatekeepers such as auditors and statutory auditors. [170] These gatekeepers are expected to be independent in performing their duties and subject to the regulations by their respective professional bodies and Statutory Acts, for instance, the Certified Public Secretaries of Kenya Act Cap 534 of 1990, the Accountants Act No 15 of 2008and the Advocates Act, Cap 16 of 2012. These gatekeepers have various sanctions for

[170] Ibid, Part XXVII, Division 3.

failing to perform their duties professionally. When an independent review of the internal control system at Mumias Sugar Company was carried out by KPMG in 2015, it provided a candid report on the ills at Mumias Sugar Company. Unfortunately, the report could not be published since the then Managing Director obtained a court order to stop the publication of the audit report.

Record keeping is another important aspect of the internal control system implementation. Accurate record-keeping procedures enable an organization to have a reference point for clarification and continuity purposes. One of the greatest shocks in the aftermath of corporate failure of the sugar sector in Kenya was the widespread non-effective record systems and mechanisms. This necessitated the National Assembly, Committee on Agriculture, Livestock and Cooperatives to investigate the predicament that was facing the sugar sector in Kenya. The Committee established that there were rampant false declarations concerning the importation of sugar and it was evident that the internal control mechanisms did not detect the falsehood in the declaration records of imports leading to losses and eventual corporate failure at Mumias Sugar Company.[171] The company records had also indicated that it had only exported 52,284 tonnes of sugar but the Committee was informed that the company had exported 757,431 metric tons of sugar but there was no evidence of such mass export.[172]

Apparently, no insider blew a whistle on the nondisclosure of the fiction that took place at Mumias Sugar Company. This is due to the failure of the Kenyan legal system in protecting such whistle-blowers. Even though Anti-Corruption and Economic Crimes Act, 2003 has undertaken significant measures to ensure the protection of informers in corruption or economic crime cases, the protection is not sufficient to warrant risks involved in whistle-blowing in Kenya. Some of these

[171] Report of The Departmental Committee on Agriculture, Livestock and Cooperatives, "The Crisis Facing the Sugar Industry in Kenya" (Kenya National Assembly, 2015) p. 10.
[172] Ibid p. 10.

risks include death threats. With such risks, a culture of silence for fear of being killed persists. In the absence of proper whistle-blowing protection, the investors could not understand the extent of corporate failure at Mumias Sugar Company even though the employees were aware of the under dealings and ills that were ailing the industry.

The chief drive of risk assessment and management is to guarantee that the company does not encounter an outcome that is contrary to its objective. Even though business undertakings are generally risky, the avoidance of some of the risks ensures that the shareholders are not caught by surprise when they eventually happen. Mumias Sugar Company had many financial red flags noted and documented in their annual financial statements yet the board of directors did not take note of these through the risk assessment and management mechanism until when those risks could not be managed.[173] Although the government bailed the company financially, those bailout strategies were in effect not helpful since they did not address the problems but the symptoms of an effective risk assessment and management scheme brought about by an inefficient internal control mechanism.

Monitoring and oversight of revenue management, capital investment, and/ or procurement processes in an organization are tasks that are performed by professionals with specific specialization although the processes are interconnected. These processes are carefully monitored and nowadays, technologically controlled. Most of the company operating systems and processes at Mumias Sugar Company were, fortunately, computerised. These systems and processes ranged from internal audit system, internal human resource process, cane harvesting to payment of the farmers yet these systems and processes were compromised by the internal staff members to benefit themselves and therefore it was not possible to carry out an audit trail based on the records in the operating system of the company. Some records had been falsified or were changed by the staff

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[173]Benson Amadala, "Mumias Sugar Seeking Sh. 2bn More in Bailout" (September, 11, 2018) <https://www.businessdailyafrica.com/corporate/companies/Mumias-Sugar-seeking-Sh2bn-more-in-bailout>.

members in charge to suit their interests. Unfortunately, even the external auditors could not carry out a proper audit given the kind of records that were availed to them. The rampant corruption in the implementation of the internal system allegedly led to what the farmers referred to as computer farmers and the loss of earnings to rightful farmers.

> We used to have a very large workforce. What used to perplex me was the extra-large number of employees on the payroll. We were told that some workers were 'ghosts'. Maybe in future and if the company shall be revived the audit and control mechanisms should be such that they are able to account for each worker whether in the field or in the factory (Anonymous, 15/10/2019).

5.3 Disclosure Mechanisms

Disclosure mechanisms and procedures demand that corporations elucidate and publicize information, responsibilities and roles of managers with clear implementation procedures that independently authenticate and protect the integrity of the company's financial performance, situation, governance and ownership of the corporation.[174] To achieve the foregoing, the revelation must be timely, judicious with strict adherence to high-quality standards of accounting and fiscal and non-monetary disclosures.[175] Furthermore, the Constitution of Kenya, 2010 has provided for disclosure mechanisms through the provision for a right to access information.[176] The provision is reinforced by Companies Act 2015 and bestows upon a member of a corporation the right to scrutinize the organization's records.[177] Besides, the Act expects directors of a corporation to include fiscal statement particulars of all benefits that the directors have in the relevant year of the corporation's accounting. [178]

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[174] OECD, *Principles of Corporate Governance* (OECD Publications Service, 2004) p. 22.
[175] Ibid.
[176]The Constitution of Kenya, 2010, Art. 35.
[177] Companies Act, 2015, s635.
[178] Ibid, s650.

The Capital Markets Authority in Kenya underscores the main objective of disclosure as a tool for enhanced investor protection. It, therefore, follows that disclosure mechanisms have been designed to assure investors that their capital investment is protected. The outcry over the corporate scandals has called for more detailed financial disclosures by the investors. By implication, the agency theory avers that increased disclosure reduces conflicts between the agents and shareholders since there is more transparency and reliability in the disclosed financial information. It is in this vein that the Companies (General) (Amendment) Regulations, 2017 require directors to prepare individual directors' remuneration reports in two categories; information subject to audit and information not subject to audit.

Some of the information is however not subject to audit but ought to be recorded in the directors' annual remuneration report includes decisions made on directors' remuneration and any changes made to such remuneration, percentage of votes withheld, cast for, and against the report on directors' remuneration and remuneration policy, duration of directs contracts, notice periods and termination payments that can enable the shareholder to approximate the liability in event of such termination. The detailed information subject to audit includes directors' share options, emoluments and compensation, long term incentive schemes, pension, past directors' compensation and payment to third parties. These disclosures have, no doubt resulted in the detection of the excessive length of service by individual directors. They have also enhanced transparency in the remuneration of company directors. Disclosure concerning each director will result in disclosure of excessive length of stay and shareholders no longer guess what each executive director and non-executive director are paid.

The yearly reports and fiscal statements for 2004 -2018 indicate that the MSC recorded optimistic financial earnings after the contract with Booker Tate ended in 2003. In fact, in 2004 it recorded the highest profit in the history of the company and even achieved a high sugar production of 264,000 metric tonnes. This high production of sugar enabled the company to increase its distribution and visibility in the market. In 2005 the annual records indicate that MSC recorded the highest production of 269,184 metric tonnes and therefore the management embarked on a project to increase capacity to 300,000 tonnes the following year. The first major loss of Ksh.1.64 billion was recorded in 2014. Subsequently, the firm continued to make the losses and recorded the highest loss of Ksh.15.1 billion in 2018. These losses were attributed to a high turnover of staff and particularly the managers but a lot was not disclosed to benefit the investor.

> The KPMG audit report must have named big fishes that swindled the company of its fortunes that is why the very big fishes sought the court orders to prevent it from being implemented or made public. Employees in Mumias also became computer farmers, they planted sugar cane on the computer, harvested on the computer and paid themselves through the computer. That is why we think that the profits that were made in the year 2004 through to 2006 were very strange. Since we could not access the KPMG report, we suspect that the audit discovered very serious accounts manipulation and cheap sugar imports that had not been accounted for or disclosed. These are some of the issues that the auditors ought to have told the stakeholders but they were compromised by the management of MSC. These are the very issues that brought MSC down (S. Busolo, 14/9/2019).

The Companies Act, 2015 requires the directors to make annual business appraisal reports that comprise information about the employees of the company, social and community issues and the environment.[179] However, Section 655 of the Companies Act, 2015 permits directors to escape the responsibility if the business report indicates missing information in the report. Furthermore, sanctions are applicable where directors do not issue a business report but not when they fail in the preservation of the environment.

Although the Companies Act, 2015 provides for Corporate Social Responsibility, it does not provide that companies disclose any of their Corporate Social Responsibility activities.[180] Corporate

[179]Companies Act, 2015, s658.
[180] ibid

Social Responsibility provides companies with an opportunity to give back to the community it operates in hence sustainable development is enlisted in the Constitution of Kenya as a principle of good governance and national values.[181] However, Corporate Social Responsibility is unregulated by the government in Kenya and therefore, there are no sanctions for nondisclosure of financial expenditures on such activities. It, therefore, provides a conduit for corruption and pilferage of resources. In 2011, the records sampled at Mumias Sugar Company indicated that the company sponsored the Kenya National Music Festivals, the Kenya Schools and Colleges Drama Festivals and was the main sponsor of the Kakamega forest half marathon yet the annual financial records of the year did not indicate the exact cost of these sponsorships.

The only report that the directors are expected to include in their annual reports is on the environment.[182] The Environmental Management and Coordination Act (EMCA)[183] states that an environmental impact assessment study should be done and submitted to National Environment Management Authority for public participation and publication before the commencement of any project.[184] The core role of the impact assessment is to critically scrutinize the adverse and constructive effects of development on the environment and certify that company operations do not damage it.[185]

5.4 Conclusion

Arguably, the internal control and disclosure mechanisms are fundamental tools for managing investors' confidence in companies. They are the mandatory and common regulatory methods that the Capital Markets Authority and Nairobi Stock Exchange have used to safeguard

[181] The Constitution of Kenya, 2010, Art. 10.
[182] Companies Act, 2015, s655.
[183] No. 5 of 2015, Laws of Kenya.
[184]EMCA, 1999 , s58.
[185] EMCA, 1999, s59.

stockholders. Although internal control and disclosure mechanisms have promoted transparency, efficiency and confidence in the investment market, they have increased the costs borne by the shareholders in the publications of the financial statements. The chapter has demonstrated that the insufficiency in the internal control and disclosure mechanisms significantly contributed to the corporate failure of the Mumias Sugar Company through poor records and lack of sufficient information to investors to make informed decisions as was articulated by one of the suppliers.

> I supplied my services to the company for over ten years. Though we were aware that the company was not doing well, its total collapse caught us off-guard yet we had already offered them our services. Had we heard the exact information on the operations of the company, we would have been strategic with our investments. Instead, the managers kept us in darkness and kept on promising that the government was planning to pay us for our supplies. We are now forced to seek redress from the court based on the contract we had with them but again, there is no hope for payment (Anonymous: 15/9/2020).

CHAPTER SIX: LESSONS FROM INDIA: A STUDY OF E.I.D. – PARRY (INDIA) LIMITED

6.1 Introduction

India is amongst the world largest producers of sugar. It ranks second in the production of sugar after Brazil.[186] In 2019/2020, India produced about 28.5 million tons of sugar which accounted for about 17% of 166.8 million metric tonnes of sugar produced worldwide.[187] Sugarcane is amongst the most cultivated crops in India that is pivotal to the citizens' socioeconomic empowerment through provision of an income for about fifty million families and farmers and job opportunities for more than five (5) lakh expert and unskilled workforce in the sugar industry.[188]

6.2 Historical Development of the Sugar Industry in India: Case Study of E.I.D. – Parry (India) Limited

Sugarcane cultivation is believed to have begun in the northern part of India in the first century AD. [189] The first sugar factory in India was established in 1784 and it was privately owned by Crofters. In 1788 EID Parry (India) Limited was established by Thomas Parry a British trader. Subsequently, Thomas Parry established the first sugar factory in 1842 and in 1843 began to distil sugar. By 1845 the sugar business was so lucrative that the company initiated a farmer-centric model in the sugar manufacturing business, a model that is used to date by the sugar industry in India. Currently, E.I.D. – Parry (India) Limited is a limited liability company since 1928 and it is the largest and leading sugar company.

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[186] https://worldpopulationreview.com/country-rankings/sugar-producing-countries accessed on 2nd July 2020.
[187] Statista. 'Sugar production worldwide in 2019/2020.' https://www.statista.com/statistics/495973/sugar-production-worldwide/ Accessed Dec. 17, 2020.
[188] T.S. Krishnamoorthy Durgesh Nandhini, 'A Study on Sugarcane Production in India' (2017) International Journal of Advanced Research in Botany (IJARB) Volume 3, Issue 2.14.
[189] Tsugitaka Sato, Sugar in the Social life of medieval Islam (2014) BRILL p.1.

6.3 Ownership Structure of the E.I.D. – Parry (India) Limited

E.I.D. – Parry (India) Limited is a part of the INR 369 billion Murugapp Group. Its shareholding pattern is dispersed with the public holding shares of the company. In the 2019/2020 4th quarter, out of 52057 shares, only 55 shares were held by the promoter and promoter group (promoter is a unique term used in India to refer to founders and controlling shareholders) while the rest of the shares were held by the public. In essence, the shares were not concentrated in only a particular shareholder as is the case with Mumias Sugar Company where the government held 20% of the total share; hence, the majority shareholder. This afforded Mumias Sugar Company a chance to dominate the management and control of the company so much that the company only operated in the interest of government.

E.I.D. – Parry (India) Limited indicates a relatively sound stakeholders' engagement through their Annual General Meetings since the board has a committee representing the stakeholders' interests.[190] From the company's website, shareholders are properly notified of the general meeting and issued with attendance slips that contain the agenda of the meeting and a proxy form. The proxy forms offer a semblance of equal opportunity for attendance at the general meeting by the shareholders. Furthermore, the E.I.D. – Parry (India) Limited has provision for postal ballot.[191] This postal ballot is designed in a way that offers the shareholder an opportunity to ballot on any issue at general assembly without necessarily attending physical general meeting.

[190] https://www.eidparry.com/wp-content/uploads/2020/07/Quarter-ended-%e2%80%93-30.06.2020.pdf accessed on June 4, 2020.

[191] https://www.eidparry.com/wp-content/uploads/2020/12/Postal-Ballot-Notice-only-e-voting-Final.pdf accessed on June 4, 2020.

Stayam Computer Services in India experienced a corporate failure similar to that of Enron in 2009.[192] Since the Satyam scandal came to light, many changes have been prominently made to the securities laws that have seen the country adopt the ***'comply or else'*** method in enforcement of corporate governance issues.[193] This is in contrast to the Kenyan approach of "***apply or explain'*** which encourages box ticking mentality from the enforcers of the guidelines and expects that the shareholders take the lead in enforcing it; hence, giving the substantial shareholder an advantage over the minority shareholders.

6.4 Composition of Board of Directors of the E.I.D. – Parry (India) Limited

The frequency of global corporate failure has necessitated different jurisdictions in the world to vigorously improve their respective corporate governance mechanisms. India invigorated itself and enacted the Companies Act 2013 which superseded the Companies Act 1956. The invigoration partly, was an effort to get the board of directors' right. Section 149 of Indian Companies Act, 2013, a corporation is mandated to have a board of directors. As already discussed, the board of directors performs a cornerstone part in the corporate governance of a company. A healthy composition founded on board size, diversity and board independence is therefore key to attainment of the company's objectives.

6.4.1 Board Size at E.I.D. – Parry (India) Limited

Board size at E.I.D. – Parry (India) Limited consists of eight members. The membership of the board is small compared to what Mumias Sugar Company had yet E.I.D – Parry (India) Limited is

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[192] George Chen, 'Satyam scandal rattles confidence in accounting Big Four' https://www.reuters.com/article/companyNews/idINHKG30879120090108?edition-redirect=in accessed on June 2, 2020.
[193] Guest, 'Apply and Explain' – An Alternative Model of Corporate Governance https://indiacorplaw.in/2020/02/apply-and-explain-an-alternative-model-of-corporate-governance.html accessed on June 4, 2020.

flourishing with a very large shareholding than Mumias Sugar Company. As already explained E.I.D. – Parry (India) Limited would benefit most from what small board of directors offer such as commitment to the company affairs. The cost in terms of remuneration and meeting coordination is significantly reduced. This in turn reduces monitoring costs that the shareholder is burdened with.

6.4.1 Diversity at E.I.D. – Parry (India) Limited

In India, diversity of the board is a critical feature of corporate governance. Companies Act 2013, provides an ideal combination of knowledge, skills, qualifications, attributes and leadership skills that is required for board of directors to achieve diversity.[194] The board at E.I.D. – Parry (India) Limited consists of persons with high repute and is well blended to ensure that the high standards and compliance with the Companies Act, 2013, Indian laws, the Securities and Exchange Board of India Listing Agreement and rules on qualifications and appointment of Directors.[195]

Section 166 of Companies Act, 2013 Indian Laws enumerates the directors' duties which replicate the common law that Companies Act, 2015 Kenyan Laws reflects. The rationale for codification of directors' duties was to provide the promoters of companies a slate upon which to base when guiding the shareholders on what the diversity of the board ought to look like.

6.4.1 Board Independence at E.I.D. – Parry (India) Limited

Independence for directors is the most important part of board composition. Although the independence of directors is an objective that is yet to be achieved fully, E.I.D. - Parry (India) Limited endeavours to have more non-executive directors. From their records available on corporation's website, this research avers that the design of compliance is more of a box-ticking approach. This is because some of the directors are appointees of the promoter and promoter

[194] Companies Act 2013, Section 178(3).
[195] Companies Act 2013, Section 149(1), Rule 3 of the Companies (Appointment and Qualification of Directors) Rules 2014, Clause 49 of the Securities and Exchange Board of India Listing Agreement.

groups. It is unlikely that promoter appointed directors can have the requisite independence to protect the shareholders outside the promoters' interests. It is against this backdrop that the Securities and Exchange Board of India Advisory Board proposes an increase in transparency in appointment and removal of directors, especially those appointed by the promoters.[196]

6.5 Internal Controls and Disclosure Mechanisms at E.I.D. - Parry (India) Limited

India experienced a paradigm shift in internal control and disclosure mechanisms over internal control and financial reporting mechanisms that are similar to those adopted by SOX Act in the United States of America 2009.[197] This was as a result of Satyam Computer Services scandal, one of the biggest accounting scandals in India. Upon confession by the chairman of the Satyam Computer Services about the accounting falsification on several occasions, the share of the corporation fell to its lowest in January 2009 at 11.50 rupees from 588 rupees in the previous year.[198] Price Waterhouse Coopers who served as their independent auditors were fined by Securities and Exchange Board of India for not following the code in carrying out their duties and were barred from carrying out any audit functions in India for two (2) years.[199] To invigorate its company laws, India enacted the Companies Act, 2013 that expects directors to design internal fiscal controls and disclosure mechanisms which a company ought to follow and, which should be adequate and operate effectively.[200] Furthermore, it is now mandatory that auditors comment on design and the efficacy of internal controls and disclosure mechanisms.[201]

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[196] https://www.sebi.gov.in/reports-and-statistics.html accessed on June 4, 2020.
[197] George Chen, 'Satyam Scandal Rattles Confidence in Accounting Big Four' https://www.reuters.com/article/companyNews/idINHKG30879120090108?edition-redirect=in accessed on June 2, 2020.
[198] George Chen, 'Satyam Scandal Rattles Confidence in Accounting Big Four' https://www.reuters.com/article/companyNews/idINHKG30879120090108?edition-redirect=in accessed on June 2, 2020.
[199] Ibid.
[200] Companies Act, 2013 section 134 (5) (e).
[201] Ibid, Section 143 (3) (i).

The Companies (Accounts) Rules 2014 also expects that the board of directors account for the suitability of internal financial control in relation to the financial statements.[202] Further, the company Chief Executive Officer is expected to maintain and report the internal control mechanisms to Securities and Exchange Board of India. Additionally, Chief Executive Officers of all listed companies are expected to specify to auditors and audit committees any variations in the internal control and accounting policies.[203] Clause 49 of the Listing Agreement requires that corporations provide specific account disclosures, if there is any deviation from the accounting standards, proceeds from all shares among other requirements. This clause demonstrates the robustness of corporate disclosures that are expected from listed companies in India and E.I.D. - Parry (India) Limited being among the listed corporations has lived up to the expectations.

E.I.D. - Parry (India) Limited recognizes importance of timely, accurate information disclosure that is accessible by the shareholders and stakeholders to make informed decisions on future investments. Indeed E.I.D. - Parry (India) Limited is consistent in posting quarterly reports on their website.[204] The traditional means for communication in many organizations has been through annual reports that are circulated during the annual general meetings. However, the internet has provided media that augments the traditional communication forms in recognition of the international nature of some companies and in an endeavour to ensure timely information reaches all the shareholders and any interested stakeholder. As such, E.I.D. - Parry (India) Limited has effectively embraced this media and uses it optimally for its internal control and disclosure mechanisms.

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[202] Rule 8 (5) (viii).
[203] Listing Agreement between a company and the Stock Exchanges, Clause 49. accessed on www.sebi.gov.in on June 4, 2020.
[204] https://www.eidparry.com/financials/ accessed on June 4, 2020.

6.6 Conclusion: Lessons from India on Preventing Corporate Failure in Corporations

This chapter has established that India is not immune to corporate failures as evidenced by the case of Satyam Computer Services in 2009. Therefore, the Companies Act, 2013 (Indian law) just as Kenyan Companies Act, 2015 has endeavoured to align the aspects of corporate governance mechanisms for optimum performance of corporations. While the Kenyan sugar industry has experienced corporate failure due to various aspects pointing to corporate governance, the Indian sugar industry indicates success based on corporate governance as much as it has also had other challenges not related to corporate governance. The success of the Indian sugar industry is therefore a pointer to probable robustness of its legal and regulatory framework that anchors proper ownership structure, composition of board of directors with proper internal controls and disclosure mechanisms. Further, the following lessons were imported from the study:

6.6.1 Historical Development of the Sugar Sector in India

The sugar sector in India is older than the Kenyan industry. While the Indian sugar industry just like the Kenyan sugar industry began as a privately owned sector, the Indian industry embraced a farmer-centric model that is practised to date thereby, allowing the participation of the minority shareholders and stakeholders in the control of the industry. Unfortunately for the Kenyan sugar industry, it failed to adopt a farmer-centric model yet the farmers are historically, the resource providers of the industry.

6.6.2 Ownership Structure of the Indian Sugar Industry

The study has established that the sugar industry in India is operated mostly on partnership, limited company and public company formation. With particular reference to E.I.D. – Parry (India) Limited, this study established that the ownership was mostly dispersed because business investors pulled their resources together to be more competitive. For instance, the history of E.I.D. – Parry (India) Limited indicates that the corporation ventured into partnership that led to dispersed shareholding as follows:-

Year	**Activity**	**Shareholding**
1788	Thomas Parry established the business	Concentrated
1789	Thomas Parry joins with Thomas Chase in partnership.	Dispersed
1790	Chase Parry & Co joined by Henry Sewell as a third partner.	Dispersed
1792	The Company is wound up.	
1795	Thomas Parry and Company is formed.	Concentrated
1819	Parry enters into partnership with John William Dare to form Parry & Dare.	Concentrated
1928	Parry & Dare is registered as a limited liability Company and renamed Parry & Company Limited.	Dispersed
1981	E.I.D. – Parry (India) Limited was registered in Chennai (Erstwhile Madras) around 1975 and in 1981 the company became a part of Murugappa Group.	Dispersed
2010	E.I.D. – Parry (India) Limited acquires GMR Industries Limited, subdivides shares and sells them off.	Dispersed
2019	Out of 52057 shares, only 55 shares were held by the promoter and promoter group	Dispersed

Source: https://www.eidparry.com/about-us/our-history[205]

From the above analysis, there is no substantial ownership and the government does not participate in the control and management of the sugar industry. In fact, the sector is primarily dominated by public limited companies or private limited companies. The sugar industry is therefore purely privatized in India.

[205] Accessed on 15/09/2021.

6.6.3 Composition of the Board of Directors

The research revealed that the board of directors comprised eight (8) directors, with only one executive director and seven (7) non-executive directors. These arrangements exude independence in decision making. Furthermore, the diversity in knowledge, skills and experience is evident in the composition of the board. While the chairman of the board was an engineer with a postgraduate Diploma in Management and has wide experience in the management of other corporations, other board members are either accountants, agricultural scientists, chemical engineers or biochemistry graduates with diverse experience in the management of big corporations.

The lesson for the Kenyan sugar industry is to have a board of directors that comprises of people who have diverse knowledge, skills and experience in the operation of industrial machinery, general operations, management and even research in cane cultivation. As such, they are able to guide and make informed decisions for the control and operation of the industry appropriately.

There is an indication of a transparent appointment of the non-executive board members as evidenced by their appointment letter available on the website and which restates the Companies Act, 2013 provisions. This point towards a semblance of transparency with an indication of independence on appointment of directors. A further lesson for the Kenyan sugar industry is that the appointment of directors should be purely left to the shareholders as envisioned by the Companies Act, 2015 and not based on political affiliation.

6.6.4 Internal Controls and Disclosure Mechanisms

The study established that the internal controls and disclosure mechanisms at E.I.D. – Parry (India) Limited were strictly adhering to the legal and regulatory mechanisms. E.I.D. - Parry (India) Limited's website consistently posts quarterly reports and the company has also shifted from its traditional means of communication through printed annual reports to the provision of information through their website. The website is easy to navigate and very informative for any investor who wishes to make an informed decision about their investment.

The lesson for the Kenyan sugar industry and particularly Mumias Sugar Company is to invest in electronic communication and provision of adequate information on the corporation's internet site. The Kenyan sugar industry has websites which are outdated, inaccurate and not informative for anybody including researchers to establish the control and management of the corporations.

CHAPTER SEVEN: FINDINGS, CONCLUSION AND RECOMMENDATIONS

This Chapter of the study provides; a summary of the research findings, conclusion and recommendation to the study.

7.1 Findings of the Study

The key objective of this study was to review, analyse and identify the impact of ownership structure, board of directors' composition and effects of internal controls and disclosure mechanisms on performance of the sugar industry in Kenya and how these elements of corporate governance have contributed to the collapse of the sugar industry in Kenya. To achieve the objective of this thesis, a study of Mumias Sugar Company was undertaken. From the research, it was established that the success of the sugar sector is reliant on the efficacy of the corporate governance system adopted by corporations in the sector.

This study illustrated that failed corporate governance in the Kenyan sugar industry, particularly Mumias Sugar Company, adversely impacted social and economic welfare of all the shareholders and stakeholders who include the small-scale sugar cane farmers, the creditors, suppliers, employees, the government of Kenya and even the community and chain of businesses in which the company operated. While some shareholders and stakeholders lost their investment, and confidence in the sugar sector, other stakeholders who depended either directly or indirectly lost an opportunity that supported their livelihood or employment. This has resulted in social adversities such as school dropout, increase in crime rates, drug addiction and stalled community outreach programmes.

According to recent auditing, Mumias Sugar Company is indebted to a sum of Ksh 15 billion owing to debts and unpaid creditors. To blame is the failed corporate governance which is attributed to varying reasons as outlined in detail in the subsequent paragraphs.

7.1.1 Ownership Structure and the Performance of the Sugar Sector in Kenya

The ownership structure in corporate entities no doubt translates to their management hence the performance. Therefore, whether an entity is publicly or privately owned plays a key role in its management. This also applies to concentrated ownership. The ownership structure of the sugar sector in Kenya has changed significantly since its inception. In the colonial and post-colonial times, all sugar companies were privately owned. This, however, changed after the Republic of Kenya attained independence and the government of Kenya was involved directly in the control and management of the sugar industry. Presently, most of the sugar corporations in Kenya are owned by the state while only one is public owned and others are privately owned. Unfortunately, all the state-owned and publicly owned sugar entities are insolvent. The only successful sugar entities in Kenya are now all privately owned.

Although Mumias Sugar Company was privatized in 2001, most of the shares were held by the Government of Kenya, thereby making it the majority shareholder. This study merited the shareholding structure and established that it has been the cause for most of the corporate governance failure in the sugar industry. This is because the government enjoys so much control and shapes the decisions and management of the corporations. The ownership structure of Mumias Sugar Company was no less different from the State-owned sugar enterprises and therefore, the impact of this concentrated ownership structure is that the control and management of the same were vested in the owners, herein the Government. The decisions relating to the control and management of the sugar companies were overly left to the Government hence the politicization of the entity. This, therefore, led to managerial inefficiency and ineffectiveness and subsequent unsound financial decisions without and in disregard of shareholders and stakeholders' input. To remedy the challenge, the researcher proposes separate or diverse ownership of sugar industries in Kenya.

7.1.2 Composition of the Board of Directors in Corporate Entities in Sugar Industry in Kenya

This study established that discourses on corporate governance indicate the centrality of composition of board of directors at shaping the success or otherwise of the corporate entity. The study contends that proper composition of the board of directors in pursuance of sound legal and regulatory framework is pivotal in steering a corporate entity into success. However, attaining a proper composition of board of directors' demands *inter alia* optimum board sizes, higher independence of the directors, and diversity in terms of expertise and knowledge.

However, the study indicates that most corporate entities in Kenya do not have proper board composition, which adversely impacts the efficacy of the corporate governance. This study has illustrated that Mumias Sugar Company did not embrace the above yardsticks on proper board composition. The inadvertent consequence of the preceding trend was that the board's composition became compromised due to political reasons which negatively derailed the independence of the directors. As a result, the board was unable to reach independent and viable investment decisions, resulting in massive losses attached to the company and the sugar industry in extension, hence the economy at large. In this regard, the study posits that the Kenyan sugar industry has and is experiencing corporate failure due to the reason *inter alia* improper composition of the board of directors. Noteworthy, however, this is also rooted in inadequate legal and regulatory framework coupled with poor implementation of existing framework as far as the board's composition is concerned.

7.1.3 Internal Controls and Disclosure Mechanisms in Sugar Sector in Kenya

The study sought to examine how impactful internal controls and disclosure mechanisms have been on the corporate failure in the sugar industry in Kenya. As discussed in detail under the fifth chapter of this study, effective internal controls within a corporate are indispensable in attaining efficiency in operations, proper financial reporting as well as ensuring adherence to the policies and regulations of the industry. In similar strength, corporate entities are also required to devise appropriate and effective disclosure mechanisms to enhance accountability in expenditures and investment. Indeed, the Companies Act, 2015 requires that companies develop auditing mechanisms through the appointment of the auditors to ensure accurate evaluation and reporting of the company's financials. This should be alongside constant and consistent monitoring of the risks associated with the corporation's activities.

Despite the above yardstick for gauging proper corporate governance, the research indicates that Mumias Sugar Company failed to adhere to them. In particular, the board of directors failed to ensure proper record keeping of the entity's financials. In fact, despite the red flags raised on the viability of the company, the board failed to undertake effective and timely risk assessments to test the prospects of the investment. This resulted in poor investment and unaccounted embezzlement of corporation's assets.

In light of the foregoing, the study attributes the failed corporate in the sugar industry to inadequate or lack of proper internal controls and disclosure mechanisms. Essentially, the sugar industry is fraught with inaccurate auditing and risk assessment of the entities' financials. This results in poor investment strategy and embezzlement of the company's finances as was the case in Mumias Sugar Company.

7.2 Conclusion

The sugar industry in Kenya suffers as a consequence of failed corporate governance. According to this research, sugar companies in Kenya are run in disregard of the desirable principles of corporate governance. The collapse of Mumias Sugar Company succinctly illustrates failed corporate governance in the administration of the sector attributable to various factors.

First, the historical background of the sugar industry set the stage for failure. This began as soon as the government became directly involved in the sugar industry. As already discussed, and established, state-owned entities are not meant for profit-making. On that basis, the participation of the government in the sugar sector was a pointer to a potential failed sector.

Secondly, there is an overconcentration of ownership of the sugar companies in Kenya that is held by the government. At the time of this study, most of the sugar corporations were state-owned, with the implication that the Government enjoys maximum active control and management over the sugar industry. This has diminished the competitiveness of the industry and resulted into the politicization of the management of the sector and subsequent embezzlement of funds through improper investments and corrupt practices.

The third challenge resulting in failed corporate governance in the sugar industry is poor or inappropriate composition of board of directors. Through lens of Mumias Sugar Company, the study has illustrated that the board's effectiveness and efficiency is derailed by lack of independence in decision making due to political backlashes, inadequate expertise and minimum diversity. On the other hand, the lack of internal controls and inadequate disclosure mechanisms in sugar companies has hindered transparency in the administration of the corporation's finances. The net effect of the preceding has been failed corporate governance hence massive losses in the sugar industry. This notwithstanding the centrality of the industry to the economy at large. For instance, the collapse of the Mumias Sugar Company left many Kenyans jobless and weakened the country's economy.

The study therefore argues that instilling efficient corporate governance is critical in re-awakening and sustaining the success of the sugar industry in Kenya.

7.3 Recommendations

To enhance corporate governance which will ensure the success of the sugar industry in Kenya, the study makes the following recommendations;

- Re-Structure Company Ownership and Privatize the State-Owned Entities of the sugar industry in Kenya. There should be a separation of ownership of sugar companies in Kenya. In this regard, there should be a reduction in the overconcentration of government ownership to minimize the politicization of the management of the sugar company. County governments can be capacitated as strategic partners in the restructured company ownership. One of the ways to attain this would be through privatization of the state-owned sugar enterprises.
- Although the Companies Act, 2015 has brought about a lot of reforms in corporate governance mechanisms, particularly the protection of minority shareholders, the unusual reforms that are being undertaken through statutory amendments should be subjected to proper public participation from both the shareholders and stakeholders, particularly, the

small-scale farmers, the creditors, suppliers, financial institutions and the county governments in which the companies operate in.

- The existing legal and regulatory framework should be made robust enough to reinforce and implement the full effect of the board diversity, size and independence of board of directors. To achieve this, a sugar specific legislation should be enacted to ensure the robustness of the legal and regulatory framework on composition of board of directors and implementation of internal controls and disclosure mechanisms with concisely enumerated duties and powers of directors.
- The sugar industry's visibility in the agriculture sector should be recognized through a policy formulation environment that is speedy, purposeful, result-oriented and all-inclusive. In an effort to revive the industry, the policy formulators should undertake a proper risk assessment prior to the investment in the industry. This would ensure that viable investment strategies are adopted to avoid losses to sugar companies' assets.
- Further studies of successful sugar industries in the world can be undertaken to import lessons to Kenya.

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APPENDIX I – RESEARCH LICENSE

REPUBLIC OF KENYA

NATIONAL COMMISSION FOR SCIENCE,TECHNOLOGY & INNOVATION

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Date of Issue: **09/September/2019**

RESEARCH LICENSE

This is to Certify that Ms.. MILDRED SIMIYU of University of Nairobi, has been licensed to conduct research in Kakamega on the topic: Corporate Failure in the Sugar Industry: A case study of Mumias Sugar Company for the period ending : 09/September/2020.

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APPENDIX II – CONSENT FORM

Consent Form

My name is Mildred Nafula Simiyu. I am a student at the University of Nairobi, School of Law, researching on Corporate Failure of the Sugar Industry in Kenya: A Case Study of Mumias Sugar Company. As part of the partial fulfilment for the award of the Degree of Master of Laws (LL.M.) of the University of Nairobi, I request that you voluntarily participate in this interview. It will take about one hour. In carrying out this research, I do not anticipate any risks, but you are free to withdraw from the interview at any time. Furthermore, you do not have to answer all the questions. Your participation is confidential and your identity will not be divulged to any person. However, should you wish to be quoted, please indicate so.

I wish to understand the following:

(i) The historical development and governance of the sugar industry in Kenya;
(ii) The impact of ownership structure of the sugar industry;
(iii) The effect of board of directors composition in the sector;
(iv) The consequences of internal controls and disclosure mechanisms in the sugar industry in Kenya.

If granted permission, I will record the conversation to facilitate my accurate transcription of this interview. I also undertake to safeguard the recordings from unauthorized use, access and modification after the research is finalized. I also undertake to discard the recordings after use.

No costs shall be incurred by you except your time. There is also no payment for the participant in this interview since the research is for academic purposes.

I confirm that I have understood the above information and agree to participate in this interview voluntarily.

Name…………………………………………Signature………………………………

Date …………………………………………………..

APPENDIX III – INTERVIEW GUIDE FOR SHAREHOLDERS/STAKEHOLDERS

Interview Guide: For Shareholders/Stakeholders

Profile of the Respondent

Name of the Study Area	Mumias East
Location	
Name of the Respondent	
Gender	
Age of the Respondent	
Economic Activity	
Date of Interview	

1. What is your business or role with MSC? Farmer/Supplier/Creditor?

2. What is the history of Mumias and Mumias Sugar Company in general?

3. What is your view about the historical and current ownership, board of directors' composition and internal controls and disclosure mechanisms at MSC?

4. How has the current status of Mumias Sugar Company affected you or the community around you?

5. Are you aware of any legal and regulatory body that protects you as either a shareholder or a stakeholder?

6. At any one point, do you ever feel like the law and the regulatory bodies have or have not protected your rights, roles or engagement with MSC? How?

7. What do you think has led to the current status of Mumias Sugar Company? Ownership structure? Board of Directors composition or lack of internal control and disclosure mechanisms.

8. What are your recommendations about the operations, status and control of Mumias Sugar Company?

APPENDIX IV – INTERVIEW GUIDE FOR FORMER/CURRENT MSC EMPLOYEES

Interview Guide: For Former/Current MSC Staff

Profile of the Respondent

Name of the Study Area	Mumias East
Location	
Name of the Respondent	
Designation	
Gender	
Age of the Respondent	
Economic Activity	
Date of Interview	

1. When were you engaged by MSC? Are you still an employee or you have since left, if so when?

2. What is/was your role in the management and governance of Mumias Sugar Company?

3. Have you or did you experience any governance challenges while discharging your duties? I may guide you on this for example, what was the ownership structure of the industry like, the composition of the board of directors and the internal control and disclosure mechanism?

4. How were those challenges responded to (if any)?

5. Are you aware of any legal and regulatory framework that governs the sugar industry? And if you are has it been of any help in the industry? Let us limit ourselves to just three issues that is, ownership structure, and the composition of the board of directors, internal controls and disclosure mechanisms?

6. Who in your view should play a role in the management or control of Mumias Sugar Company? How about the employees, the creditors and even the community around?

7. How have you been affected by the current status of the Mumias Sugar Company? Please state how?

8. What would you recommend towards the management and governance of the sugar industry and particularly Mumias Sugar Company?

APPENDIX V – INTERVIEW GUIDE FOR COUNTY GOVERNMENT OF KAKAMEGA OFFICIALS

Interview Guide: For County Government of Kakamega Officials

Profile of the Respondent

Name of the Study Area	Kakamega County
Location	
Name of the Respondent	
Designation	
Gender	
Age of the Respondent	
Economic Activity	
Date of Interview	

1. When was Mumias Sugar Company established?
2. Are its operations now the same as they were when it was established? Why?
3. Is there any role you play in the governance of Mumias Sugar Company?
4. Are there any legal or regulatory hurdles you have experienced when playing your role in the governance of MSC?
5. In your view what impact has Mumias Sugar Company had on the people of Mumias or Kakamega County at large?
6. Who in your view should play major roles in the management and governance of the sugar industry?
7. What are your recommendations for the future of Mumias Sugar Company?

TRANSCRIBED RESPONSES

Responses from Shareholders/Stakeholders

1. **What is your business or role with MSC? Farmer/Supplier/Creditor?**

    - I was a farmer and a shareholder of the Mumias Sugar Company through Mumias Outgorwers Company (MOCO). It collapsed and our assets are still with it.

2. **What is the history of Mumias and Mumias Sugar Company in general?**

    - **Answer 1:** I was a teenager when Mumias Sugar Company was built in the early 1970s. We used to cultivate only foodstuff such as groundnuts, cassava and maize on my grandfather's land and consumed everything as a family.

    Why did it collapse?

    - People who worked at MOCO were mostly politicians. As much as it was a farmer's cooperative society but the managers were appointed by the political class so there was a lot of corruption and theft of assets.

    - **Answer II:** the factory was built in early 1970 when my family was moved to pave way for its construction. My grandfather had a title for his land in Shibale where we lived together as a clan on different neighbouring farms. We were however relocated when the company was being built and allocated land elsewhere. The relocation earned the Wanga clan a name and now we are referred to as ***Abahuyi*** meaning "movers" in Luhya.

3. **What is your view about the historical and current ownership, board of directors' composition and internal controls and disclosure mechanisms at MSC?**

    - When Mumias Sugar Company began, it was well managed by Booker Tate. We did not even know how the management operated. All we did was to supply them with cane and get paid. This place was doing very well. In fact, we had better schools, we had water and even a hospital. People were employed and if you walked around during the day, you would never have seen people idling around like today. There were no drunkards, we had no petty thieves and everyone was either busy with ensuring that their shops are operational because there was business. When Mumias Sugar Company collapsed, it was disastrous. I do not think I have enough time to explain to you how we have suffered. Businesses have failed, the crime rate is so high, we have no clean water, we cannot access cheap hospitals, the roads are bad, the sports field are destroyed, and there are many school dropouts.

4. **How has the current status of Mumias Sugar Company affected you or the community around you?**

    - **Answer 1:** As you can see I am now frail, I have no money to take myself to the hospital. I was a rich man those days, now look at me.

    - **Answer II:** I had invested in sugar cultivation. I used to get school fees for my children from the sale of sugar cane, I was even driving the track you see outside there but now I have no money, I have uprooted my sugarcane plantation because the last three harvests have not been paid to us to date.
    - My children used to attend good schools such as the Booker Academy but now I cannot afford fees in such good schools. I feel like I am a failed parent.

5. **Are you aware of any legal and regulatory body that protects you as either a shareholder or a stakeholder?**

    - **Answer 1**: even if I was aware, of what help is it to me now. They have taken everything from us and they never even involve us in making those laws.

    - **Answer II**: yes I am aware but it is of no use now. It would have been of use if we were involved in making some of these laws because we the small scale farmers are the ones that support the sugar companies to survive but nobody talks to us when they are formulating laws. And if they want our views, like you today, you don't pay us anything.

6. **At any one point, do you ever feel like the law and the regulatory bodies have or have not protected your rights, roles or engagement with MSC? How?**

    - **Answer 1:** The law has not protected me at all. I can't start explaining to you again.

    - **Answer II:** if there is any law in the sugar industry, then it is the one that has messed us up. I feel very bitter about the whole thing about Mumias Sugar Company

    - **Answer III:** The law would have protected the sugar industry in Kenya. I say so because I headed Kenya Sugar Board but there was a lot of politics involved and right now there is very little that can change in terms of what the Sugar Directorate can do for the sugar industry as long as it remains answerable to the government through the Ministry of Agriculture. This is because all the decisions that are made in the board room of the directorate may or may not be approved by the Ministry of Agriculture. Some powerful politicians are capable of influencing the board room decisions of the directorate. When I was the board chairman, I did not know sometimes, that the Ministry of Agriculture had initiated sugar imports. Big sugar barons would get the contracts of importing sugar directly from elsewhere. The law therefore cannot do much right now if the politics in the sugar industry are still there.

- **Answer IV:** The KPMG audit report must have named big fishes that swindled the company of its fortunes that is why the very big fishes sought the court orders to prevent it from being implemented or made public. Employees in Mumias also became computer farmers, they planted sugar cane on the computer, harvested on the computer and paid themselves through the computer. That is why we think that the profits that were made in the year 2004 through to 2006 were very strange. Since we could not access the KPMG report, we suspect that the audit discovered very serious accounts manipulation and cheap sugar imports that had not been accounted for or disclosed. These are some of the issues that the auditors ought to have told the stakeholders but they were compromised by the management of MSC. These are the very issues that brought MSC down.

7. **What do you think has led to the current status of Mumias Sugar Company? Ownership structure? Board of Directors composition of lack of internal control and disclosure mechanisms**.

- **Answer 1:** I think the government led to the current status of Mumias Sugar Company, they directed everything in the company and appointed all the board of directors who did not even give us information about the performance of the company. We only relied on rumours after MOCO collapsed too. When we were to go and vote for Directors, we were always told that the list has already come from Nairobi. At one point we thought our attendance at the AGM was useless. In any case, these AGMs were held in Kisumu yet we were not facilitated to attend. The end of year balance sheets were never also given to us, so we did not know if the company was making profits. There was also a lot of corruption. For example, some people did not grow sugar cane but earned it from the company because they used to steal from us. The worst was when they brought about the issue of having the records of cane deliveries on the computer. Those records were never accurate. How do you deliver three Lorries of cane and end up having a deficit in the payment? Have you ever heard of that?

- **Answer II:** Those people who seat on the Board and the people who managed the company were usually appointed by the government. We only heard that some board members had resigned and others had been appointed. The AGM used to be held in Tom Mboya College in Kisumu which required a lot of money to travel to, so we left it to those who could travel to attend the meetings, then we were told the outcomes.

- **Answer III:** I supplied my services to the company for over ten years. Though we were aware that the company was not doing well but its total collapse caught us off-guard yet we had already offered them our services. Had we been involved in the governance of the company; we would have helped with ideas of reviving it before it became this bad. We are now forced to seek redress from the court based on the contract we had with them but again, there is no hope for payment.

- **Answer IV:** When KSB noted that there was embezzlement of funds, we raised the alarm with Capital Markets Authority. This is because we were the watchdogs of the farmers. But what followed was the call for the disbandment of Kenya Sugar Board and indeed we were disbanded.

8. **What are your recommendations about the operations, status and control of Mumias Sugar Company**?

- The government should stop meddling in the sugar industry.
- We as farmers should be involved in planning for the revival and sustainability of the industry.
- The law should be clear and harsh to the corrupt officials in the sugar industry.
- We should be able to get constant updates.
- The country government should also be involved in the governance of Mumias Sugar Company.

Responses from Former/Current MSC Staff

1 When were you engaged by MSC? Are you still an employee or you have since left, if so when?

Answer I: I was employed in 2001 when Booker Tate was still managing the company. I was however retrenched in 2015. I was also a sugar cane farmer. In the year 2004, I received some very good dividends from cane farming. As an employee, we all got some bonus that year due to the huge profits the company had made. We, however, wondered what miracles the new manager had employed for the company to make such profits. However, we thanked God for his grace for the profits.

Answer II: I was employed in 2003 and left in 2018 due to non-payment of salaries.

2 What is/was your role in the management and governance of Mumias Sugar Company?

Answer 1: I was a clerk and a shop steward.
Answer II: I was an accounts clerk.

3 Have you or did you experience any governance challenges while discharging your duties? I may guide you on this for example, what was the ownership structure of the industry like, the composition of the board of directors and the internal control and disclosure mechanism?

Answer I: The government owned most of the shares. It also appointed the board of directors. Some of these directors were just coming to get allowances and were even the ones that messed the procurement system in the company for their interests. We were never informed of anything about the performance of the company. We only saw the accounts sometimes in the paper or we heard about them through grapevine.

Answer II: We used to have a workforce a very large force. What used to perplex that the records showed that we were so many yet we could see a handful of us around. There were many ghosts or computer-generated (*vifaranga vya compute*r) workers but since we were not involved in the governance of the company, we could do very little about it. Maybe in future, and when the company is revived, a shop steward should be allowed to seat on the board so that he/she can represent the employees' grievances.

Answer III: I worked at Mumias Sugar Company for over twenty years. Despite the losses, we made, we still procured goods and services without following procurement procedures. Tenders were usually secretly awarded by the senior managers and externally officers before they were opened.

4. How were those challenges responded to (if any)?

The government of Kenya, the board of directors and the management of the company responded to them without involving us.

5 Are you aware of any legal and regulatory framework that governs the sugar industry? And if you are, has it been of any help in the industry? Let us limit ourselves to just three issues that is, ownership structure, and the composition of the board of directors, internal controls and disclosure mechanisms?

Answer I: Yes I am but it was repealed. The Capital Markets Authority did not do much to help us other than threaten the management through letters and news bulletins but nothing much was done to them.

Answer II: Yes I am but I have not known its effect in any of those questions you are asking.

6 Who in your view should the county government play a role in the management or control of Mumias Sugar Company? How about the employees, the creditors and even the community around?

Answer I: Yes they should because now they are the closest government around
Answer II: Yes they should after all they even bailed the company recently, but they should not be allowed to operate like the way the government of Kenya operated. They should be given very few roles to play in the control of the industry.

7 How have you been affected by the current status of the Mumias Sugar Company? Please state how?

- I am jobless, I cannot support myself and my family.
- We can't afford health care because we were getting it free.
- I resorted to drinking alcohol to forget my problems but then that does not help me at all.
- Indeed we are very poor now.

8 **What would you recommend towards the management and governance of the sugar industry and particularly Mumias Sugar Company?**

- The government should stop playing a major role in the governance of the sugar industry.
- If the government stops then the board of directors will not be friends and relatives of politicians.
- The companies can then operate like Butali Sugar Company which is now run by Indians.
- We get an investor and the shareholders are listed and known to the farmers.
- The law that governs should be enacted quickly. When the sugar act was repealed, we now do not have a framework upon which robust regulations can take place as was the case with Kenya Sugar Board.
- I am aware the government has been looking for an investor to take over Mumias Sugar Company but the government should not just release the company to the investor but make sure that our rights as the farmers and shareholders are also protected.
- Again it takes so long for something to be implemented, every time something is about to happen we are told parliament has not done one or two things.

Responses from the County Government of Kakamega Officials

1 **When was Mumias Sugar Company established?**

I will provide you with written information on this you can transcribe it at your pleasure.

2 **Are its operations now the same as they were when it was established? Why?**

The operations are not the same. From the records I have shared with you, you can see that Mumias Sugar Company began failing in 2013 or even earlier.

3 **Is there any role you play in the governance of Mumias Sugar Company?**

Although we bailed them out with some Ksh.200 million, there is no role we play. We are just well-wishers (laughs).

4 **Are there any legal or regulatory hurdles you have experienced when playing your role in the governance of MSC?**

- Yes, there are. First, I feel like we are not a part of the ownership structure and therefore are strangers to the company.
- Secondly, the board of directors do not represent our interests as a country government.
- Thirdly we hardly get any updates on the company.

5 **In your view what impact has Mumias Sugar Company had on the people of Mumias or Kakamega County at large?**

- When it was operating well, those people were rich. I am told they could joke around and threaten to beat up someone and pay them. Right now there are so many problems in the areas that surround their lives.
- There is no water in the area and the county government is trying to get them boreholes.
- There are no good roads.
- The crime rate is very high.
- Alcoholism is the order of the day.
- There are many school dropouts.
- Ill health to the elderly though we have now tried to take the hospital close to them.

6 **Who in your view should play major roles in the management and governance of the sugar industry?**

The county government should and not the central government after all we are the people hosting the company. However, the people who should play a major role are the small scale farmers in the governance of the sugar company yet they are relegated.

7 **What are your recommendations for the future of Mumias Sugar Company?**

The county government of Kakamega recently appointed a task force to investigate and come up with recommendations on how to revive Mumias Sugar Company. There is a myriad of recommendations we have made as a county government that can go a long way in reviving the factory and sustaining its operations. I will share with you the draft. Please note that this draft is purely for your academic work.

If the Taskforce report by the county government of Kakamega is finalized and not implemented then our hands as a county government are tied. Again, MSC is a private-public company and we cannot do much unless the government of Kenya steps down its shareholding to us so that we become shareholders in MSC.