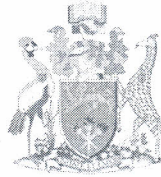


UNIVERSITY OF NAIROBI

SCHOOL OF LAW



**CORPORATE GOVERNANCE IN KENYA' S STATE CORPORATIONS: A
CRITIQUE ON THE APPOINTMENT AND DISMISSAL OF DIRECTORS OF
BOARDS OF STATE CORPORATIONS**

BY

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A thesis submitted in partial fulfillment of the requirements for the award of the Degree
of Master of Laws (LLM), of the University of Nairobi.

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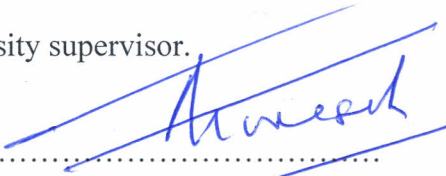
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DEDICATION

This work is dedicated to my family members who have given me immense support through the process of conceptualizing, compiling and completing it. May God bless you exceedingly and abundantly.

ACKNOWLEDGEMENT

I wish to express my profound gratitude to my supervisor, Mr Tim O.A. Mweseli for guiding me through conceptualization and writing of this thesis. I also wish to thank all public officers who provided me with official documents which were invaluable to this study. I warmly thank Virginia Wanjku Mwangi and Carol Munyweia Musangi, my office secretaries for their contribution in typing, formatting and having this thesis printed. Lastly but by no means least, my deepest appreciation goes to my friend Jane Wangari Mburuti for her unfailing encouragement and constant companionship throughout this study.

LIST OF STATUTES

Anti Corruption and Economic Crimes Act, No. 3 of 2003

Anti Counterfeit Act, No. 13 of 2008

Capital Market Act (Cap 485)

Companies Act, (Cap 486)

Constitution of Kenya, 2010

Ethics and Anti Corruption Commission Act, 2011

Interpretation and General Provisions Act, Cap 2

Kenya Industrial Property Institute Act, No. 13 of 2008

Leadership and Integrity Act, No. 19, 2012

Public Audit Act, No. 4 2003

Public Officer Ethics Act, No. 4, 2003

State Corporations Act (Cap 446)

Sarbanes Oxley Act, 2002

Sessional Paper No. 10 of 1965

LIST OF ACRONYMS AND ABBREVIATIONS

BCCI	Bank of Credit and Commerce International limited
CCG	Center for Corporate Governance
CCK	Communication Commission of Kenya
CEO	Chief Executive Officer
CG	Corporate Governance
CGC	Corporate Governance Centre
CMA	Capital Markets Authority
EACC	Ethics and Anti Corruption Commission
EAPCC	East African Portland Cement Company Limited
ERSWEC	Economic Recovery Strategy for Wealth and Employment Creation
IPO	Initial Public Offer
KANU	Kenya African National Union
KCC	Kenya Corporative Creameries
KenGen	Kenya Electricity Generating Company
KICOMI	Kisumu Cotton Millis
KIE	Kenya Industrial Estate
KIPI	Kenya Industrial Property Institute
KMC	Kenya Meat Commission
KNAC	Kenya National Assurance Company
MOU	Memorandum of understanding
MOUNTEX	Mount Kenya Textiles Limited
NSE	Nairobi Stock Exchange

NSSF	National Social Security Fund
OECD	Organization for Economic Corporation and Development
PIC	Public Investments Committee
SCA	State Corporations Act
SCAC	State Corporations Advisory Committee
SOE	State Owned Enterprise
SOX	Sarbanes - Oxley Act
Rivatex	Rift Valley Textiles Limited
UK	United Kingdom
US	United States of America

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application APPL No.278 of 2012. Nairobi High Courts J.R. Misc Application No. 278 of
2012.

Mark Ole Karbole v Acting minister for Ministry of industrialization, Permanent
secretary, Ministry of industrialization and East African Portland and four other
Interested Parties. Nairobi High Court, Judicial Review Division, Misc. Application No.
337 of 2011

ABSTRACT

This study interrogates corporate governance practices within Kenya's State Corporations with particular reference to the appointment and dismissal of directors of the Boards of these corporations. It recognizes that these directors are the anchors for the implementation of corporate governance practices in these corporations. The appointment and dismissal of these directors have been based on, inter alia, political considerations kinship, patronage, ethnicity and other non objective criteria other than merit. This has often impacted negatively on the performance of these corporations. This study traces the evolution of corporate governance generally, documents it's historical development in Kenya and examines the current practices on the appointment and dismissal of directors of boards of state corporations. The data collected targeted a majority of State Corporations which demonstrates that past criteria for Directors recruitment and their dismissal was based on non objective criteria. The study is instructive on the fact that though best practice and corporate governance principles have not been fully embraced in the appointment and dismissal of Directors of Boards of State Corporations there is a positive move towards the adoption of these principles in such appointments and dismissals. The impetus for this was the promulgation of the Kenya constitution 2010 which is itself a good corporate governance document.

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CHAPTER ONE

INTRODUCTION

1.0 Introduction

Corporate governance is a topical issue in the constitution and management of corporations throughout the world as will be shown in this study. Corporate scandals and collapses have established it as an important and integral discipline in the emerging and developing area of corporate law.

A study of Corporate Governance reveals that it has many aspects and it will therefore not be possible to do justice to the entire literature touching on all aspects of this discipline. This study consciously highlights the appointment and dismissal of the Directors of Boards of State Corporations in Kenya and how these appointments comply or breach sound Corporate Governance principles.

As will clearly emerge in this study, Directors of State Corporations are an integral part for the enhancement of corporate governance practices in these corporations as they are the main actors for the implementation of Corporate Governance structures and principles therein.

This phenomenon is specifically interrogated in respect to the appointment and dismissal of the directors of Boards of State Corporations in Kenya. A common thread running through all State Corporations in Kenya is that they are all governed and are subject to

the provisions of the state corporations act¹ whether they are established by an Act of Parliament, under the provisions of the Companies act or by Kenya gazette. To that extent therefore the study addresses all state corporations in Kenya.

Corporate Governance as an emergent discipline is a framework used by a Corporate entity to control and manage its functions. It documents how the entity relates to its stakeholders and may be defined as the stewardship responsibility of corporate directors to provide oversight for the goals and strategies of a Corporation and foster their implementation². In Kenya, Corporate Governance has been defined in the Capital Markets Act³ as, “the process and structure used to direct and manage business affairs of the company towards enhancing prosperity and Corporate accounting with the ultimate objective of realizing shareholder ultimate value while taking into account the interests of other stakeholders”. It is concerned with striking a balance between the Corporations’ economic and social goals; “between individual and communal goals while encouraging efficient use of resources, accountability in the use of power and stewardship, and as far as possible, aligning the interests of individuals, Corporations and society”.⁴

¹Chapter 446 (1987), Laws of Kenya.

² Kaufmann, D., Kraay, A., & Mastruzzi, M. (2003). Governance matters III: governance indicators 1996-2002. Retrieved September 12, 2011 www.worldbank.org/wbi/governance/pdf/govmatters3.pdf

³ (CAP. 485A): Guidelines on Corporate Governance Practices By Public Listed Companies In Kenya. *Gazette Notice No. 3362*, Section 1.2

⁴ Ibid Section 1.

In the definitions contained in the State Corporations Act ⁵ a State Corporation, also known as a parastatal or State Owned Enterprise (SOE), is defined as a State Corporation established by an order of the President to perform specific functions⁶. A corporate body set up by an Act of Parliament; a bank, financial institution or company which is wholly owned by Government/State Corporation or in which the Government or State Corporation has a controlling majority; and, a subsidiary of a State Corporation. However, a local authority, co-operative society, building society and Central Bank are not considered as State Corporations.

The Act confers on a State Corporation powers inherent in companies; that is, among other things, suing and being sued in its own name, perpetual succession, and, holding and alienating movable and immovable property⁷. State Corporations can be for-profit or not-for-profit. The Act requires the President to assign ministerial responsibility to any State Corporation⁸ In Kenya State Corporations were initially established by the colonial Government with a mandate of providing essential services to white settlers. The first State Corporation can be traced to the incorporation of the Kenya Railways Corporation⁹.

The corporations were used as tools for excluding Africans from the economy during the colonial period. They mostly comprised of agricultural commodity regulatory and marketing boards¹⁰. This, however, changed with independence. State Corporations were

⁵ Supra Note 1

⁶ *ibid*, Section 3(2).

⁷ *ibid*, Section 4

⁸ *Ibid* Section 1.

⁹ Chapter 397, Laws of Kenya

¹⁰ Sessional Paper No. 10 of 1965 on African Socialism and its Application to Planning in Kenya., Government Printer. Republic of Kenya

then meant to: bring about equitable distribution of development gains; ‘Kenyanize’ or indigenize the economy; solve regional imbalances; and, accelerate economic growth.¹¹ The Government of the time envisaged that these corporations would be efficient, cost effective and profitable. This led to high economic growth of 6.8% per annum between 1963 and 1970.

However, the impressive economic growth declined to 5% between 1970 to 1980. This is well documented in a study commissioned by the centre for Governance and development ¹²which clearly established that decline in the performance of State Corporations was due to poor management budgetary crisis and poor governance especially in the manner in which Directors of State Corporations were appointed and dismissed¹³. This continued to the end of the third decade (1980s) with further decline in economic growth and State Corporations performance being recorded. Owing to public and international concern over the poor State of the Corporations’ performance, the Government undertook a review and inquest into their poor performance.

Economic growth declined further to 0.3% in the 1990s. Among the cited reasons for the sharp decline included increased Government’s investment and expenditure in underperforming, wasteful and inefficient State Corporations¹⁴ By 1990, the Government

¹¹ ibid

¹² Centre For Governance And Development (CGD). *A Decade of Parastatal Waste: A Study of the Audited Accounts of State Corporations over the Period from 1993 to 2002*. A Publication Of The Centre For Governance And Development (CGD) and US Agency for International Development (USAID)

¹³ ibid

¹⁴ Republic of Kenya (2012). *Draft Policy on Management of State and County Corporations*. Nairobi: Government Printer.

had a stake in 250 State Corporations of which it had majority shareholding, either directly or indirectly, in more than half of the corporations. In the period between 1990 and 2002, the Government took steps to divest and privatize some of them¹⁵.

According to a commission appointed by the Government¹⁶ to inquire into the decline in state corporations' poor performance, several reasons were documented. These included the haphazard manner of the appointment and dismissals of Directors of State Corporations, the role of Government in their management; inefficient investment and accountability of State Corporations; lack of clear operational guidelines; and, poor quality of management (mostly by unqualified personnel). Other reasons established were: pathetic management procedures; insufficient supervision; and, lack of budgetary control¹⁷. Lack of clear guidelines meant that some state corporations shifted from their original functions leading to confusion and overlap of their functions or duplication of roles¹⁸.

Since 2003, reforms have been introduced in State Corporations through the push for good Corporate Governance that would enhance delivery of their mandates. The concept of Public Private Partnership was introduced to facilitate investment in infrastructure to ease State Corporations' functions. During the period, the Report on Harmonization of

¹⁵ *ibid*

¹⁶ Republic of Kenya. (1979). Review of Statutory Boards. *Report and Recommendations of the Committee* appointed by His Excellency the President. Nairobi, Government Printer.

¹⁷ *ibid*

¹⁸ Klaus, Hans G. (1979). Parastatals in Kenya: Analysis of Their Condition and Methods for an Improved Performance. *Research Proposal*, University of Nairobi.

Terms and Conditions of Service for Public Officers¹⁹ recommended, *inter alia*: the merging of superfluous State Corporations whose functions overlap; categorizing Corporations into various subsectors; the competitive recruitment of Chief Executive Officers; the proper appointment and dismissals of Directors and setting minimum qualifications for these Directors.

State Corporations that have experienced upheavals owing to bad corporate governance are: the Kenya Cooperative Creameries (KCC); National Housing Corporation; Kenya National Assurance Company (KNAC) which was wound up in 2001; Kenya Meat Commission (KMC); Mount Kenya Textiles (Mountex) and Kisumu Cotton Mills (KICOMI) among others²⁰. An example of the breach of Corporate Governance is in the case of KNAC's senior executives allocating themselves allowances which were way above the ceiling²¹. Uchumi Supermarket Limited which collapsed and was revived by the Government was characterized by perfunctory expansion of branches, unsuitable financing, poor resource policy and heavy borrowings which were not channeled to their intended purposes²². The National Bank of Kenya faced liquidity problems due to imprudent loan allocation and interference from politicians who used to impose their cronies on the Board of Directors without following due procedure for their

¹⁹ Circular from the office of the president date 18th June 2001. Ref. OP 18/IA/VII/141

²⁰ Muthumbi, M. (2007). After reviving KMC and KCC Kenya Government goes after Rivatex. *Daily Nation* July 29, 2007

²¹ Standard Reporter (2006). KMC - a History Littered With Crippling Debts. *The East African Standard*, June 21, 2006

²² Wambugu, Benson (2011). Permanent Secretary lists reasons for Uchumi collapse before Nairobi court. *Daily Nation*, March 14 2011

appointment²³. KMC, a meat supplier in Africa, Europe and the Middle East in the mid-1960 declined due to policy misdirection, high-level corruption and political patronage²⁴ KCC collapsed following political interference and sale of equipment to individuals well-connected with the Government²⁵. A central thread in the collapse and mismanagement of these State Corporations was the non meritorious appointments of directors of the boards which were not in consonance with sound Corporate Governance principles.

The period after 1980s witnessed Corporate Governance emerge as a major area of interest in corporate law. This follows numerous global Corporate scandals such as Enron and World Com Ltd. This gave rise to the development of guiding principles in countries and supranational organizations such as Sarbanes-Oxley (SOX) Act²⁶, Cadbury Report 1992²⁷ King's Report on Corporate Governance for South Africa 2002 among others²⁸. In Kenya, unlike the private sector, there are no formal and prescriptive Corporate Governance guidelines for State Corporations. In cognizance of the nonconformity to Corporate Governance in Kenya, CMA established a Capital Markets Corporate Governance Committee whose mandate is to "strengthen the Corporate Governance framework in the capital markets"²⁹. However, the committee was only charged with the

²³ <http://mjengakenya.blogspot.com/2008/07/national-bank-of-kenya-bigger-scandal.html>. 23.7.2013

²⁴ Supra note 24

²⁵ The Organic Farmer (2012). The scramble for New KCC. *The Organic Farmer*, 88, September, 2012

²⁶ 2002, Pub. L. No 107-204, § 116 Stat. 745 (2002)

²⁷ Bain, N. 1992, 'In the Wake of the Cadbury Report on Corporate Governance, Boardroom Shake-ups are Long Overdue', *The Observer*, May 31, 30

²⁸ King 3 Code of Corporate Governance for South Africa". Institute of Directors in Southern Africa. 2009. Retrieved 3 April 2012

²⁹ Geoffrey (2013). Kenya's Capital Markets Authority (CMA) establishes Corporate Governance Committee. *Emerging Markets ESG*, January 11, 2013

review of Corporate Governance standards of publicly listed companies. Additionally, the Centre for Corporate Governance (CCG) was established in the wake of the collapse of both public and private Corporations. CCG came up with a Sample Code of Best Practice of Corporate Governance in Kenya which the government has not fully incorporated in the management of State Corporations³⁰.

According to the State Corporations Act, the Board of a State Corporation is responsible “for the proper management of the affairs of a State Corporation”. The law therefore recognizes that the Board of Directors of a State Corporation is the engine that drives Corporate Governance in these Institutions. It is therefore imperative that directors who are recruited to these Boards must be competent, exercise financial probity, have the necessary skills and management acumen to run these State Corporations³¹. The chief executive officer (CEO) of the State Corporation represents the board to the external stakeholders. The Act also established an Inspector-General (Corporations) office whose mandate is to advise the government on the State of affairs of and matters affecting State Corporations; report to the minister on the management practices of State Corporations; inspect all records, books, returns and documents relating to the execution of the Corporations’ functions and accounts thereof; and, inspect premises, plants and installation of state corporations³². The Controller and Auditor-General is also

³⁰ Atieno, Yvonne Awuor. (2009). Corporate Governance Problems facing Kenyan parastatals: A case study of the sugar industry. *Masters Thesis in Law and Business*, Bucerius Law School and Otto Beisheim School of Business

³¹ Ibid Section 1.

³² Supra Note 18

empowered by the Act to work with the Inspector-General (Corporations) office in carrying out the function of oversight of State Corporations.

Besides the offices of the Controller and Auditor-General there is the office of the Inspector-General (corporations) which carries out the function of oversight of State Corporations. Other than the offices of the Controller and Auditor-General there is the office of the Inspector-General (Corporations) office, the Act established a State Corporations Advisory Committee (SCAC) mandated with the review and investigation of the affairs of a State Corporation³³. Sections 27 and 28 provides for reorganization or even dissolution of a State Corporation, on the advice of SCAC for a Corporation which fails to realize its functions.

1.2 Problem Statement

The study examines the problem of Corporate Governance in State Corporations in Kenya. This is because in relation to the appointment and dismissal of Directors of Boards of State Corporations who are the centerpiece and the apex of the corporate governance structure in those Corporations there have not been carried out in accordance with best practice with the result that these Corporations are characterized by dismal performance as the appointments and dismissal are based on non- objective and extraneous criteria.

1.3 Research Questions

³³ Ibid, section 26-7

The study seeks to answer the following interrogatories:-

1. Is there a relationship between the productive performance of State Corporations and their compliance or non compliance with sound corporate principles in state corporations in Kenya?
2. Has it been the practice in Kenya that the appointments and dismissal of directors of State Corporations have been based on criteria other than merit?
3. Does there exist an enabling legal framework in Kenya which is the basis for the enforcement of corporate governance principles especially in regard to the appointment and dismissal of directors of Boards of State Corporations?
4. Are Directors of Boards of State Corporations currently being appointed and dismissed in accordance with the law and best practice?

1.4 Hypothesis

The study is premised on the hypothesis that good corporate governance structures are an imperative in the Running of State Corporations in Kenya and in particular in regard to the appointment and dismissal of Directors of the Boards of these corporations. This imperative is predicated on the fact that State Corporations being public entities are funded by tax payers money. It is hypothesized that directors of Boards of state corporations who are appointed on merit and in accordance with the law and sound corporate governance principles will invariably ensure that these corporations performance is not only enhanced but derive value for the taxpayer as well.

1.5 Theoretical Framework

The dominant theory in this study which is the most recognized theoretical perspective applicable to corporate governance is the Agency theory. The study also interrogates the stakeholders' theory which deviates significantly from the postulations of agency theory. The managerial hegemony theory is also relevant to this study. The above theories are discussed below:-

a) Agency Theory

This theory originated from Berle and Means as described by Dalton, Daily, Ellstrand and Johnston³⁴. Though the theory has existed for long, the succinct postulations were developed in early 1960s and late 1970s as a theoretical approach to the risk sharing problems among individuals and groups and their attitude or approach towards risks; that is, parties in a contractual relationships have conflicting and different goals and visions. Among the contributors to the theory are Michael Jensen, Harold Demsetz and Armen Alchian³⁵. Developed from contract theory, agency theory posits that corporations and firms are a nexus of contract between resource holders and such relationship is effected when the holders of resources who are the principals (shareholders or public) entrust

³⁴ Dalton, D. R., Daily, C. M., Ellstrand, A. E. & Johnson, J. L. 1998, 'Meta-analytic Reviews of Board Composition, Leadership Structure, and Financial Performance', *Strategic Management Journal*, vol. 19, no. 3, pp. 269-290.

³⁵ Jensen, M. C., & William H. M. Theory of the Firm, Managerial Behavior, Agency Costs, and Ownership Structure. *Journal of Financial Economics* 3 (October 1976), 305-360.

individuals (agents) to perform functions or service on their behalf and fully hand-over decision-making function to them³⁶.

This relationship is however not necessarily harmonious as it raises constraints in the principal-agent model. Eisenhardt has described this as a problem where “the desire or goal of the principal and agent conflict, and it is difficult or expensive for the principal to verify what the agent is actually doing [or that] the agent has behaved appropriately”³⁷.

The theory, thus, seeks to determine the most efficient contractual terms which will minimize the principal-agent problem given the assumption that people are driven by self-interest, bounded rationality and are risk averse”; organizations are characterized with goal conflicts between and among members; and, information is a “commodity that can be purchased”³⁸ ⁶⁰. The agency theory holds that under the likelihood of adverse selection or moral hazards, fixed remuneration does not motivate the agent but variable remuneration based on residual claimancy on the corporations’ performance or profits would.

This theory is significant in a State Corporation as the ultimate owner of a state corporation is the citizen who delegates his ownership to the executive arm of the government which further appoints Boards of Directors to be the principals in these corporations. While the private sector has a single principal and agent, namely the

³⁶ Fama, E. and Jensen. M. (1983). Agency Problems and Residual Claims." *Journal of Law and Economics* 26, 327-349

³⁶ Ibid,

³⁷ Ibid,

³⁸ Ibid

shareholders and the managers there are multiple agents in State Corporations. Since the state derives its mandate from voters, the state and the board of directors are both agents of the voters. Serious agency problems arise as a result of this complexity. For instance, given that politicians are accountable to voters, they are likely to lose sight of the commercial goals of a state corporation whilst attempting to please strategic parts of the electorate. The economic efficiency of the State Corporations is also undermined by the fact that the politicians do not have a personal equity in the stake of the entities. As a result, they have no financial incentives to ensure Parastatals are managed effectively³⁹.

b) Stakeholder theory

This theory was originally detailed by R. Edward Friedman⁴⁰. It's underpinnings are derived from the importance of a corporation paying special attention to the various stakeholder groups in addition to the traditional attention given to investors⁴¹. That is, organizations serve a broader community besides the maximization of shareholders' wealth⁴². The theory opines that corporations' actions affect various stakeholders and their success can be gauged from their ability to add value to all these stakeholders⁴³. These various groups of stakeholders such as customers, the environment, suppliers,

³⁹ Mwaura k. The failure of Corporate Governance in state owned enterprise and the need for restructured governance in fully and partially privatized enterprises: The case of Kenya (2007) 31/34 Fordham International Law Journal.

⁴⁰ Friedman R. Edward (1984) Strategic Management. A stakeholder approach. Boston Pitman. ISBN 0 – 273 – 0193 - 9

⁴¹ Gibson, K. (2000), "The moral basis of stakeholder theory", Journal of Business Ethics, Vol. 26 pp.245-57.

⁴² Mulili, B. M. (2011). Corporate Governance Practices in Developing Countries: The Case for Kenya. *International Journal of Business Administration*, 2(1), 14 – 27.

⁴³ Dunphy, D., Griffiths, A., & Benn, S. (2003). *Organizational Change for corporate sustainability*. London: Routledge.

employees, the local community and shareholders are all deemed to have a stake in the business of a corporation. Thus, a corporation does not only have a moral right, but a legal obligation to serve these stakeholders well as they are all instrumental to its success⁴⁴.

When these stakeholders are satisfied, they are motivated to return to the corporation for more. As a result, corporations should consider claims of stakeholders in their decisions and conduct their business responsibly mindful of the various stakeholders⁴⁵. Proponents of stakeholder theory, thus, argue for representation of all stakeholder groups on boards of Directors for effective corporate governance, reduction of conflicts and increase in efficiency⁴⁶.

This appears to be the theory advising the Constitution when it calls for the participation of regional representation, gender equality, the youth and marginalized persons to participate in all public activities including those of State Corporations. This is echoed by the provisions of Article 73 of the Constitution which enshrines affirmative measures in the governance of State Corporations which shall acknowledge and represent the diversity of Kenya and adequate and equal opportunity for appointment, training and

⁴⁴ Ulrich, P. (2008). *Integrative Economic Ethics: Foundations of a Civilized Market Economy*, Cambridge: Cambridge University Press.

⁴⁵ Manville, B. & Ober, J. (2003). Beyond empowerment: building a company of citizens, *Harvard Business Review*, 81(1), 48-53.

⁴⁶ Rothman, J. & Friedman, V.J. (2001), Identity, conflict, and organizational learning, in M.Dierkes, A.B. Antal, J.Child & I. Nonaka (Eds.), *Handbook of Organizational Learning and Knowledge*, (pp. 582-97), New York: Oxford University Press.

advancement at all levels of the public service of men and women; the members of all ethnic groups; the youth and persons with disability⁴⁷.

Gibson⁴⁸ argue that certain actions of management might have conflicting effects on various classes of stakeholders. This implies that managers have a multiplicity of objective functions to optimize. Corporations should therefore adopt a proactive rather than reactive approach when integrating its decisions with stakeholders' interests. Currall and Epstein⁴⁹ attribute the collapse of Corporations such as Enron and WorldCom to the failure to align their interest with those of stakeholders⁵⁰.

c) Managerial Hegemony theory

According to this theory corporate boards are legal fictions which are ineffective in averting conflicts between management and stakeholders in spite of the powers conferred on them to realize the same⁵¹. That is, corporate boards are just symbols which are ritualistic though ineffective appendage institutions. It states that while shareholders and managers have different interests, the latter control the main levers of power. The

⁴⁷ Republic of Kenya (2010). The Constitution of Kenya . Nairobi: Government Printer ,Article 232(1h,i)

⁴⁸ Gibson, K. (2000), "The moral basis of stakeholder theory", *Journal of Business Ethics*, Vol. 26 pp.245-57.

⁴⁹ Kaptein, M. & Van Tulder, R. (2003). Toward effective stakeholder dialogue, *Business and Society Review*, 108(2), 203-24.

⁵⁰ Currall, S.C. & Epstein, M.J. (2003). The fragility of organizational trust: lessons from the rise and fall of Enron, *Organizational Dynamics*, 32(2), 193-206.

⁵¹ Cornforth, Chris (2001). Power relations between boards and senior managers in the governance of public and non-profit organizations. *In: 2nd International Conference on Corporate Governance and Direction, 13-15 October 1999*, Henley Management College

Corporate boards' function is to ratify decisions made by management, support the management and give legitimacy to or 'rubber stamp' such decisions⁵².

Managerial hegemony theory is related to agency theory by virtue of recognizing shareholders as legal owners of the corporation but have no or limited control over large corporations⁵³. The theory is also suitable for this study because of its argument on the role of the board of directors. In many State Corporations, the board does not have power to carry out its duties. It is merely reduced to a rubber stamp institution for management decisions emanating not only from executives but also politicians and managers. Secondly, the theory is applicable to large corporations and is relevant as State Corporations are large institutions.

1.6 Literature Review

The phenomenon of the application of corporate governance practices or lack of them as they relate to State Corporations in Kenya has been studied by various authors who have examined the various aspects related to State Corporations. As earlier observed since corporate governance is an emerging discipline so too are studies that will naturally grow and increase as this discipline develops. Oloo Ochieng⁵⁴ has studied the impact of market regulation in bolstering corporate governance in the capital market. His study concludes that a high level of public accountability is expected of public owned institutions such as State Corporations as this has to be managed on behalf of the shareholder who is a citizen

⁵²Ibid

⁵³ Supra note 67

⁵⁴ Oloo Ochieng (2013). Market regulator moves to bolster Corporate Governance in capital markets. Think Business Africa, April 25, 2013

who funds these corporations through payment of taxes. Mbai C. Odhiambo⁵⁵ in his study on public service accountability and corporate governance in Kenya since independence has concluded that the poor performance of corporate governance in Kenya is due to ineffective corporate governance practices and poor quality of directors of boards of these State Corporations. He has attributed the reasons for the poor performance of these State Corporations to, inter alia, a weak legal framework, corruption and political interference with the running of these corporations.

Miring'u Alice N., & Muoria, Esther T⁵⁶. have carried out an analysis of the effect of corporate governance on the performance of State Corporations in Kenya and made the observation that the ability of any corporate entity to effectively respond to external factors and changes is heavily dependent on its governance structures and the effectiveness of its Boards of Directors.

Okundi Benson⁵⁷ in his study exhorts the Kenyan Authorities to adopt good corporate governance tenets in the management of corporate governance. Klaus, Hans G⁵⁸ in his analysis of the conditions and methods of Parastatals in Kenya has examined the methods and factors that are required to improve Parastatals performance in Kenya.

⁵⁵ Mbai, C. Odhiambo. (2003). Public Service Accountability and Governance in Kenya since Independence. *African Journal on Political Science*, 8(1), 113-45.

⁵⁶ Miring'u, Alice N., & Muoria, Esther T. (2012). An analysis of the effect of Corporate Governance on Performance of Commercial State Corporations in Kenya. *International Journal of Business and Public Management*, 1(1): 36-41.

⁵⁷ Okundi Benson. (2011). Kenya should adopt good corporate governance tenets. *Business Daily Africa*, February 18, 2011

⁵⁸ Supra Note 18

Kegode, Peter has studied the governance problems affecting the sugar sub sector in Kenya and suggested areas for reform⁵⁹. Muthumbi, M⁶⁰ has argued that it is important to revive State Corporations after they have been reformed which observation is predicated on his study of Kenya Meat Commission (KMC) the Kenya Creameries Corporative (KCC) and Rift valley Textile Limited (Rivatex). Wambugu Benson⁶¹ has underscored the reasons that led to the collapse of Uchumi Supermarket Limited.

Atieno Yvonne Awuor⁶² has articulated the various corporate governance problems facing State Corporations in Kenya with reference to the Sugar Industry in Kenya. The weak legal framework affecting corporate governance in Kenya has been the subject of the study of Musikali, Lois M⁶³ who has recommended the need for a review thereto. The failure of corporate governance in State Owned Enterprises and the need for restructured governance in fully and partially privatized enterprises has been subject of a study by Mwaura K⁶⁴. Atieno⁶⁵ has provided a critique on the management of Parastatals in Kenya in light of the current Kenya Constitution.

There have been few studies that have specifically analyzed the need for the appointment and dismissal of directors of Boards of State Corporations being based on sound corporate governance principles and the applicable law. Even where this law exists they

⁵⁹ Kegode, Peter. (2005). Economic Governance Reform In The Sugar Sub-Sector. Center For Governance and Development Report, 1-14.

⁶⁰ Supra note 20

⁶¹ ibid

⁶² Supra note 30

⁶³ Musikali, Lois M. (2008). -The law affecting corporate governance in Kenya: a need for review. International Company and Commercial Law Review P. 18

⁶⁴ Supra note 39

⁶⁵ Supra note 30

address this issue perfunctorily. The importance of having competent directors of State Corporations appointed on merit and best practice cannot be gainsaid as they form the apex of the governance structure in State Corporations. This in turn leads to efficient and enhanced performance of these corporations. This study therefore seeks to fill in this knowledge gap by providing a critique on the appointment and dismissal of Directors of Boards of State Corporations in the context of sound corporate governance principles.

1.7 Methodology of the study

The research in this study was:

- (i) Library Based
- (ii) Based on the interrogation of officials of State Corporations.
- (iii) Based on information and data collected by the writer as a member of the task force on state corporations within the Ministry of Industrialization
- (iv) An analysis of the above

1.8 Chapter Breakdown

Chapter one is the introduction to the study. The chapter is broken into statement of the problem, hypothesis of the study, theoretical framework, literature review, methodology and chapter breakdown

Chapter two is a critique of corporate governance principles, a summary of codes of best practices in corporate governance as provided of by codes of corporate governance such as OECD, 2004, Kings Report (1994), Cadbury report (1992), Sarbanes Oxley Act (2002) and the sample code of best practices in Kenya (2002) ,history of State Corporations in Kenya and guidelines on the appointment and dismissal of boards of directors.

Chapter three is an encapsulation of the legal framework of state corporations in Kenya.

Chapter four specifically interrogates the appointment and dismissal of directors of boards of State Corporations. Directors of boards of State Corporations are the architects, movers and shapers of the application of corporate governance principles and practices in their boards and the criteria for their appointment must therefore be objective and based on the code of best practices.

CHAPTER TWO

EVOLUTION OF CORPORATE GOVERNANCE AND HISTORY OF STATE CORPORATIONS IN KENYA

2.0. Introduction

The chapter traces the evolution of corporate governance by briefly examining the comparative history of corporate governance, analyzing corporate scandals and debacles that have shaped the History of Corporate governance in the world, summarizes the comparative codes of best practice in corporate governance and discusses the appointment and dismissal of directors of State Corporations in Kenya.

2.1. History of Corporate Governance

The history of corporate governance is essentially an economic history and the history of a country's governance and legal system⁶⁶. The best that this study can do is to highlight the essential features which are foundational to the development of corporate governance practices.

Corporate governance thrives in capitalist societies which recognize free market economies whose central entity is the corporation⁶⁷. Corporate governance has therefore been linked and is part of the history of the open market economy. Due to the constraints of this study this section will briefly delve into the background of the open market economies in a few countries which laid the basis for the development of the corporation and corporate governance practices and principles.

A few examples will suffice;

⁶⁶ Barca, Fabrizio and Marco Becht, eds. 2001. *The Control of Corporate Europe*, European Corporate Governance Network, Oxford University Press.

⁶⁷ Boyd, C.1997. *Ethics and corporate Governance: The issues raised by the Cadbury report in the United Kindom*. School of commerce, University of Saskatchewan. Canada. p. 20 – 25.

Canada's pre-industrial history is traced to the period when it became a French colony of resource extraction built around the fur trade and then as a British colony of settlement⁶⁸. The pattern in Canadian corporate control dates back a full century where large corporate entities look as much as they do now. They are characterized by a predominance of family control pyramidal business groups⁶⁹. These wealthy families and their partners in business controlled most of the businesses in Canada in the first half of 20th century and sold their businesses with the stock market boom, however their businesses went bankrupt when the recession struck and their shares were diluted by the issuance of stocks to fund takeovers and liquidate their corporate empires to pay estate taxes⁷⁰.

There was a resurgence of these pyramidal groups in the 1960s and early 1970s which grew as a result of the emasculation of the estate tax coupled with the dramatic expansion of state intervention in the economy⁷¹. These groups exploited the political connections to grow their businesses as they were professionally managed due to their adoption of sound corporate governance principles and were greatly assisted by the drive for universal education for the production of entrepreneurial ideas, the establishment of corporate financial systems and the formulation of public policy regarding inheritance that significantly prevented these entrepreneurs from entrenching themselves and blocking others⁷². The history of corporate governance in Canada was to grow in sync with the history of the expansion of the corporation which is the central entity in an open

⁶⁸ Morck, R.K. . A history of corporate Governance around the world: Family business groups to progressive managers. The University of Chicago. p. 121 – 130.

⁶⁹ Hasan, Z. (2009). Corporate Governance: Western and Islamic Perspective. International Review of Business Research papers. Vol 5(1). pp 277 – 293.

⁷⁰ Supra note 62

⁷¹ Ibid

⁷² Supra note 62

market economy⁷³. The real impetus for the rapid and sure growth of the phenomenon of corporate governance in market economies was provided by the financial scandals that afflicted other free market economies as will be discussed in the next section.

The experience of Canada is replicated in other open markets economies like US, France and UK to mention but a few. The only difference between the Canadian history and these other countries was in the detail on how their economies grew and with them the corporation. The most significant development in the UK was the development of corporate disclosure which was implemented in 1948 to make hostile takeovers less risky for raiders hence becoming a defense mechanism⁷⁴. The great depression had been a critical junction of corporate evolution in many countries including the UK⁷⁵. Sylla and Smith⁷⁶ point out that the 1890 Directors' Liability Act (England and Wales) made company directors liable for statements made in prospectuses, and the Companies' Act of 1900 (England and Wales) strengthened the principle of compulsory corporate disclosure as the explanation for rapid growth of British financial markets around the century. There is speculation that shareholders' rights have been stronger in the early 20th century.⁷⁷

In the US, Italy and Germany the legal framework that was introduced by these countries shaped to a very great extent corporate governance in these countries in the 19th and 20th

⁷³ Becht, Marco, Patrick Bolton, and Ailsa Röell. 2002. Corporate Governance and Control. In George Constantinides, Milton Harris and René Stulz, eds. *Handbook of Economics and Finance*, Amsterdam: North Holland. p. 130 – 136.

⁷⁴ Randall K. Morck and Lloyd STIER, *Supra* note 62 at 25

⁷⁵ *ibid*

⁷⁶ Sylla and Smith *The Rise of Securities Markets: What can governments do?* The world Bank Policy Research Department (1995). p. 34- 45.

⁷⁷ Randall K. Morck and Lloyd STIER, *Supra* note 62, at 25

Centuries⁷⁸. The outcomes of these corporate laws were unique for each country. For instance in France, the French civil law encouraged family control over large corporations which relied on government connections. In Germany, banks and other financial institutions became prominent shareholders and were more powerful over other shareholders⁷⁹. However, the civil law provided for constitution of supervisory and management boards that still exist today⁸⁰. As indicated above, the real impetus for the growth of corporate governance in open market economies was provided by the financial scandals to which this study must now turn.

2.2. Growth of Good Corporate Governance: Scandals and debacles

Corporate Governance gained deserved attention in the world in the 1980s and 1990s. This was mainly because though developed countries had well established legal systems on corporate law they experienced a series of concurrent corporate scandals⁸¹. In UK, four large companies namely Wallpaper group Coloroll, Asil Nadri's Peck Consortium, Bank of Credit and Commerce International (BCCI) limited Collapsed⁸². The collapse of these otherwise blue chip companies necessitated an inquiry as to the cause of the corporate scandals which led to the recommendations contained in the Cadbury report 1992⁸³.

⁷⁸ *ibid*

⁷⁹ *Supra* note 62

⁸⁰ La Porta, Rafael, Florencio López-de-Silanes, Andrei Shleifer, and Robert Vishny.1999. Corporate ownership around the world. *Journal of Finance* 54 (2): 471–520.

⁸⁰ *Supra* note 62

⁸¹ *ibid*

⁸² Bain, N. 1992, 'In the Wake of the Cadbury Report on Corporate Governance, Boardroom Shake-ups are Long Overdue', *The Observer*, May 31, 30.

⁸³ *ibid*

The collapse of BCCI clearly demonstrates that a breach of sound corporate governance principles is fatal for any corporation however big and complex. The bank was founded in 1972 and had 47 branches in 13 countries. It had a branch called BCCI overseas which was registered in the Cayman Islands as well as through 63 branches in 28 countries whilst the former was in Luxembourg. Investigations revealed that BCCI financial statements were falsified ever since the bank was founded in 1972. This was to escape detection by the regulators for a period of over 20 years. Eventually with the discovery and disclosure of the massive fraud at BCCI, the bank was eventually placed into liquidation. Price Waterhouse which had been commissioned by the bank of England to investigate the financial status of BCCI unearthed fraud on a massive scale⁸⁴. The irregularities in the 1990 accounts for BCCI led the Bank of England to commission a report from Price Waterhouse, which by this time had become the sole external auditor of BCCI. A draft of this Report was delivered to the Bank of England on June 22, 1991. It described fraud on a massive scale including (i) falsification of accounting records; (ii) external vehicles used to route fund transfers and “park” transactions; (iii) the use of nominee and hold-harmless arrangements; (iv) the fraudulent use of ... [funds belonging the rulers of Abu Dhabi]; (v) the creation of 70 companies to facilitate and disguise lending to the Gulf Group; (vi) collusion with third party banks to make loans to BCCI customers, so as to avoid disclosure of such lending on BCCI’s balance sheet; [and] (vii) collusion with customers and others to give false confirmations to the auditors of fictitious and non-recourse loans and loans received as nominees....” Price Waterhouse

⁸⁴ *ibid*

concluded they could not give an opinion on the 1990 accounts and could not even be sure that BCCI SA was a going concern⁸⁵.

The Corporate Governance Committee was set up in May 1991 by the Financial Reporting Council, the Stock Exchange and the accounting profession in response to continuing concerns about standards of financial reporting and accountability. The committee was chaired by Sir Adrian Cadbury and had a remit to review those aspects of corporate governance relating to financial reporting and accountability. The final report was published in December 1992 and contained a number of recommendations to raise standards in corporate governance⁸⁶.

The Cadbury committee established that the scandals arose from the fact that the auditors of these corporations were unable to detect financial impropriety in the corporations as public listed companies in the London stock Exchange hitherto had been allowed to have a self regulatory mechanism⁸⁷. This often meant that financial reporting emanating from these corporations did not reflect the true picture of their financial status. The second principal reason was the lack of ethical conduct in the board of directors. This allowed them to collude with senior managers to effect huge payments both in their favour and that of managers. This was possible because the chairperson of the board was also the chief executive officer of the company thereby fusing management business with that of the board with the result that it was easy to manipulate the composition of the board of directors and business of the management in the service of their selfish interests.

⁸⁵ *ibid*

⁸⁶ *ibid*

⁸⁷ *ibid*

In 1994 the King report on corporate Governance (King I) was published by the King Committee on Corporate Governance, headed by former High Court Judge, Mervyn King S.C. King I, incorporating a Code of Corporate Practices and conduct was the first of its kind in the country and was aimed at promoting the highest standards of corporate governance, King I advocated an integrated approach to good governance in the interests of a wide range of stakeholders. Although groundbreaking at the time, the evolving global economic environment together with recent legislative developments, have necessitated that King I be updated. To this end, the King Committee on Corporate Governance developed the King Report on Corporate Governance for South Africa, 2002 (King II)⁸⁸.

King II acknowledges that there is a move away from the single bottom line (that is, profit for shareholders) to a triple bottom line, which embraces the economic, environmental and social aspects of a company's activities. In the words of the King Committee⁸⁹.

“...successful governance in the world in the 21st Century requires companies to adopt an inclusive and not exclusive approach. The company must be open to institutional activism and there must be greater emphasis on the sustainable or non financial aspects of its performance. Boards must apply the test of fairness, accountability, responsibility and transparency to all acts or omissions and be accountable to the company but also

⁸⁸ The King Committee on Corporate Governance launched the King Report on Corporate Governance for South Africa-2002 (King II Report) at an institute of Directors (IoDSA) Conference attended by &)) person at the Sandton Convention Centre, 26 March, 2002.

⁸⁹ *ibid*

responsive and responsible towards the company's identified stakeholders. The correct balance between conformity with government principles and performance in an entrepreneurial market economy must be found, but this will be specific to each company"⁹⁰.

It is recommended that South African companies have a unitary board structure. This should comprise executive and non executive directors, preferably with a majority of non executive directors, of whom a sufficient number should be independent of management in order to ensure the protection of minority shareholders interests⁹¹.

The legal mechanisms relied on for enforcement of King II and the Code of Corporate practices and Conduct (the Code) were: existing legal remedies, principally under the Companies Act (such as section 424, dealing with liability of directors and others for the fraudulent or reckless conduct of a company's business) and the common law; and, the provisions of the amended listing requirements of the JSE.

In order to prevent the Code from becoming too burdensome and because King II is largely non prescriptive in nature, compliance is for the most part treated as a matter between boards and the stakeholders of companies⁹². King II encourages greater activism by shareholders, business and the financial press and relies heavily on disclosure as a regulatory mechanism in this regard it is important to note that King II recommends a number of changes and developments to existing legislation and

⁹⁰ *ibid*

⁹¹ *ibid*

⁹² King 3 Code of Corporate Governance for South Africa. Institute of Directors in Southern Africa. 2009. Retrieved 3 April 2012.

enforcement processes so as to ensure that role players do not merely pay lip service to the Code and the provisions of King II. Boards should implement effective measures to achieve compliance with the Code and the provisions of King II and should monitor corporate governance issues closely in order to ensure that they are not caught unawares by changes and developments⁹³.

South Africa has been singled out as an icon of corporate governance in Africa after the release of the King's Report of 1994⁹⁴. The report has been cited as one of the best codes of conduct in corporate governance not only in Africa but all over the world. All the public listed companies trading in Johannesburg stock exchange are required to comply with the recommendations of the King's Report. The principles in the report which have been reviewed in 2002 and 2009 can be summarized as leadership, sustainability and good corporate citizenship. On leadership, the principles view good governance as essentially being effective and ethical leadership. The leaders should direct the company to achieve sustainable economic, social and environmental performance. It views sustainability as the primary moral and economic imperative of this century; the code's view on corporate citizenship flows from a company's standing as a juristic person⁹⁵.

⁹³ Clark, R.C.(2005). Corporate Governance Changes in the wake of the Sarbanes Oxley Act: A Morally Tale for Policy. John M. Olin Centre for Law, Economic and Business.

⁹⁴ Okpara,O.J.(2010).Perspective on corporate governance challenges in a sub Saharan African Economy. Journal of business and policy research, Vol 5(1).pp110-122.

⁹⁵ King 3 Code of Corporate Governance for South Africa". Institute of Directors in Southern Africa. 2009. Retrieved 3 April 2012

In USA, between the year 2000 and 2002, corporate fraud occurred in large corporations such as Enron, World Com and Tyco which ultimately culminated in the enactment of Sarbanes Oxley Act of 2002⁹⁶.

The Sarbanes Oxley (SOX) Corporate Governance Act is a united states Federal law that set new or enhanced standards for all U.S. public company boards, management and public accounting firms. The Act is also known as the “The Public Company Accounting Reform and Investor Protection Act” (in the Senate) and “Corporate and Auditing Accountability and Responsibility Act” (in the House). It is more commonly called Sarbanes Oxley, Sarbox or SOX; it is named after sponsors U.S. Senator Paul Sarbanes (D-MD) and U.S. Representative Michael G. Oxley(R-OH). As a result of SOX, top management must now individually certify the accuracy of financial information. In addition, penalties for fraudulent financial activity are much more severe⁹⁷. Also, SOX increased the oversight role of boards of directors while also increasing the independence of outside auditors who review the accuracy of corporate financial statements.

A study on collapse of Enron clearly demonstrates that a breach of corporate governance principles is fatal to a corporation however large, complex or sophisticated. In just 15 years of its existence, Enron grew from nowhere to become America’s seventh largest corporation employing 21 thousand people in more than 40 countries in the world. Its success however, turned to have involved an elaborate scam. It lied about its profits and

⁹⁶ Sarbanes-Oxley Act of 2002, Pub. L. No 107-204, § 116 Stat. 745 (2002).

⁹⁷ Peek, Lucia E., Blanco, Huguette and Roxas, Maria, Sarbanes- Oxley Act of 2002. Corporate Governance and Public Accounting Firms Oversight in NAFTA Countries. American Accounting Association 2004 Mid Atlantic Region Meeting Paper. Available at SSRN: <http://ssrn.com/abstract=489046> or <http://dx.doi.org/10.2139/ssrn.489046>.

concealed its debts so they did not show up in its accounts and was assisted by its main auditors Arthur Anderson. Enron's core business which was energy trading involved Enron's partnership with a company called Centrica which was a former British gas company and a power project in India's Maharashtra state which was by then the biggest foreign investment project in India⁹⁸. The findings of the committee which was the precursor to the enactment of the above Act had similar findings with the Cadbury committee in the United Kingdom in 1993. It was established that auditors were unable to detect impending bankruptcy of the corporation. This was not accidental as there was lack of control of business conduct since corporations were allowed to have a self regulatory mechanism. The mechanisms were often abused as there was conflict of interest by the external auditors who were meant to be the watchdogs of the shareholders in public listed companies who, other than carrying out the audit also provided these corporations with non audit services which meant that they were also customers of the corporations. This meant that they could not provide a true and fair picture of the corporations' finances because they feared these would jeopardize their relationship with their clients. These practices naturally provided room for the misconduct of the auditors⁹⁹.

There was a more significant finding which was attributed to the incompetence of board members in executing their role in board committees. These were specifically the inability of the audit committee to provide an oversight role over management with

⁹⁸ *ibid*

⁹⁹ Clark, R.C.(2005). Corporate Governance Changes in the wake of the Sarbanes Oxley Act: A Morally Tale for Policy. John M. Olin Centre for Law, Economic and Business. p. 12- 18.

regards to financial reporting¹⁰⁰. In summary therefore, the conflict of interest affected board members, management and auditors and was the root cause of the collapse of these corporations.

The enactment of Sarbanes Oxley Act in 2002 significantly contributed to the corporate governance movement across the globe by contributing to the strengthening of the principles of corporate governance by the Organization for Economic Corporation in Development (OECD). A critical look at the findings of Cadbury Report (1992), the provisions of Sarbanes Oxley Act of 2002, the Kings Report 1994 and the principles of OECD 2004, demonstrate that they are directed at strengthening CG in public listed corporations. This led to formulation of the codes of best practices in CG which emphasized following aspects;

Strengthening the role of board of directors in the corporation through non interference by the stakeholders thereby enabling the directors to bring about objectivity and independent judgement on management performance. The inclusion of non executive directors in the board is an imperative as it is designed to ensure that no individual or group of individuals can dominate the board's decision making process as they have no material relationship with the organization beyond the directorship. It is therefore desirable that non executive directors be the majority in the board. The presence of the non executive directors in the board assist in ensuring that they afford oversight role to the management of the corporation as they would be recruited in the first place due to their competencies. Non executive directors are invaluable in a well composed board as

¹⁰⁰ ibid

there are key to the efficient management of board committees especially the one concerned with the audit of the corporation. The fusion of the role of chief executive and that of the chairperson of the board of directors has been one of the dominant factors in the dismal performance of all corporations. The role of CEO and that of chairperson should be separated so that each oversees the other¹⁰¹.

The codes recommended the importance of a minimum number of non executive directors; Sarbanes Oxley Act 2002 requires that these be the majority, Cadbury 1992 recommends a minimum of three directors whilst the Kings report recommends at least two. The regulations were also meant to address the issue of insufficient information on financial management to the board which was the main cause of conflict of interest as explained by the agency theory. The role of an independent auditor is a common provision in all the reports. The auditors are expected to carry out audit and make an independent report to the board. In addition, internal checks and balances within the corporations were to be strengthened in two ways. One of the ways is the separation of the role of chief executive officer from that of chairman of the corporate board and the need to ensure that there is a limited term to be served by members of the board. The unanimous recommendation in this regard is that a member of the board is supposed to serve for three years without automatic reappointment¹⁰².

2.3. History of State Corporations in Kenya

¹⁰¹ ibid

¹⁰² Republic of Kenya (2005). Sessional Paper of 2005 on Privatization Of State Corporations And Investments. Nairobi: Government Printer.

The existence of State Corporations in Kenya dates back to the advent of construction of the Uganda Railway, which later became the Kenya Railways Corporation a century ago. The Kenya Railways Corporation which was a successor to the African railways was one of the earliest State Corporations in Kenya. The colonial government established other statutory boards to regulate the production of Agricultural commodities and regulate the marketing of these commodities through marketing boards¹⁰³. From 1963 when Kenya achieved political independence up to 1979 when a comprehensive review of the State Corporations sub-sector was carried out, the Government's participation in commercial activities grew rapidly and broadly resulting in state dominance in various forms in many commercial activities.¹⁰⁴

The establishment of the Parastatals was driven by a national desire to accelerate economic social development by ensuring regional economic balance, the promotion of indigenous entrepreneurship and foreign investments¹⁰⁵. This desire was expressed in Sessional Paper No. 10 of 1965 on African Socialism and its application to planning in Kenya which was to achieve Africanization without hurting the economy and within the country's declared aims¹⁰⁶. It emphasized that rigid doctrinal systems had little chance for survival and that as a must the strategy had to be adaptable to new and changing circumstances in order to survive¹⁰⁷. The paper also outlined the principles, which guided nationalization under which a few private sector operations were brought under

¹⁰³ *ibid*

¹⁰⁴ *ibid*

¹⁰⁵ *ibid*

¹⁰⁶ Sessional Paper No. 10 of 1965 on African Socialism and its application to planning in Kenya

¹⁰⁷ *ibid*

government control. The paper indicated that once in government hands the nationalized operations had to operate efficiently, cover costs and earn profits at least equivalent to taxes paid when operating efficiently¹⁰⁸.

Further in 1970, the Inspectorate of Statutory Boards was transferred to the Office of the President purposefully to spread its appraisal and monitoring services to all other Government Ministries, notably with the mandate to regulate and control clauses set out in enabling legislations of various Ministries and respective statutory boards, various circulars emanating from the Office of the President and the Treasury; and The Exchequer and Audit Act¹⁰⁹. A comprehensive review of the public enterprises performance was carried out in 1979 that necessitated the reorganization of the Government in December 1979. The Inspectorate was placed under the control of the Permanent Secretary in-charge of the newly established Department of Development Co-ordination in the Office of the President. The working party on Government expenditure further consolidated the position and underscored the critical role of the Inspectorate of Statutory Boards, turning the Department into the “de jure” technical arm of the then Parastatals Advisory Committee to prepare material which may assist the Committee to formulate its policy recommendations to the Government and monitoring the internal management and financial control functions of all parastatal organizations. The office of

¹⁰⁸ *ibid*

¹⁰⁹ ‘EAA,412’

the Inspectorate of State Corporations was active till 1990 when its technical capacity was vastly reduced¹¹⁰.

The Report on the Review of Statutory Boards further pointed out that:¹¹¹ the growth in the Parastatal sector had not been accompanied by development of efficient systems to ensure that the sector plays its role in an efficient manner leading to prolonged inefficiency, financial mismanagement, waste and malpractices in many Parastatals. It also pointed out that many of the Parastatals had moved away from their primary functions, especially the regulatory boards most of which had translated their regulatory role into an executive one, resulting in waste and confusion; and there was danger of over-politicizing production and distribution through establishment of too many Parastatals¹¹².

In 1982, a review of government expenditure was effected and the Report on the Working Party on Government Expenditure¹¹³ concluded that productivity of the State Corporations was quite low while at the same time they continued to absorb an excessive portion of the budget, becoming a principal cause of long-term fiscal problems.¹¹⁴ The report also observed that some of the resources used to finance the state corporations' activities could have contributed more to national development if these State

¹¹⁰ Kenya Committee on Review of Statutory Boards.(1979). Review of statutory boards:Report and recommendations of the committee appointed by His excellent the President. Government Printers.Nairobi Kenya.

¹¹¹ibid

¹¹² ibid

¹¹³ Philip Ndegwa.(1982). Report and Recommendations of the working party on Government expenditures. Government Printers. Nairobi, Kenya.

¹¹⁴ 1982 (the Report of the Working Party on Government Expenditures)

Corporations were left in the private sector¹¹⁵. Following the two reviews a number of measures were put in place. One of the measures was the enactment of the State Corporations Act¹¹⁶. This was a major attempt to streamline the management of the State Corporations but the performance of most of the corporations continued to deteriorate due to continued reliance on limited public sector financing which was not adequate to meet all the sector's needs¹¹⁷.

Sessional Paper No.4 of 1991 on Development and Employment in Kenya¹¹⁸ decried the continued deterioration of the performance of State Corporations after four years since the enactment of the State Corporations Act¹¹⁹. The Paper observed that while the creation of State Corporations through which government participation in economic activities was promoted was perhaps appropriate soon after independence, the objectives for and the circumstances under which most of the State Enterprises were created had since changed. The paper underlined the need to implement privatization and divestiture of State Corporations urgently in view of the managerial problems afflicting the Parastatals leading to poor return on government investments, the existence of a larger pool of qualified manpower, availability of more indigenous entrepreneurship to permit private sector led economy and the need for non-tax revenue for the Government¹²⁰. It recommended that the government should act as a creator of favourable setting within which people can develop themselves and the economy, the government should divest

¹¹⁵ *ibid*

¹¹⁶ *Supra* Note 1

¹¹⁷ *ibid*

¹¹⁸ Sessional Paper No.4 of 1991 on Development and Employment in Kenya. Government printer. Nairobi Kenya

¹¹⁹ *ibid*

¹²⁰ *ibid*

from its investments in commercial and industrial enterprises to transfer active participation to more Kenyans through participation in shareholding. The government should reduce exposure to risk in areas in which the Private Sector can assume risk without government intervention, the government should dismantle some of the existing administrative hurdles which discourage private sector initiative and provide needless opportunities for corruption; and the government should reorganize legal and institutional framework regarding monitoring and supervision of Parastatals.

In 1992 the KANU Government initiated a comprehensive State Corporations reform programme whose main objectives were to shift more of the responsibility for production and delivery of products and services from the public to the private sector, reduce the demand by the State Corporations on the Exchequer, rationalize the operations of the State Corporations sector and improve the regulatory environment by selecting more economically rational means of regulation (thereby reducing conflicts of interest between the regulatory and commercial functions of state corporations). One of the major reforms was to privatize a number of parastatals which is still in progress today ¹²¹.

In 2002, most of the non-strategic Commercial Enterprises had either been fully or partially privatized¹²². At that time, the direction of thinking regarding restructuring and retention of a number of strategic corporations under Government operation and control had also changed due to the inadequacy of public resources to finance the requisite investment in infrastructure facilities¹²³. It was not until 2003 after the change of regime

¹²¹ Muindi, S. Public enterprises in Reform and privatization in Kenya.

[Http://unpan1.un.org/intradoc/groups/public/documents/AAPAM/UNPAN028231.pdf](http://unpan1.un.org/intradoc/groups/public/documents/AAPAM/UNPAN028231.pdf).20.10.2013.

¹²² *ibid*

¹²³ *ibid*

when former President Mwai Kibaki came to power when actual strengthening of State Corporations took off by Government allowing the Inspectorate to fill critical vacant positions in the Department¹²⁴. Under the Economic Recovery Strategy for Wealth and Employment Creation (ERSWEC) 2003-2007, the Government implemented a number of key privatization transactions. These included the Kenya Electricity Generating Company (KenGen) Initial Public Offer (IPO), the concessioning of the Kenya Railways operations, Mumias Sugar Company Second Offer, Kenya Reinsurance Corporation IPO, Sale of 51% Telkom Kenya shareholding to a strategic partner and the recently completed Safaricom IPO. Through these transactions, the country mobilized over Kshs.80 billion used to support the country's recovery and overall development agenda¹²⁵.

Following expiry of the Economic Recovery Strategy for Wealth and Employment Creation (ERSWEC) 2003-2007, Kenya has embarked on the implementation of a long term strategy, Vision 2030. On the basis of Vision 2030 and its First Medium Term plan for the period 2008 – 2020, the Government is focusing on growing the economy to a middle level developed country. Under the strategy the government intends to use State Corporations to achieve the objectives of the vision. In fact there are a number of projects under vision 2030 that are being implemented by State Corporations¹²⁶. In fact State Corporations will be involved in a massive rice irrigation scale through the Tana River Development Authority (TARDA). The development of 2x 140 megawatts Ol Karia VII and VIII by Kenya Generating Company Limited (KenGen). The further

¹²⁴ *ibid*

¹²⁵ Government's Economic Recovery Strategy for Wealth and Employment creation 2003-2007

¹²⁶ Kenya Vision 2030 (2007). A Globally Competitive and Prosperous Kenya.

development by Geothermal development corporation (GDC) of 2x100 megawatts Menengai Phase one. The National Oil Corporation of Kenya (NOCK) will build the Mombasa Petroleum Trading hub. Eco Lodges and Tourism adventure facilities will be developed by Kenya Wildlife Services(KWS) . The Mombasa Convection centre will be developed by the Kenya Tourist Development Corporation whilst the Eden, Cradle of mankind will be developed by the National Museums of Kenya¹²⁷.

2.4. Code of Best Practices

Corporate governance is different and diverse in all countries but the principles of good corporate governance applies to all¹²⁸. OECD principles of good corporate governance have become international benchmarks for Public Traded Corporations providing guidelines to regulations in OECD and non OECD countries¹²⁹. The OECD guidelines on Corporate Governance of State Owned Enterprises give concrete advice to countries on how to manage more effectively their responsibilities as company owners, thus helping to make State Owned Enterprises more competitive, efficient and transparent. The integrity of businesses and markets is central to the vitality and stability of our economies. So good corporate governance rules and practices that govern the relationship between the managers and shareholders of corporations as well as stakeholders like employees and creditors – contribute to the growth and financial stability by underpinning market

¹²⁷ Mugo Kibati. 2012. Kenya Vision 2013 Flagship projects. Kenya Vision 2013 Delivery Secretariat. Nairobi Kenya.

¹²⁸ Corporate Governance: A survey of OECD Countries, ISBN 92-64-10605 – 7 © OECD,2004. www.asx.com.au/corporategovernance.23.7.2013

¹²⁹OECD, 2004. OECD Principles of corporate governance. Paris, France.OECD publications services.

confidence, financial market integrity and economic efficiency¹³⁰. The OECD principles of Corporate Governance provide specific guidance for policymakers, regulators and market participants in improving the legal, institutional and regulatory framework that underpins corporate governance, with a focus on publicly traded companies¹³¹. They also provide practical suggestions for stock exchanges, investors, corporations and other parties that have a role in the process of developing good corporate governance. They have been endorsed as one of the Financial Stability Forum's 12 key standards essential for financial stability.

The OECD principles were originally issued in 1999 and have since become the international benchmarks for corporate governance, forming the basis for a number of reform initiatives, both by government and the private sector. The principles were revised in 2003 to take into account development since 1999 through a process of extensive and open consultations and drawing on the work of the Regional Corporate Governance Roundtable for non OECD countries. The new principles were agreed by OECD governments in April 2004. This Policy Brief outlines the salient features of the principles and illustrates how they address key corporate governance issues.

The principles cover six key areas of corporate governance ensuring the basis for an effective corporate governance framework: the rights of shareholders; the equitable treatment of shareholders; the role of stakeholders in corporate governance; disclosure and transparency; and the responsibilities of the board. There are explanation annotations for each area that also indicate the range of policy measures which have proved useful in

¹³⁰ Supra Note 129

¹³¹ *ibid*

achieving them. Key to the success of the principles is that they are principle based and non prescriptive so that they retain their relevance in the legal, economic and social context¹³².

It contains the basic requirements of the institutional and legal framework needed to support effective principles. The text includes principles for developing such a framework and addresses the need for laws and regulations which are both enforceable and are backed by effective enforcement agencies. Experience around the world shows that although the powerful concept of listed company has been successfully introduced in many countries, the accompanying legal and regulatory system has often lagged behind, leading in some cases to abuse of minority shareholders and to reduced growth prospects when financial markets lose credibility or fail to achieve it in the first place¹³³. Other areas covered by the principles are aimed at establishing an effective system of checks and balances between boards and management. Professional managers for example have a key role to play in the modern listed or widely held company but to avoid possible misuse of their position requires, *inter alia*, effective monitoring by the board. The principles stress that such monitoring should not involve day to day management but rather ensure strategic guidance of the company and the oversight of internal controls¹³⁴.

The principles are directed to managing relationship between shareholders, management, board of directors and other stakeholders¹³⁵. Many countries have developed codes of best practices and formulated corporate laws that have borrowed heavily from OECD

¹³² Supra note 129

¹³³ *ibid*

¹³⁴ *ibid*

¹³⁵ *ibid*

principles with focus on managing ownership, control and interest of other stakeholders¹³⁶. The impact of the code of best practices has been found to mitigate agency risks, prevent conflict of interests between stakeholders and protect the rights of shareholders significantly¹³⁷. From the literature reviewed there are five main principles of good corporate governance namely protection of the rights of shareholders, equitable treatment of all stakeholders, the role and responsibility of corporate boards, disclosure and transparency and adherence to an effective corporate governance framework¹³⁸.

Corporate laws have continued to be formulated to protect the rights of shareholders and other stakeholders¹³⁹. In USA, the enactment of Sarbanes Oxley Act of 2002 was applauded as one of the best legal frameworks in the world as it was directed at the protection of shareholders in public traded corporations. The Act has the highest standards of corporate accountability and sets the penalty of any wrong doing by board of directors, management and auditors¹⁴⁰. Shareholders have several rights to be protected and legal frameworks must facilitate the exercise of these rights. These rights include secure methods of ownership registration, transfer of shares, accessibility of relevant information on a timely and regular basis, participation in voting in a general meeting, election and removal of board members and share of the profit of the corporations¹⁴¹.

In the spirit of equal treatment of all stakeholders, corporate governance frameworks must ensure that Corporations are sustainable for the purposes of creating wealth, jobs

¹³⁶ *ibid*

¹³⁷ *ibid*

¹³⁸ *ibid*

¹³⁹ *supra*

¹⁴⁰ *Supra* note 93

¹⁴¹ *ibid*

and financially sustainable enterprise. Traditionally, legal reforms have strengthened shareholders rights and protected shareholders from exploitation by Corporate insiders¹⁴². However, with the current trend in good Corporate governance in the world, the interests of other stakeholders are increasingly being recognized and necessary attention is paid especially in the countries where Corporate governance is focused on the rights of shareholders¹⁴³. In some countries like Germany corporations have a two tier board with a supervisory board constituted by the stakeholders and a management board by shareholders for the sole purpose of ensuring that other stakeholders participate and enjoy equal treatment in the Corporations' management¹⁴⁴.

Disclosure and transparency is encouraged in all good Corporate governance practices. High performing public listed Companies should have internal controls and high level of accountability. Financial scandals that have happened in the past revolved around poor financial management of the Corporation. The transparency and accountability of the Corporation is reflected by the extent at which honest financial reports are generated. In USA, Sarbanes Oxley Act has set strict standards on financial reporting processes by facilitating independent and Corporate responsibility of managers, auditors and audit committees of the board in this respect¹⁴⁵.

An effective CG framework is a structure that supports all the other principles of good CG. This entails integrity and ethical behavior based on the code of ethics within the agency that creates a balanced relationship and a pattern of behaviour between different

¹⁴² ibid

¹⁴³ ibid

¹⁴⁴ ibid

¹⁴⁵ ibid

agents in a limited liability Corporation¹⁴⁶. A sustainable good Corporate culture is the immediate result of effective Corporate structure that nurture participatory corporate governance among the stakeholders and promotes equity market growth due to the growth of financial institutions¹⁴⁷. The board of directors is a moderator of any corporate governance framework by conducting objective monitoring and supervision of management¹⁴⁸. All codes of best practices have recognized the importance of having a significant number of non executive members in the board. This encourages the aspect of independent judgment and objectivity in the oversight role of the board. The composition and structure of the board has also been a requirement in all public listed Companies and their operations must ensure objective judgement and challenge the management on Corporate Governance¹⁴⁹.

2.5. Code of best practices in Kenya and the appointments and dismissals of directors of board of state corporations

In Kenya, the code of the best practice was developed by the centre for Corporate Governance and disseminated to all public listed companies and State Corporations. In 2002, guidelines for Corporate Governance practices by public listed companies were gazetted¹⁵⁰. The principles of good Governance in Kenya have clearly stated the role of stakeholders and board of directors in managing Corporations. The code of best practice

¹⁴⁶ Kenya private Sector initiatives for corporate Governance. 1999. Principles for corporate governance in Kenya and code of best practices for corporate governance. Private Sector Corporate Governance Trust. ISBN 9966-9969-0-12

¹⁴⁷ Australian Stock exchange Councils. 2010. Principles of good corporate governance and best practices recommendations. Australian Stock Exchange Ltd. ABN 98008624691.

¹⁴⁸ ibid

¹⁴⁹ ibid

¹⁵⁰ Guidelines on corporate governance practices by public listed companies in Kenya, 2002 Gazette Notice No.3362.Governemnt Printer.

recognizes the supreme authority of the shareholders in Corporations because they are the owners. The codes demand of the shareholders to exercise their authority by appointing effective management boards and to hold the members of the board accountable and responsible over the management of the Corporate affairs. The code has made it mandatory for shareholders to conduct board appraisals and effect changes based on performance including the removal of board members who do not add value to the Corporation vision¹⁵¹.

The board of director's role remains key in the Kenya Corporate sector like in other countries in the world. The code clearly states that there must be a formal and transparent procedure for nomination and appointment of the Board of Directors.¹⁵² A nomination committee should be constituted to carry out nomination of members of the board.

In summary the composition of Board of Directors should have a mix of executive and non executive directors, a balance between executive and non executive directors to ensure that decision making is not dominated by one type of directors, non executive directors should have no material relationship with the company, executive and non executive directors should have the right skills and knowledge mix that is valuable to the company and a size that will facilitate productive and constructive discussions on the performance of the company which ideally should be between 7-11 members¹⁵³:

The code has also brought to the fore the importance of conducting board review on its composition every year. This is an aspect that has been lacking in the Corporate Sector.

¹⁵¹ *ibid*

¹⁵² *ibid*

¹⁵³ *ibid*

The review focuses on the appropriateness of the mix of membership and commitment of non executive members¹⁵⁴. The principles on appointment and dismissal of the directors of State Corporations are derived from the codes of best practices guided by Company law, Capital Market Act¹⁵⁵ , the different statutes that form State Corporations, administrative circulars routinely issued by the Office of the President, directing the Corporations to apply good Corporate Governance principles and the codes of best practices as contained in the principles set out by the Center of Corporate Governance in Kenya.

2.6. Conclusion

From the foregoing account it is clear that the financial scandals examined played an extremely important role in stimulating the unprecedented growth of Corporate Governance throughout the world. These scandals were instrumental in the formulation of the principles and formulation of OECD codes of best practice which provides a comprehensive bible as it were of sound Corporate Governance. It is against these benchmarks that the next chapters will interrogate the extent to which they have been applied in Kenya.

¹⁵⁴ *ibid*

¹⁵⁵ *ibid*

CHAPTER THREE

LEGAL FRAMEWORK OF STATE CORPORATIONS IN KENYA

3.1. The Legal Framework regulating State Corporations in Kenya

3.1.1 The Constitution of Kenya, 2010

Chapter six of the constitution deals with the test of Leadership and Integrity. Article 73 provides that authority assigned to a state officer is a public trust which is to be exercised in a manner that is consistent with the purposes and objects of the Constitution, demonstrates respect for the people, brings honour to the nation and dignity to the office and promotes public confidence in the integrity of the office. Further, Chapter Six regulates conduct of state officers. It provides that state officers shall behave, whether in public and official life, in private life, or in association with other persons, in a manner that avoids any conflict between personal interests and public or official duties, compromising any public or official interest in favour of a personal interest, or demeaning the office the officer holds.¹⁵⁶

In Article 75 (2), the Constitution provides that a state officer shall be subject to the applicable disciplinary procedure for the relevant office, and may, in accordance with the

¹⁵⁶ Ibid

disciplinary procedure be dismissed or otherwise removed from office, and they will be disqualified from holding any other state office¹⁵⁷.

In line with the 2010 constitution of Kenya, officers of the State are to be appointed on merit, and there should be an observance of gender equality and regional balancing. This ensures an effective mechanism of reducing corruption, for example the appointment of directors based on political patronage and/or tribal/racial, political and other affiliations.

3.1.2. The State Corporations Act, 1986, As Revised In 2002.

The Act makes provision for the establishment of state corporations; for control and regulation of state corporations; and for connected purposes¹⁵⁸.

Section 3 empowers the President to, by order, establish a state corporation as a body corporate to perform the functions specified in the order. The President is required to assign ministerial responsibility for the state corporation to the Vice-President and the several Ministers as he/she may by directions in writing determine¹⁵⁹.

Section 2 (vii) enables the President to declare a State Corporation, by notice in the Gazette, not to be a State Corporation. Furthermore, section 5 A (1) empowers the President to exempt a State Corporation, not being a State Corporation established under section 3, from provisions that are allowed by the Act. These powers should be revoked

¹⁵⁷ *ibid*

¹⁵⁸ *Supra* note 4, preamble.

¹⁵⁹ *ibid*, section 4.

as they disable the public, as stakeholders, to hold Parastatals accountable for financial mismanagement¹⁶⁰.

Under section 7 (1), the President may give directions of a general or specific nature to a Board with regard to the better exercise and performance of the functions of the State Corporation and the Board must give effect to those directions. If at any time it appears to the President that a Board of a State Corporation has failed to carry out its functions in the national interest, he may revoke the appointment of any member of the Board and may himself nominate a new member for the remainder of the period of office of that member or he may constitute a new Board for such period as he shall, in consultation with the State Corporations Advisory Committee, determine. The Committee is established under section 26 to, among others, review and investigate the affairs of State Corporations and make such recommendations to the President as it may deem necessary¹⁶¹. Unfortunately, the Committee does not possess any quasi-judicial powers and is merely limited to an advisory role. Subsequently, it cannot compel State Corporations to comply with its recommendations¹⁶².

The powers of the President over the Corporations are unnecessarily extensive and infringe on the ethics of a free market economy thus impairing the ability of Parastatal' boards to make sound competitive decisions. A major challenge is to find a balance between the State's responsibility for actively exercising its ownership functions, such as

¹⁶⁰ *ibid*

¹⁶¹ *ibid*,

¹⁶² *ibid*

the nomination and election of the board, while at the same time refraining from imposing undue political interference in the management of the Corporation. The OECD suggests that the ownership entity's ability to give direction to the Parastatal or its board should be limited to strategic issues and policies¹⁶³. It should be publicly disclosed and specified in which areas and types of decisions the ownership or coordinating entity is competent to give instructions¹⁶⁴. The government should not be involved in the day-to-day management of Parastatals and should allow them full operational autonomy to achieve their defined objectives¹⁶⁵.

The Board of Directors of a State Corporation is responsible for the proper management of the affairs of the State Corporation and is accountable for the moneys, the financial business and the management of a state corporation¹⁶⁶. Subsequently, the chief executive of a State Corporation may be summoned by the Public Investments Committee (PIC) to answer on behalf of the Board any question arising from a report, including a special report, of the Controller and Auditor- General concerning the State Corporation¹⁶⁷.

3.1.3. The Capital Markets Authority Guidelines on Corporate Governance Practices by Public Listed Companies in Kenya, 2002

In regard to Parastatals, these guidelines do not apply as they apply only to listed Public Companies. In the recent move towards the privatization of Corporations, Kenya, like other developing countries, has adopted a Corporate Governance code in the form of the

¹⁶³ *ibid*

¹⁶⁴ *ibid.*

¹⁶⁵ *ibid*

¹⁶⁶ *Supra* note 1, section 15 (1).

¹⁶⁷ *ibid*, section 15 (2).

Sample Code of Best Practice of Corporate Governance in Kenya 2002, which was developed by the Centre for Corporate Governance¹⁶⁸. The code is enforced by the Capital Markets Authority (CMA) through the CMA *Guidelines on Corporate Governance by Public Listed Companies in Kenya*, which are the result of a combination of ideas from Corporate Governance Codes from different jurisdictions¹⁶⁹. The guidelines were developed as a response to the recognition of the role of good governance in maximization of shareholders value as well as protection of investors' rights¹⁷⁰.

The guidelines define Corporate Governance, for its purposes as the process and structure used to direct and manage business affairs of the company towards enhancing prosperity and Corporate accounting with the ultimate objective of realizing shareholders long-term value while taking into account the interest of other stakeholders¹⁷¹.

The guidelines require that there should be a formal and transparent procedure in the appointment of directors to the board and all persons offering themselves for appointment, and directors should disclose any potential area of conflict that may undermine their position or service as director¹⁷². The directors' remuneration should be

¹⁶⁸Supra note 3.

¹⁶⁹Section 1.3 of the CMA Guidelines states that "these guidelines have been developed taking into account the work which has been undertaken extensively by several jurisdictions through many task forces and committees *including but not limited to* the United Kingdom, Malaysia, South Africa, Organization for Economic Cooperation and Development and the Commonwealth Association for Corporate Governance".

¹⁷⁰Id, section .3 of the CMA Guidelines states that the adoption of international standards in corporate governance best practice is essential for public companies in Kenya in order to maximize shareholders value"

¹⁷¹ibid, section s.1.2.

¹⁷²ibid, section 2.1.5.

sufficient to attract and retain directors to run the company effectively and should be approved by shareholders¹⁷³.

To ensure transparency, the board should present an objective and understandable assessment of the Company's operating position and prospects annually¹⁷⁴. The board should ensure that accounts are presented in line with International Accounting Standards¹⁷⁵. The board should establish a formal and transparent arrangement for shareholders to effect the appointment of independent auditors at each annual general meeting¹⁷⁶. The board of directors should assume a primary responsibility of fostering the long-term business of the corporation consistent with their fiduciary responsibility to the shareholders¹⁷⁷. There should be shareholders participation in major decisions of the Company¹⁷⁸. The board should therefore provide the shareholders with information on matters that include, but are not limited to, major disposal of the Company's assets, restructuring, takeovers, mergers, acquisitions or reorganization¹⁷⁹.

3.1.4. The Public Audit Act, Chapter 4 Of 2003

Section 12 of the Act requires State Corporations to prepare audit accounts for each financial year to be submitted to the Controller and Auditor-General within three months after the end of the financial year to which the accounts relate¹⁸⁰. The Controller and

¹⁷³ibid, section 2.1.2. (i)

¹⁷⁴ibid, section 2.4.1.

¹⁷⁵ibid, section 2.4.1.

¹⁷⁶ibid, section 2.4.3.

¹⁷⁷ibid, section 3.1.1.

¹⁷⁸ibid, section 2.3.1.

¹⁷⁹ibid, section 2.3.1.

¹⁸⁰The Public Audit Act; section 12 (1) and 13 (1).

Auditor-General and his staff collectively constitute the Kenya National Audit Office¹⁸¹. The Controller and Auditor-General are then required to examine and audit the submitted accounts, express an opinion on the accounts and certify the result of the examinations and audits¹⁸². Section 39 (1) allows the Controller and Auditor-General to appoint an auditor who is not a member of the staff of the Kenya National Audit Office to assist in an examination and audit of accounts. This allows for the appointment of independent auditors which enhances the capacity of the Audit Office and increases financial oversight over Parastatals.

The Controller and Auditor-General must afterwards prepare a report on the examination and audit and submit the report to the Minister for Finance¹⁸³. The report must identify cases in which money has been spent in a way that was not efficient or economical¹⁸⁴. The Minister for Finance must subsequently table the report before the National Assembly.

Section 44 grants the Kenya National Audit Office requisite security of tenure. Furthermore, section 46 assures the independence of the offices of the Controller and the Auditor-General.

The Act amends the Exchequer and Audit Act in the manner specified in the Second Schedule. The auditing of accounts of State Corporations and the mandate of the

¹⁸¹ibid section 34.

¹⁸²ibid; section 14.

¹⁸³ibid; section 15 (1).

¹⁸⁴ibid, section 15 (3) (a).

Controller and Auditor-General were previously regulated by the Exchequer and Audit Act, 1995.

3.1.5. The Anti-Corruption and Economic Crimes 3 Act, Chapter Of 2003

The Act provides for the prevention, investigation and punishment of corruption, economic crimes and related offences and for matters incidental thereto¹⁸⁵. Section 6 establishes the Kenya Anti-Corruption Commission (KACC) whose mandate includes examining the practices and procedures of public bodies in order to facilitate the discovery of corrupt practices and to investigate the conduct of any person that, in the opinion of the Commission, is conducive to corruption or economic crime¹⁸⁶.

While the Anti-Corruption and Economic Crimes Act and the Public Audit Act have an enormous potential to curb corruption in parastatals, they have been trivialized by a political system that lacks the will to enforce the Statutes.

3.1.6. The Public Officer Ethics Act, 2003

The Act advances the ethics of Public Officers by providing for a Code of Conduct and Ethics for Public Officers and requiring financial declarations from certain Public Officers and to provide for connected purposes¹⁸⁷.

Section 26 requires Public Officers to declare the income, assets and liabilities of himself, his spouse or spouses and his dependent children under the age of 18 years. Unexplained assets are deemed to be improperly acquired and may be forfeited to the state. This

¹⁸⁵ The Anti-Corruption and Economic Crimes Act, Preamble.

¹⁸⁶ *ibid*, section 6 (b) and (e).

¹⁸⁷ 'Public Officer Ethics Acts ,2003'

cushions State Corporations against corruption by Public Officials. Unfortunately, there is a general lack of political will to enforce this statute.

3.2. Conclusion

In documenting the history of State Corporations in Kenya, this chapter has at the same time traced the history of a Public Corporation in an open market economy. The chapter has also demonstrated how Statute Law, principally the State Corporations Act has structured State Corporations with the objective of making them efficient and productive. It has also shown how the government through other legal instruments has gradually though in a haphazard manner introduced principles of good corporate governance in these Corporations. It has captured the phenomenon that the most important legal instruments that holds great promise for the incorporation of sound corporate governance principles in these Corporations is the Constitution of Kenya 2010. This legal document is exceedingly important as it is the basic law of the state and all other laws must comply with its provisions. The provisions enunciated in the constitution have borrowed heavily from the OECD code of best practice which has already been discussed. A total application of Corporate Governance principles to State Corporations in Kenya is however a work in progress as the following chapter will demonstrate.

CHAPTER FOUR

APPOINTMENT AND DISMISSAL OF DIRECTORS OF BOARDS OF STATE CORPORATIONS IN KENNYA

4.0 Introduction

The central theme in this study has been that the board of directors of a State Corporation plays a central role in its governance. It carries the responsibility for the performance of the State Corporation and should therefore have the authority and autonomy to make decisions that determine not only the performance of the State Corporation but also its relationship with all the stakeholders. It is also meant to act as an intermediary between the State and the State Corporation on behalf of the owners who in this case are the citizens¹⁸⁸. As will presently emerge, boards of directors of State Corporations have failed to achieve their mandate and to be the central players in State Corporations performance. One of the main reasons for this phenomenon is that most boards of State Corporations have no structured criteria for the appointment and dismissal of their directors. This is well illustrated when the process of the appointment and dismissal of these directors is matched against the code of Best practices in this regard.

4.1. Legal framework on the appointment and dismissal of directors of boards of State Corporations

¹⁸⁸ Fredrick, w. Richard Enhancing the role of the boards of directors of state owned enterprise, p11. www.oecd.org/dat.24.9.2013.

As earlier indicated all State Corporations are subject to the State Corporations Act¹⁸⁹. The principal feature in the provisions of this Act is that virtually all the Chairpersons of boards of State Corporations are appointed by the President¹⁹⁰. However, this does not apply to all state corporations since in some of them such as the Kenya Industrial Property Institute (KIPI)¹⁹¹ and the Ant Counterfeit Agency¹⁹², the responsibility for the appointment of the Chairpersons rest with the Minister of the Parent Ministry. As will be seen shortly, the history of the development of corporate governance principles in the appointment and dismissal of State Corporations boards has not been consistent and/ or well thought out.

To its credit the government of Kenya should be commended for attempting from time to time, albeit haphazardly, to incorporate principles of good corporate governance in State Corporations. This has been principally done by circulars emanating from Office of the President¹⁹³. It is probably as a result of this initiative that State Corporations that have been formed recently, incorporate sound governance principles by taking away the power of the President to appoint chairpersons of these Boards and donated it to the Sector Minister.

Although the majority of the State Corporation are established by an act of Parliament, the President has in certain occasions established State Corporations by legal notice. Such

¹⁸⁹ Supra note 1

¹⁹⁰ *ibid*

¹⁹¹ *ibid*

¹⁹² Kenya industrial Property Institute Act 13, 2008.

¹⁹³ Ref. from Prime Minister's Office /CIRC (A)/3, Ref. No. Office of the President /CAB.9/1, OP.CAB9/1A

is the case with the Kenya Accreditation Services Order¹⁹⁴. This State Corporation was established pursuant to Section 3 of the State Corporations Act through legal notice¹⁹⁵ No. 55 of 2009. This is not a desirable way to establish a State Corporation as the validity of its legality is open to challenge in view of the provisions of section 134 of the Interpretation and General Provisions Act¹⁹⁶. This requires the legal notice to be placed before the appropriate committee of the National Assembly for adoption or rejection by the national assembly. At the time of writing this paper, the legal notice which is in breach of the legal timelines for it to be placed before parliament has expired. Clearly the Tenure of the Directors of this State Corporation is not definite and is against sound corporate governance principles.

Generally it is significant to note that there are no criteria either under the State Corporations Act, and or legal instruments constituting State Corporations for the qualification of Chairpersons and Directors of Boards of State Corporations. This therefore gives the President and the Ministers wide ranging discretionary powers with the latitude to appoint their friends, political allies and cronies to these positions.

There is also the unique case of certain State Corporations being incorporated under the Companies Act which are also governed by the provisions of the State Corporations Act. This creates a conflict between the Articles and Memorandum of Association of the State Corporations and provisions of the State Corporations Act. More often than not the Memorandum and Articles of Associations of the incorporating companies would have

¹⁹⁴ 'Kenya Accreditation Service Order,2009'

¹⁹⁵ Legal notice No. 55 of 2009.

¹⁹⁶ Interpretation and General Provisions Act ,Chapter 2 Laws of Kenya

provisions for the appointment and dismissals of boards of directors by the shareholders whilst under the State Corporation's Act this power lies with the president or parent's ministry. An example of this type of State Corporations is East African Portland Cement Company Limited (EAPCC) and Kenya Industrial Estates (KIE) Ltd.

Although most of the statutes that form State Corporations make provision for the dismissal of boards of State Corporations the grounds for such removal are technical and do not relate to substantive grounds for such dismissals. They merely relate to dismissals for failure to attend the requisite statutory number of meetings and issues of conflict of interest¹⁹⁷. Since invariably the appointment of directors of State Corporations is based on patronage and political cronism, dismissals are based on whether the directors are loyal to the appointing authority and not to statutory provisions for dismissal. Boards of State Corporations are in a precarious position as they can be dismissed at will by the appointing authority. The recent case of Mark Ole Karbole vs Acting minister for Ministry of industrialization, Permanent secretary, Ministry of industrialization and East African Portland and four other interested parties¹⁹⁸ clearly illustrates that boards of directors have no autonomy and security. In this case the Acting Minister and the Permanent Secretary both of the Ministry of Industrialization purported to suspend the entire board of EAPCC on alleged malpractices. It should be noted that the board of directors consisted of the first applicant who is the chairman appointed by the president,

¹⁹⁷ *Supra* note 1. Typically in all statutes there is provision that a director of the board may be dismissed if he absents himself from the attendance of board meetings without good reason.

¹⁹⁸ Mark Ole Karbole vs Acting minister for Ministry of industrialization, Permanent secretary, Ministry of industrialization and East African Portland and four other Interested Parties. Nairobi High Court, Judicial Review division, Misc. Application No. 337 of 2011

permanent secretaries for the Ministry Finance and Industrialization, a government nominee to represent the public interest, a nominee appointed by National Social Security Fund (NSSF), two nominees appointed by the Lafarge group and the managing director of the company.

Justice Warsame(as he then was) in finding that the alleged suspension of the board was unlawful held that the Permanent Secretary Ministry of Industrialization being a director like any other director of the board of EAPCC had no authority to suspend the other directors whilst purporting to exercise supervisory power over the other board members and the company. The alleged suspension of the board was also irregular as the Permanent Secretary and the Minister were purporting to suspend the Chairman (first applicant) who was the President's appointee. Moreover both the Acting Minister and Permanent Secretary had no authority to dismiss the Permanent Secretary Treasury and the other shareholders who owned a substantial stake in EAPCC. The court then proceeded to reinstate the board and remove the acting appointed managing director.

The above case demonstrates that courts of law are increasingly playing a significant role in ensuring that appointments and dismissals of directors of Boards of State Corporations should comply with good Corporate Governance principles. Another case involved the dismissal of the then Managing Director of the Communications Commission of Kenya (CCK). Mr. Charles Njoroge who having been dismissed by the board of directors the Minister purported to reinstate him by appointing him through a Gazette notice. Since the power to appoint Directors of Boards of State Corporations lies with the board and not the minister the court had no hesitation in declaring the purported Gazette notice null and

void.¹⁹⁹. The court has also asserted its authority in the case concerning the Vice Chancellor of Jomo Kenyatta university of Agriculture and Technology Mabel Imbuga whose appointment by the Education Cabinet secretary Jacob Kaimenyi has been challenged in court on the basis that it had not been advertised. The courts overruled the objection and allowed her to continue until the determination of the case²⁰⁰. In the case of **Nairobi High courts J.R.MISC application APPL No.278 of 2012,- Kenya medical association vs Attorney General**²⁰¹ the court held that the President's appointment of a director of the Kenya Medical Association pursuant to the power bestowed upon him by section 7(3) of the State Corporations Act did not comply with the provisions of section 4 of the National Hospital Insurance Fund. The High Court (W.K.Korir J.) issued an order of stay suspending the President's decision thereto until the judicial review proceedings were heard and determined.

Courts have moreover not shied away from interrogating the propriety of circulars emanating from the Office of the President. In the case of **Ann Kinyua vs Nyayo Tea Zone Development Corporation and three others (2012)**²⁰². One of the issues before the court for determination was a circular from the Head of Public Service dated 9th May 2008 and another one dated 23rd November 2010 which set out the procedure for the reappointment of service of Chief Executive Officers of State Corporations. These two

¹⁹⁹ Geoffrey Mosoku, 'Board, Cabinet Secretary fail to agree on hiring of new parastatal heads'. The Standard (Nairobi, 12th August 2013). Mwaura, K. Constitutional Restructuring of corporate governance in state owned enterprises dynamism or distraction (2011).Journal of Mount Kenya University Law School.

²⁰⁰ *ibid*

²⁰¹ NAIROBI HIGH COURTS J.R.MISC APPLICATION APPL NO.278

²⁰² Ann Kinyua vs Nyayo Tea Zone Development Corporation and three others eKLR Republic of Kenya. Industrial Court of Kenya causes 1065

circulars formed the guidelines upon which Boards of State Corporations proceeded to consider the reappointment of CEO's when their terms of service came to an end.

In an extremely ground breaking finding the court held that the said circulars amounted to interference with the autonomy of State Corporations and their Boards. The court held that the powers of the President under section 7 of the State Corporations Act only allows his office to give direction of a general or specific nature to a Board with regard to the better exercise and performance of the functions of State Corporations and does not allow his office to meddle with the internal affairs of State Corporations or its Boards. The court found that the reappointment of a CEO was an internal matter for the Board and the State Corporation and was not subject to direction by the Office of the President.

Many cases exist demonstrating conflict between Boards of Parastatals and Cabinet Secretaries on the appointment of Chief Executive Officers who sit on these boards. Currently both the Board of Kenya Electricity Generating Company Limited (KenGen) and Energy Cabinet Secretary cannot agree on who to recruit as the CEO since the Cabinet Secretary has refused to accept the candidates offered to him for formal appointment after the Board has competitively recruited the individual²⁰³.

As pointed out earlier the lack of coherent and structured policy for the appointment and dismissal of directors of Boards of State Corporations has meant that Chief Executive Officers of these Corporations are exposed to the most unstable jobs in the Public Service. It has for instance been documented that the Managing Director of the Kenya Bureau of Standard (KEBS), Eva Oduor and the Managing Director of Kenya Airports

²⁰³ Supra note 199

Authority have both been sent parking before the expiry of their contracts of employment²⁰⁴. The conflict between the Boards and Cabinet Secretaries on the appointment and dismissals of directors of Boards of State Corporations is bound to continue as long as the authorities insist on the Board of directors competitively recruiting the CEO and requiring the Cabinet Secretary to choose from a proposed list of three recommended candidates. The Cabinet Secretary is under no obligation to choose the best candidates for the job²⁰⁵. This has meant that most State Corporations are run by people who are not necessarily the most competent with the result that the performance of these State Corporations is undermined.

The culture of patronage is highly internalized in the psyche of the political class which is a phenomenon that seriously militates against the appointment and dismissal of directors of State Corporations in Kenya. As an illustration of this in the year 2012, the then Minister for Transport made appointment by Gazette notices²⁰⁶ for the Chairpersons and directors of Kenya Ferry Services, the Kenya Ports Authority, Kenya Airports Authority and the Kenya Civil Aviation Authority which was in direct breach of Article 215 of the Constitution of Kenya 2010 which requires that public appointments reflect regional representation. Nine of the fourteen nominees appointed in these strategic State Corporations were drawn from one ethnic group which appointments amount to 64% of the total number of appointees whilst the ethnic group from which the Minister hails from

²⁰⁴ Muthoki Mumo' Purge exposes top parastatals posts as Kenya's most unstable public jobs' (Daily Nation 17,2013,pg 37)

²⁰⁵ Policy review proposal 2013 (unpublished) - State Corporations Advisory Committee's office - Nairobi

²⁰⁶ Gazette Notice No. 5060 of 13th April 2012, Gazette Notice No. 5061 of 10th April 2012, Gazette Notice No. 5062 of 10th April 2012, Gazette Notice No. 5063 of 13th April 2012, Gazette Notice No. 5064 of 10th April 2012, Gazette Notice No. 5065 of 10th April 2012, Gazette Notice No. 5066 of 10th April 2012.

comprises approximately 23% of the national population. It would have been expected that the minister would have familiarized himself with the principles of leadership and national values enshrined in the constitution and made the appointment according to the Constitutional dictates thereto. The minister however, in a clear example of impunity went ahead to make the appointments without recourse to the provisions of the constitution. This does not augur well to the application of sound corporate governance principles on the appointment and dismissal of directors of Boards of State Corporations.

Since State Corporations are a creation of a political process, the conflict among the political class will continue to militate against their efficiency and ability to deliver on their mandate. Currently there is a row between the Jubilee Government and Opposition Alliance Cord on appointments and dismissals of Chief Executive Directors in several State Corporations. The Cord Alliance claims that the dismissals and sackings of State Corporations chiefs who come from perceived opposition strongholds can only mean that they are being dismissed in order to pave way for their replacement by appointees of the Jubilee Government²⁰⁷. This political bickering does not augur well for the prospective appointees as their appointments will be politicized.

We have noted that the legal instruments establishing the State Corporations do not make provisions for the skills mix of the directors of Boards. Whereas best practice requires that independent directors be the majority in a Board of any Corporation, the practice with regard to virtually all State Corporations is that the number of Government directors,

²⁰⁷ Moses Michira, 'Coalition for Reforms and Democracy (CORD) hits at Jubilee over top state Jobs'. The Standard(Nairobi,20th August 2013)

representing the different Principal Secretaries of different Ministries is more than Independent Directors. Independent Board of directors are desirable as they can easily challenge top management and have no difficulty in responding to failure of the management team²⁰⁸. In this regard, it is difficult to differentiate a State Corporation from a typical Government Department wherein bureaucracy and inefficiency looms. Moreover the skills mix of Government Directors in almost all the boards have not been defined with result that most of these directors have no capacity to make valuable contribution to the business of the State Corporations. More importantly the Government representatives in these boards being Civil Servants are unlikely to bring any innovative or independent thinking and /or contribute to open minded discussions and generally do not have the status or experience to function as peers of executives of other high level Board appointees. However, their knowledge of State Corporations combined with the understanding of the workings of the Government is sometimes useful in making valuable contribution on the running of State Corporations²⁰⁹.

By law all State Corporations are owned by the Principal Secretary treasury²¹⁰ The Permanent Treasuries Act, the State Corporations Act and different statutes establishing different Parastatals require that the Principal Secretary Treasury sits in the Boards of all State Corporations whilst the Principal Secretary of the line ministry is expected to sit in all the State Corporations in his ministry. It is therefore not possible for the Principal Secretaries to sit on all of these boards and in the absence of any legal requirement

²⁰⁸ Mirungu . Analysis of the effects of corporate governance on performance of commercial state corporations in Kenya.

²⁰⁹ Wilson G. Business, state and community: Responsible PUK Tarvers: New Labour and governance on corporate business. *Journal of Law and society* (2000) 27/1,102 -110.

²¹⁰ Supra note 1

defining the criteria of their alternates the reality of their appointing mediocre alternates cannot be gainsaid.

The size of a Board is important in enhancing its efficiency and adherence to sound Corporate Governance principles. However, in virtually all the State Corporations, the number of directors is excessive²¹¹ and does not comply with the recommended size of the board whose membership ideally would be between 7 and 11 directors. It is heartening to note that a circular from the Office of the President has directed the different authorities to comply by reducing the number of directors to the required level²¹². This is however, not easy as the number of directors of State Corporations is set out in the statute establishing the State Corporations.²¹³ To ensure that the recommended size is attained it will therefore be necessary to have the provisions of board sizes amended in the constituting statute amended by parliament.

It is clear that the Boards of these State Corporations are governed by political expediency and the need to reward politicians' cronies rather than for any other reason. In all the legal instruments constituting State Corporations there are no explicit provisions for an exit and succession plan. And the cycle for appointment and dismissals of directors depend on the change in the wielders of political power come general elections.

²¹¹ The author was a member of a taskforce established to review State Corporations within the Ministry of Industrialization with the purpose of bringing their constituting statutes in tandem with the constitution. The Author as a chairman of the board of directors of the Anti Counterfeit Agency, a State Corporation within the Ministry of Industrialization was able with other members of the task force to study all the ten State Corporations within the ministry and in none of them was the number of directors within the recommended size of 7-11 directors. The task force was established by Legal Notice No. 82 of 19th August 2011. The findings of the task force have not been published.

²¹² Circular from office of the president date 27th July 2011, Ref. No. OP.CAB.9/1

²¹³ Anti Counterfeit Act, Cap 13 of 2008, Section 6. For instance sets out the description of the government directors and independent director together with their qualification whose number is 15.

All in all the lack of policy and legal framework for the appointment and dismissal of boards of directors, the size and skills mix of the board, the appropriate exit and succession plan means that boards of State Corporations are changed with the change in political power. There is excessive turnover of board members, appointments are based on friendship and patronage and there is therefore inability to attract and recruit competent and skilled directors. These ills can only be cured with the formulation of a conscious deliberate and well thought out policy which will establish a formal process for the appointment of directors of boards with the effect that there will be no surprises or ad hoc changes in the appointment and dismissals of directors of boards as the process will be strictly transparent²¹⁴.

The Constitution has through its various provisions infused sound corporate governance principles in the appointment and dismissals of Directors of Boards of State Corporations. The main contribution in this respect is the provisions contained in Chapter Six of the Constitution²¹⁵ which requires that a public officer strictly observe the governance values set therein. The Constitution further requires the Public Officer to be cognizant and conscious at all times of the fact that the authority assigned to him is a public trust to be exercised only in a manner that is consistent with the purposes and objects of the Constitution. This requirement behoves the Public Officer to demonstrate respect for the people, bring honour and dignity to his office and promote public confidence in the integrity of his office which is a public entity as espoused by Article 73 of the Constitution. Article 201 of the Constitution, confers the Public Officer a fiduciary

²¹⁴ *ibid*

²¹⁵ *Supra* Note 14

duty requiring him to observe principles that enhance financial probity and accountability that require him or her to use public money in a prudent and responsible way. Articles 226 and 228 buttress the above provisions by requiring that the Public Officer maintains proper financial records and audits accounts of all Government and other public entities.

The Constitution strengthens the Corporate Governance principles in the appointment and dismissal of directors of Boards of state Corporations by requiring in Article 75(2) that any disciplinary action taken against such an officer must be open and transparent thereby ensuring that such an officer is not victimized on flimsy grounds. In order to ensure that the Public Officer concentrates on his core obligation to provide service to the public Article 77 restricts such an officer from participating in any other gainful employment other than his/her job.

In the past public positions were abused through patronage and cronyism with the practice which was quite prevalent where a State Officer would hold more than two concurrent remunerative positions in a State Corporation or State Organ. This provision also restricted a retired state officer from holding more than two concurrent remuneration positions in Government Institutions.

The Constitution also requires that a Public Officer be appointed on merit and that gender equality and regional balancing be strictly observed. The combined effect of these provisions means that the Constitution is itself a salutary Corporate Governance document.

The above provisions of the Constitution, inter alia, are designed to cure the mischief which existed before the promulgation of the Constitution by reducing the pervasive political influence in the appointments and dismissals of directors of boards of State Corporations.

4.2 Conclusion

This study has recognized that its area of concern namely corporate governance, its application to State Corporations in Kenya and the objective of advancing a critique of the appointments and dismissals of directors of Boards of State Corporations is a fairly broad and complex area of study. It has therefore concentrated on extracting the requisite highlights of Corporate Governance principles as they have evolved globally and how there has been an attempt to adopt them to the governance of State Corporations in Kenya. The study has clearly demonstrated that this discipline is a relatively new area of study having taken root globally in the wake of financial scandals that have been discussed. Although these financial scandals created a significant impetus for the growth of Corporate Governance in the developed world culminating with the formulation of OECD Code of Best Practices Corporate Scandals in Kenya did not unfortunately provide that impetus. All hope is not lost though, since there is a conscious effort by the government in the promotion of good corporate governance in State Corporations through the enactment of enabling legislation, the issuance of administrative guidelines from the Office of the President and the adoption of Corporate Governance Principles and Practices as developed by the CGC. An important milestone as has been shown is the

promulgation of the Kenya Constitution 2010 which on matters of governance has borrowed heavily from the OECD Codes of Best Practice.

An important observation has emerged that though the adoption of these practices has been gradual, it is not by any means complete and is a work in progress. The codes are playing an important role in ensuring that these practices are embedded in the State Corporations in Kenya and it is hoped that they will continue playing this important role. The political class constituting as it were the appointing authority of Directors of Boards of State Corporations will continue to be a stumbling block to Corporate Governance principles taking root in Kenya's State Corporations. It is therefore an imperative that all stakeholders and those who wish well for the growth of State Corporations in Kenya, play a proactive role in ensuring that the Code of Best Practice is fully embraced by these Corporations.

CHAPTER FIVE

CONCLUSIONS AND RECOMMENDATIONS

5.1. Conclusions

It is manifestly clear that State Corporations are bedeviled by a multitude of problems and challenges because they address the objectives of the politicians rather than maximize efficiency and performance. A principal objective of the politicians is the provision of jobs for their electorate. This therefore means that the main thrust of State Corporations is geared towards the desire to harness votes to secure political power rather than foster the productivity of the State Corporations.

This pervasive political imperative in State Corporations means in terms of Agency Theory that greater costs are incurred in supervising the performance of those charged with the responsibility of running and manning Parastatals. Herein lies the principal challenge in regard not only to the adoption of sound Corporate Governance Principles by the State Corporations but also the appointment and dismissal of the Boards of Directors. As has been shown herein there is no policy that formally defines the skills and competencies of directors of boards of State Corporations with the result that the field is open to the politicians to appoint their cronies to these organizations. There is however an emerging trend where Parliament in its entire wisdom has consciously legislated on the skills mix of a board of directors²¹⁶. This is a welcome move as it clearly shows that parliament is consciously encouraging the infusion of sound corporate governance

²¹⁶ Supra note 14, Section 6.

principles in the instruments that constitute State Corporations. It has also been established that virtually all Boards of State Corporations are unwieldy large which does not augur well for them as their large size leads to inefficiency and underperformance. Again it is a salutary move by the Government which consciously encourages the need to reduce the size of the Board has been stated in circulars from the Office of the President²¹⁷. The challenge herein lies in the fact that circulars cannot amend the law as the sizes of these boards are set out in the Statutes forming the State Corporations. It will be therefore necessary for State Corporations to start the process of having their Statutes amended to reflect the desired Board size in tandem with sound Corporate Governance principles.

The law requiring that the Government be over represented in Boards of directors of State Corporations is against sound corporate governance principles. The principles require that boards have a majority of their directors who are independent for they are able to easily supervise top management. This is also a challenge since these same directors are appointed by the politicians and there is no transparent or formal process for their appointment. They can therefore be manipulated to acquiesce in the malpractices of management. The absence of a succession and exit policy means that there is no continuity in the services rendered by the Board of Directors of these State Corporations which deny them the institutional memory that is vital to their efficient running. The habit of the appointment of alternate members by Principal Secretaries is not desirable as

²¹⁷ Supra note 212

their skills mix and competencies have not been set out and neither have those of these institutional directors.

Up to the time of the promulgation of the Constitution most Boards were run by directors who were appointed without taking into account gender balance and geographical diversity. This means that these State Corporations are open to litigation in accordance with the provisions of the Constitution.

5.2. Recommendations

In the light of conclusions reached in this study the recommendations are as set below;

- The Government should not be involved in the day to day running of State Corporations as boards of directors should be allowed full independence and autonomy in managing State Corporations.
- The competencies, skills mix and the size of the Boards should be clearly set out in the instruments establishing State Corporations. This should also include the criteria and procedure for identifying Board members for appointment in line with best practice and such criteria and procedure should be strictly adhered to by the Appointing Authorities.
- In respect to Boards whose membership is in excess of the recommended maximum number of 11, immediate action should be taken for the constituting legislation to be amended by parliament.
- Alternates of institutional directors should be appointed in writing by the appointing authority in compliance with set criteria for their suitability, requisite skills and

expertise and with prior approval of the Board Chairperson and Human Resource committees of the Board.

- The appointing authority should strictly comply with the constitutional requirement observing gender balance and diversity and ensuring that persons appointed to be directors of State Corporations are appointed on merit and are persons who comply with the values set out for Public Officers in the Constitution.
- When dismissing Directors of Boards the Appointing Authority should comply with provisions of the law in respect to such dismissals and in particular to the provisions of Article 47 of the Constitution.
- An exit and succession policy should be developed which will ensure that directors retire in an orderly fashion.
- All Boards of State Corporations should develop Board charters which will contain the policy for the appointment and dismissals of Boards of Directors and other matters relevant thereto.
- Since State Corporations are ultimately owned by the citizenry it is the responsibility of members of the public to ensure that the appointments and dismissals of directors of boards strictly comply with the law and Constitution by engaging Courts in ensuring that the appointments and dismissals are carried out in accordance with the law.

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