



UNIVERSITY OF NAIROBI

SCHOOL OF LAW

MASTER OF LAWS

**EFFECTIVENESS OF MWONGOZO CODE OF CORPORATE GOVERNANCE
FOR STATE CORPORATIONS IN STREAMLINING APPOINTMENT,
COMPOSITIONS AND SIZE OF BOARDS IN PARASTATALS IN KENYA**

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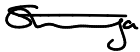
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DECLARATION

I, **EMMA SEELA TUYA**, hereby declares that this is my original work and that it has not been submitted for award of a degree in any other University.

SIGNED.......... DATE.....19/12/2023.....

EMMA SEELA TUYA

This project work has been submitted for examination with my approval as the University of Nairobi Supervisor.

SIGNED.......... DATE....18th December 2023.....

K. Wyne Mutuma PhD.

DEDICATION

I dedicate this project work to my family. A special expression of gratitude and appreciation to my loving parents, Samson and Pauline Tuya, whose support, words of encouragement and push for tenacity ring in my ears. I also, dedicate this research to my friends and family who have supported me throughout the process. I will always appreciate all their contributions and insights toward making this project come to fruition.

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LIST OF ABBREVIATION

CACG - Commonwealth Association for Corporate Governance
CBK - Central Bank of Kenya
CCG - Center for Corporate Governance
CEO – Chief Executive Officer
CG – Corporate Governance
CMA – Capital Markets Authority
EACC – Ethics and Anti-Corruption Commission
GDP - Gross Domestic Product
GOE – Government Owned Entities
GOK – The Government of Kenya
ISC - Inspectorate of State Corporations
KenGen – Kenya Electricity Generating Company PLC
KPLC - Kenya Power Lighting Company
KRC - Kenya Railways Corporation
LSC - Listed State Corporations
NSSF - National Social Security Fund
OECD – Organisation for Economic Co-operation and Development
PSC – Public Service Commission (Kenya)
PTPR – Presidential Taskforce on Parastatal Reforms
SC – State Corporation
SCAC – State Corporations Advisory Committee (Kenya)
SOE – State Owned Entities
SPSS – The Statistical Package for Social Sciences

LIST OF STATUTES

Anti-Corruption and Economic Crimes Act, 2003
Constitution of Kenya, 2010
Ethics and Anti-Corruption Commission Act No. 22 of 2011
Kenya Agricultural and Livestock Research Act 2013
Kenya Information and Communications Act (CAP 411A)
Kenya Medical Supplies Authority Act 2013
Leadership and Integrity Act, 2012 (No. 19 of 2012)
National Hospital Insurance Fund Act (CAP 255)
Penal Code CAP 63
Public Finance Management Act, 2012
Public Finance Management Regulations, 2015
Public Officer Ethics Act, 2003
Public Private Partnership Act, 2021
Public Procurement and Asset Disposal Act, 2015
Public Procurement and Asset Disposal Regulations, 2020
State Corporations Act (CAP 446)

List of Cases

1. *Benson Riitho Mureithi (Suing on his behalf and that of the general public) v J.W. Wakhungu (Cabinet Secretary Ministry of Environment, Water and Natural Resources & The Attorney General (Petition No. 19 of 2014) eKLR.*
2. *David Kariuki Muigua v Attorney General & Another (2012) eKLR.*
3. *Dr Anne Kinyanjui v Nyayo Tea Zone Development Corporation, Honourable Attorney General, Dr Romano Kiome, Permanent Secretary Ministry of Agriculture (2012) eKLR.*
4. *Mark Ole Karbolo & 4 Others v Acting Minister Ministry of Industrialisation, Permanent Secretary Ministry of Industrialisation, & East African Portland Cement Company Limited (EAPCCL) & 4 Others (2011) eKLR.*
5. *Nairobi Law Monthly Company Limited V Kenya Electricity Generating Company & 2 Others (2013) eKLR.*
6. *Republic v Hon. Attorney General, Minister for Information and Communication, Communication Commission of Kenya and Ex Parte Consumers Federation of Kenya (2012) eKLR.*
7. *Timothy Njoya & 17 Others v Attorney General & 4 Others (2013) eKLR.*
8. *Community Advocacy and Awareness Trust & Others v Attorney General & 6 Others (2012) eKLR.*
9. *Katiba Institute & another v Attorney General & another; Julius Waweru Karangi & 128 others (Interested Parties) [2021*

ABSTRACT

The Mwongozo Code of Governance issued in 2015 was in response to continued failures of State Corporations in Kenya. More than seven years have passed since The Mwongozo Code of Governance was issued, yet the issues from the past—specifically, the appointment, makeup, and size of these State Corporations' boards—remain to impede the development of these entities. This raises concerns about the effectiveness and faithfulness of the Mwongozo Code of Governance for State Corporations' implementation. The purpose of this study was to examine how well The Mwongozo Code of Governance for State Corporations is being implemented, paying particular attention to the matter of board appointment, composition, and size. This research paper's objective was to examine the efficacy of the board of directors' pillar and identify implementation issues, with a focus on state enterprises in Kenya. It was the finding of this study that the very challenges that Mwongozo was crafted to solve have continued to exist if not getting even worse. State corporations in Kenya face several challenges from a board and governance perspective, which if remain unaddressed, we shall continue witnessing failures of these State Corporations. The study through its recommendations aims to improve corporate governance in Kenyan state enterprises by implementing the Code more efficiently and effectively. It also reviews and recommends policy and legislative improvements which if passed by the legislatures shall ensure strict compliance with the Code and kick start progressive reforms journey towards improved governance by State Corporations in Kenya.

CHAPTER ONE

EFFECTIVENESS OF MWONGOZO CODE OF CORPORATE GOVERNANCE FOR STATE CORPORATIONS IN STREAMLINING APPOINTMENT, COMPOSITIONS AND SIZE OF BOARDS IN PARASTATALS IN KENYA

1.0 Background to the Study

Globally, corporate governance is becoming more and more popular, and Kenya is surely one nation where this is the case.¹ Over the past few years, corporate governance has attracted a variety of definitions. The idea was first presented in 1962, though not for the first time, in a book titled *The Government of Corporations* by Columbia Business School professor Richard Eells.²

In a 2000 speech to the World Bank's Global Corporate Governance Forum, Sir Adrian Cadbury noted that: - *'Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The corporate governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society'*.

Corporate governance has different implications in the public and private sectors in addition to the basic description given above. The public sector is the subject of this article.

In the public sector, corporate governance pertains to a set of principles that are typically implemented through formal controls. These principles are applied by agencies that aim to correct market imperfections by acting as the State's representative and approving any or all policy-making, management, and regulatory activities; primarily, they involve the use of resources without the goal of making a profit and the provision of reasonably transparent information about how those resources are allocated when there isn't a set of rational economic methods to accomplish those goals.³

The 2010 Kenyan Constitution serves as the basis for corporate governance in Kenya. In terms of a variety of subjects, such as leadership, ethics, integrity, and good governance principles, the

¹ Eells R, *The Government of Corporations*, Free Press of Glencoe, New York, 1962.

² Eells R, *The Government of Corporations*, Free Press of Glencoe, New York, 1962.

³ Bloomfield S, *Theory and Practice of Corporate Governance an Integrated Approach*, Cambridge University Press, (2013) 19

Kenyan Constitution lays a basic basis for public and state authorities in Kenya. Article 10 of the The National Values and Principles of Governance are mandated by the Constitution to be followed by all State Officers, State Organs, Public Officers, Corporate or Natural Persons, when enacting, interpreting, or applying laws, and when making or carrying out public policy decisions. Among the tenets are integrity, accountability, transparency, and good governance. Proper application of these values and principles would drastically change the appointment process for board members and the way in which the appointed boards oversee parastatals.

Article 232 of the Constitution established high criteria and expectations for the performance of public service on the values and principles of public service. It requires that the foundations for selection and representation of Kenya's many and diverse populations be more attention to detail, professional ethics standards, fair competition, transparency, and quality.⁴ It further stipulates that the same principles and values must be upheld by all state enterprises and state agencies that perform public services.⁵

Notwithstanding the numerous laws that Kenya has in place, corporate governance—especially that of State Corporations—has not improved. The Mwongozo: Kenya's State Corporations Advisory Committee; the January 2015-established State Corporations Code of Governance was informed by and concluded from this weakness. When this Code was first enacted, it was anticipated that it would help State Corporations establish the parastatals necessary for long-term, sustainable commercial operations by strengthening their corporate governance standards and processes. Since it was passed, the Code has drawn approximately equal amounts of praise and criticism. However, its efficacy has not yet been determined, especially with regard to how state firms pick new members and how big their boards are. In light of this, the study aims to evaluate how well the Code has been implemented, paying particular attention to its recommendations on the number, makeup, and appointment of state corporation boards as well as other related recommendations.

1.1 Statement of the Problem

Kenyan corporate governance has come a long way, yet despite this, both public and private companies have persisted in acting unethically, which has negatively impacted their performance

⁴ Article 232(1), *Constitution of Kenya*.

⁵ Article 232(2), *Constitution of Kenya*.

and even caused them to fail.⁶ Conflicts of interest, bloated boards, a lack of diversity on the board, a lack of transparency, escalating levels of corruption, and financial mismanagement are a few instances of unethical standards.⁷

The Mwongozo Code⁸ was created to be a crucial component of establishing industry best practices for corporate governance as well as goals and principles for public service.⁹ The Code's first pillar focuses on boards and efficacy. It provides recommendations on various aspects of boards effectiveness including appointment, composition and size, term limits, multiple directorships, succession planning, board independence among others. There have been continuous disputes on whether this Code pillar is authentically and efficiently applied in light of the ongoing issues arising from the corporate governance crises in state firms.

This research paper's objective was to examine the efficacy of the board of directors pillar and identify implementation issues, with a focus on state enterprises in Kenya. The study aims to improve corporate governance in Kenyan state enterprises by implementing the Code more efficiently and effectively.

1.2 Research Objectives

This aims to identify the primary advantages and difficulties resulting from the pillar's implementation with regard to board sizes, compositions, and appointments. The author's main focus will be on how well the pillar on board appointment, composition, and size has been implemented at different state organizations, as well as the significant challenges that were not foreseen when the Code was published.

Additionally, this study attempts to offer potential legislative, case-based, policy recommendations that can assist relevant state businesses in implementing the pillar on board appointment, composition, and size for improved corporate governance in a satisfactory and effective manner.

⁶ Orengo S, 'In Kenya, bad ethics is good business until you get caught' Nairobi Business Monthly, 4 May 2016

⁷ These unethical practices cut across both private and public sector.

⁸ the Code.

⁹ The Implementation Committee, the State Corporations Advisory Committee (SCAC), the Institute of Certified Public Secretaries of Kenya (ICPSK) and World Bank, *Mwongozo Code of Corporate Governance*, January 2015.

1.3 Research Questions

The following questions, which will also serve as the paper's axis, are addressed in this thesis:

- a) How well the pillar on board appointment, composition, and size has been implemented at different state Corporations?
- b) What are the primary advantages and difficulties resulting from the pillar's implementation with regard to board sizes, compositions, and appointments?
- c) How do the difficulties in (b) prevent state firms from reaching their goals for corporate governance?
- d) What legal, policy, and case-based reforms does this paper suggest to deal with these obstacles in the pillar's implementation regarding board sizes, compositions, and appointments?

1.4 Justification of the Study

A dearth of case studies on implementation and difficulties related to the particular pillar on board appointment, compositions, and sizes exists. Despite the abundance of data regarding the Mwongozo Code of Corporate Governance's efficacy and the accompanying study detailing its advantages and disadvantages.

In light of this, this work aims to add on to the body of knowledge already in existence regarding state corporations' experiences implementing the pillar on board appointment, composition, and size, as well as the advantages and difficulties associated with doing so. Additionally, it explores the possibility that adopting a similar approach will enhance corporate governance at state corporations, and consequently, in every other state-owned business

This study is significant because it aims to determine the advantages and difficulties associated with implementing the pillar on board appointment, compositions, and sizes at state corporations. It also seeks to determine whether implementing these changes can resolve issues related to corporate governance and offers legislative, policy, and case-based recommendations for resolving these difficulties.

The study's identified benefits and problems, together with the suggested ways to tackle those challenges, will serve as a crucial framework for state corporations as they adhere to the recommendations regarding board appointment, composition, and size.

In order to guarantee that the pillar on board appointment, compositions, and sizes at state corporations is practical and implementable moving forward in a way that aids in the realization of state corporations' objectives and efficient service for the people of Kenya, It will also act as a guide for those creating policies as they examine and perhaps change the Code's particular provisions.

1.5 Hypothesis

This study is predicated on the idea that despite the enactment of the Mwongozo Code, the State Corporations in Kenya continue to suffer the same problems for which the Code was meant to solve particular under the pillar on board appointment, composition, and size .

1.6 Theoretical Framework

It is impossible to analyze corporate governance in a vacuum without taking into account the many schools of thought and the insights they offer. The primary corporate actors in the realm of corporate governance are the shareholders, stakeholders, and other supporting actors.¹⁰

These important plays are interconnected in a way that can be interpreted by different theoretical frameworks. For purposes of this paper, we look at three main theories that describe the governance interaction.¹¹ The schools of thinking include stewardship theory, agency theory, and transaction cost theory. Below is a summary of those important corporate governance theories for the purposes of this research.

Agency theory uses a contractual relationship as the foundation for the governance process to legally define the relationship that exists between the shareholders and the nominated board members who are selected to manage their companies on their behalf. Under this arrangement, the principal, the owner, who also owes the agent a reciprocal duty, binds the agent, in his capacity as the operational controller.¹² Fiduciary duty and the highest good faith are the cornerstones of their partnership. It is the most sophisticated corporate governance theory. Jensen and Meckling (1976), as well as Ross (1973), were the first to promote this hypothesis.

¹⁰ Bloomfield S, *Theory and Practice of Corporate Governance an Integrated Approach*, Cambridge University Press, (2013) 20.

¹¹ Bloomfield S, *Theory and Practice of Corporate Governance an Integrated Approach*, Cambridge University Press, (2013) 21.

¹² S, Judge, *Business Law*, 4th Edition (Hampshire: Palgrave Macmillan,2011)

According to the hypothesis, business managers are more inclined to make decisions that advance and maximize their own utility at the expense of shareholders because ownership and control are separated. This results from a mismatch in information between shareholders and managers. This theory suggests that agency costs can be decreased by implementing appropriate corporate governance structures, especially those outlined in the pillar on board appointment, composition, and size.

The agency theory grants the boards of both public and private corporations the authority to supervise corporate activities.¹³ The board has been given authority by the shareholders, thus it is in charge of providing moral leadership and strategic direction to the personnel and management. The stockholders pay the board salary in exchange. In order to maximize shareholder value and ensure sustainability and business continuity, it is acceptable for stakeholders and shareholders to expect the board to constantly act in the corporation's best interest. Sadly, the majority of Kenyan boards have not lived up to these expectations. This suggests that most of the failures have been attributed to the agency problem.

Stream (1994) asserts that the agency problem is more acute in the public sector due to the greater number of interactions compared to the private sector. The agency problem is well-known and has become a significant barrier to modern company administration and control. Directors of companies have been entrusted with money, and as such, have not been able to manage it with the same care and devotion that would be required of them if they were managing their own.¹⁴ In addition to the agency dilemma, other problems have surfaced that have made it challenging for boards to meet standards. These consist of largely unjustified political appointments, conflicts of interest, a vague grasp of the board's mandate, lax application of rules and regulations, and a succession plan for the board that, in most situations, leaves the boards weaker.¹⁵ In the context of this paper, the pillar on board appointment, compositions and sizes is critical to how these boards perform their functions effectively and enhance the wider corporate governance in state corporations.

¹³ Bloomfield S, *Theory and Practice of Corporate Governance an Integrated Approach*, Cambridge University Press, (2013) 17.

¹⁴ Smith A, *The Wealth of Nations* (abridged), 1776.

¹⁵ R Steinberg, *Governance, Risk Management and Compliance, It Can't Happen to Us-Avoiding Corporate Disaster While Driving Success* (2011) 85

From the foundation provided by the agency arrangement, transaction cost theory suggests that the owner will implement safeguards about the delegation of managerial functions up until the point at which the costs of doing so equal the benefits of doing so. This view, which is grounded in economic rather than legal explanations of behavior, contends that each party to the agreement is largely driven by rational intents and wants to maximize their own financial gain, which is typically achieved by minimizing transaction costs.¹⁶ When the appointing authorities and board members appointed are obsessed with maximizing their financial gains, they ignore the best practices as far as proper governance of the State Corporations are concerned. This in the end leads to poorly governed enterprises headed for failure. Many have argued that this approach is to blame for the failure of most organizations, and particularly State Owned Entities in Kenya.

When it comes to their connections with companies, people have more than just economic goals and values, according to stewardship theory, often known as stakeholder theory. Stewardship theory proposes that human behavior is made up of a far wider range of motives than the individualistic ones associated with agency theory. These include achievement, responsibility, and recognition in addition to ethical values that are not always or readily subordinated to economic rationalism.¹⁷ Another term for stakeholder theory that is frequently used is "corporate social responsibility" (CSR).¹⁸ According to this idea, stakeholders who wish to have their interests safeguarded and protected would place a high value on the efficient implementation of the pillar's requirements regarding board appointment, composition, and size. The stakeholder would then expect the appointed directors to create value for them and not focus on their own financial gains. In relation to this paper, shareholders and Kenyans in general expect the board members to provide value by adhering to the laid down guidelines under the Mwongozo Code.

1.7 Research Methodology

Instead of using a quantitative technique, this study mostly used a qualitative and analytical one. The secondary methods of data collection that was used in this research included court decisions and case law, journals and reports, articles, Parliamentary Hansards, and online resources that

¹⁶ Williamson, Mechanisms

¹⁷ O. Williamson, *The Mechanisms of Governance* (Oxford University Press, 1996)

¹⁸ This theory has been lauded as one that leads to business continuity, sustainability and community development.

discuss the appointment, composition, and size of boards and the effective implementation of the pillar on them. All of these contributed to the collection of opinions and analyses of the advantages and difficulties associated with the successful application of the pillar on board composition, size, and appointment, as well as whether or not this is the solution to the problems associated with corporate governance in Kenya's State Corporations.

In addition to the above, this paper sampled Countries with leading corporate governance codes whose implementations have been largely successful, particularly regarding the governance of State Owned entities. This paper employed a comparative legal analysis with respect to the United Kingdom and South Africa.

1.8 Scope and Limitations of the Study

The primary research constraint is the paucity of literature regarding the advantages and difficulties associated with the successful implementation of the pillar on board appointment, composition, and size in state corporations. The research is heavily reliant on the reported benefits and challenges regarding the pillar on board appointment, compositions and sizes. Furthermore, we emphasize that obtaining the information from the appropriate government officials will be necessary for the research, since it will not be an easy task.

The study will focus only on the appointment, makeup, and size of state corporations' boards in order to effectively implement the pillar. It will examine the advantages and difficulties as well as the steps that policymakers should take to resolve issues that arise from the successful application of the pillar on the appointments, make-ups, and sizes of boards at state businesses. However, an assessment of global best practices must be done before suggesting policy remedies. Specifically, a comparative analysis of UK corporate governance practices will be conducted.

1.9 Literature Review

Kenya has acknowledged and is still advancing the global idea of corporate governance. Ever since the early 1990s, the same has changed throughout time. The country's private and public enterprises have collapsed due to real-life issues, reformers' and interest groups' efforts, and the impact of foreign experiences have all contributed to the need for expansion. A significant

change in the corporate governance landscape was heralded with the issuance of Mwongozo, The Code of Governance for State Corporations.¹⁹ Consequently, numerous studies and research initiatives have been conducted on this subject by academics; a selection of these are displayed here.

In his thesis, David Gitonga observes that while Kenyan laws are getting stricter, ²⁰corporate governance in the country seems to be declining, particularly when it comes to State Corporations. His goal was to find out how corporate governance affected Kenya's listed public companies' performance. The research primarily looked at how ownership structures, internal audit standards, internal controls, and financial transparency affect the publicly traded state firms' financial performance. His research was grounded in the theories of agency, stewardship, stakeholders, and resource reliance. According to his research, state businesses that practice good corporate governance outperform those that don't in terms of financial performance. This study does not look into how state corporations have done since the Mwongozo Code was passed, nor does it offer an analysis of the difficulties in putting the pillar on board appointment, composition, and size by state corporations into practice. The goal of this work is to close this gap.

The study of corporate governance²¹ and its application in public organizations is the aim of Edna Wambui Kuria's thesis. The Kenya Law National Council for Law Reporting was one of her favorite national organizations. The relevance of corporate governance practices in the public sector, the elements of its implementation, and the challenges faced in implementing it at Kenya Law were some of the objectives of her study. She learned that in order to meet the organization's current and future needs, Kenya Law constantly reviews its corporate goals and mission statement.

The list of requirements for putting Kenyan law's corporate governance framework into practice included the following: a board that is both large and diverse enough; independent; Making

¹⁹ Christine A. Mallin, *Corporate Governance*, p.45.

²⁰ David Gitonga, *the influence of corporate governance on financial performance of listed corporations in Kenya*, 2019

²¹ *corporate governance in the public sector: a case study of the national council for law reporting (Kenya law)* published in 2015.

morally and responsibly-guided decisions; being honest and open in reporting; and being dedicated to protecting and honoring the rights of its stakeholders while also boosting and advancing organizational performance. Given the difficulties in implementing corporate governance, the prevalent legal and legislative framework, financial constraints, complex channels of communication, and corporate strategy were frequent issues. She suggested that in order to guarantee that best practices are taken from the companies outperforming Kenyan law in this area, a benchmark be established. As a result, it is unclear if the Mwongozo Code's adoption has improved the situation, especially in relation to the size, makeup, and appointment pillars of the board. To close this gap is the aim of this endeavor.

In his study,²² Jude R. Ochieng begins by acknowledging that Mwongozo was designed to integrate corporate governance concepts into the administration and control of State Corporations in Kenya. It was specifically intended to incorporate best management practices and public service ideals and principles into the management of State Corporations. Jude asserts that the Mwongozo is now past the test of acceptance; nonetheless, it is unclear how long it will withstand the difficulties that have long plagued the administration and control of State Corporations. Jude concludes by saying that²³ the code does not solve the fundamental problems that have plagued Kenya's state corporation management since the country's independence. He adds that it will allow policy makers to disregard its contents if it is not passed into law with legal force. Despite being relevant to KPLC, his study has two drawbacks; one is that it was completed quickly after the Code was published, leaving no time to evaluate how it was applied. Two, it only briefly addresses the problems surrounding the pillar on board appointment, compositions, and sizes, which has been a source of contention for KPLC, and it does not go into great detail about the advantages and difficulties KPLC has faced in putting the same into practice. This research aims to close this gap. It is beneficial that this study was conducted over seven years after the Code was published.

²² Incorporating the principles of corporate governance in the management of state corporations in Kenya: A critique of the Mwongozo Code of Governance for State Corporations, 2014

²³ a critique of the application and effectiveness of the mwongozo code of governance among state corporations in Kenya, 2014

2.0 Chapter Outline

This study shall feature five chapters to be broken down as follows:

Chapter one features the background to the study, statement of the problem, the objective of the study, the research questions, hypothesis research methodology, theoretical framework and literature review.

Chapter two gives the historical perspective, context or evolution of corporate governance in Kenya. it provides for an overview of Mwongozo, and ummary of pillar 1 of the Code and particularly on the Appointment, composition, and size, Roles and Functions, Evaluation and remuneration and Term limits.

Chapter 3 interrogates the effectiveness of the implementation of the pillar on board of directors by state corporations in Kenya. It discusses the following the Pillar on Board of Directors, Challenges Facing Board Composition in State Parastatals in Kenya , Challenges Facing the Appointment of Board Members for State Parastatals in Kenya, Challenges Facing succession planning attempts for State Parastatals in Kenya, Challenges Facing strict adherence to term limits for board of directors for State Parastatals in Kenya, Why the effective implementation of Pillar 1 of the Mwongozo remains elusive for State Parastatals in Kenya and a Conclusion.

Chapter four is a comparative study on international best practices on codes on corporate governance with respect to board of directors for state parastatals. It features the UK Corporate Governance Code, its history, provisions under the UK Code speaking to board leadership, South Africa - King IV Report for Corporate Governance, Historical Context and Evolution of Corporate Governance in South Africa, Overview of Key, Principles and Provisions of King IV and the various lessons that Kenya could learn from these frameworks.

Chapter five gives the conclusion of the study and recommendations.

CHAPTER TWO

HISTORICAL PERSPECTIVE, CONTEXT AND EVOLUTION OF CORPORATE GOVERNANCE IN KENYA LEADING UP TO THE MWONGOZO CODE

2.1. Introduction

A key component of operating a firm successfully and morally is corporate governance. The West has had a major role in both the expansion of laws and conventions and the development of corporate governance. After a number of significant global crises, such as the South Sea Bubble financial crisis and the collapse of the Bank of Credit and Commerce International as a result of unethical business practices and poor management, it rose to prominence as a topic of study.²⁴ The guidelines on corporate governance principles for state firms were eventually published as a result of the influence these events had on the worldwide adoption and development of corporate governance best practices and principles.

State corporations are vital to Kenya's growth, but without effective governance frameworks in place, they are unable to carry out their missions to the people. Kenya has seen a growth in the prominence of corporate governance due to a number of recent systemic crises and business failures. For instance, ineffective corporate governance contributed to the 1985 failure of 33 Kenyan banks and the ongoing investigations of corruption in numerous organizations, including the National Youth Service (NYS), the Kenya Meat Commission (KMC), and the National Social Security Fund (NSSF).²⁵

Consequently, this chapter will look at how corporate governance has evolved in Kenya throughout time, focusing on the Mwongozo, or Code of Governance for State Corporations, and the changes that have followed.

2.2. The historical perspective, context, and evolution of corporate governance in Kenya

Kenyan corporate governance has a lengthy and intricate history that dates back to the colonial era. State-owned companies (SOEs) were founded by the colonial government to supply infrastructure and public services including power, water, telecommunications, and railroads.

²⁴ Rita Ruparelia and Amos Njuguna, 'The Evolution of Corporate Governance and Consequent Domestication in Kenya' (2016) 7.

²⁵ Njeri Waweru, 'Corporate Governance For State Corporations'.

As per the State Corporation Act, each entity established by the President to accomplish specific objectives is considered a State Corporation. It goes by the names "parastatal" or "state owned enterprise" (SOE).²⁶ The SOEs were able to exercise monopolistic power and function without monitoring or control because they lacked a clear corporate governance framework.

Kenya's post-colonial administration adopted the colonial corporate governance structure when the country attained independence in 1963, but with minor changes. In order to boost the involvement and representation of native Kenyans in the public sector and business, the government implemented an Africanization program.²⁷ **Sessional Paper No. 10 of 1965**, embarked on a process of nationalization, which involved taking over some of the foreign-owned or controlled enterprises and transferring them to state ownership or management. The government also established new SOEs to promote economic development and social welfare, such as agriculture, banking, manufacturing, and tourism. The main purpose of the SOEs was to be an instrument of national development and political patronage, rather than profit-oriented entities.

Nevertheless, despite the numerous reforms implemented by the successive governments during the 1960s, the State Corporations had numerous shortcomings that led to the failure of numerous corporations. A few of these difficulties were the unclear ownership and control divide between the government and the SOEs; political meddling and influence in the selection and dismissal of managers and board members; a lax legal and regulatory framework for corporate governance; insufficient financial and operational reporting and disclosure; and numerous other issues.

Many state firms were privatized as a result of Kenya's economy liberalizing in the 1990s, which was prompted by these difficulties as well as the state corporations' exponential development.²⁸ The dynamics of the market were altered by the privatization of government-owned businesses,

²⁶ Section 3, The State Corporation Act, CAP 446

²⁷ 'AFRICAN-SOCIALISM-AND-ITS-APPLICATION-TO-PLANNING-IN-KENYA.Pdf' <<https://repository.kippira.or.ke/bitstream/handle/123456789/2345/AFRICAN-SOCIALISM-AND-ITS-APPLICATION-TO-PLANNING-IN-KENYA.pdf?sequence=6&isAllowed=y>> accessed 4 August 2023.

²⁸ Anthony Mukangu Kiratu, 'INFLUENCE OF CORPORATE GOVERNANCE ON ORGANIZATIONAL PERFORMANCE IN KENYA: A CASE OF AGRICULTURAL STATE CORPORATIONS' (2016) 3 Strategic Journal of Business & Change Management <<https://strategicjournals.com/index.php/journal/article/view/266>> accessed 4 August 2023.

as new firms raised capital by issuing securities and drawing in investors. The goal of privatization was to lessen the burden the government was bearing on the production, distribution, and supply of goods and services, as well as to transfer or leverage the burden it was already bearing on the private sector because the government was unable to continue funding the number of State Corporations.²⁹

The government was confronted with the task of formulating regulations and guidelines aimed at enhancing corporate governance within the country, given the SOEs' persistent failure. This involved coordinating Kenyan developments with those of other African and worldwide projects, as well as investigating the creation of a national authority for corporate governance.³⁰ The work that task forces and committees in the UK, Malaysia, South Africa, the OECD, and the Commonwealth Association for Corporate Governance had finished addressing various jurisdictions was taken into consideration while creating these.³¹

Some of these reforms include;

- i. The passing of legislation, such as the Capital Markets Authority Act Cap 485A, the State Corporations Act Cap 446, the Companies Act No 17 of 2015, and the Public Finance Management Act No. 8 of 2012.
- ii. Public Finance Management Act, the Companies Act No 17 of 2015, the State Corporations Act Cap 446, and the Capital Markets Authority Act of 1989 were among the laws that were adopted. The creation of new organizations and authorities, including the Capital Markets Authority (CMA), to supervise and uphold corporate governance. Despite this, the CMA was unable to substantially change Kenya's corporate governance environment, leading to the release of Sessional Paper No. 4 of 1991 on Development and Employment in Kenya. While attempting to offer a remedy, this text insisted on reexamining the reasoning behind the creation of State Corporations. There are positions

²⁹ Christine Githiri, 'A Critique of the Application and Effectiveness of the Mwongozo Code of Governance among State Corporations in Kenya'.

³⁰ Consultative Corporate Sector seminars were held in November 1998 and March 1999 to establish a Private Sector Initiative for Corporate Governance developments.

³¹ Duncan Wagana and Kabare Karanja, 'The Influence of Corporate Governance on Corporate Performance Among Manufacturing Firms in Kenya: A Theoretical Model' (2015) 5 International Journal of Academic Research in Business and Social Sciences Pages 258.

available at the Public Service Commission (PSC), Ethics and Anti-Corruption Commission (EACC), and Office of the Auditor General (OAG).³²

- iii. State-owned enterprises (SOEs) and publicly traded companies should adopt corporate governance rules and codes. A few of these are the Code of Corporate Governance Practises for Issuers of Securities to the Public (2016), the Guidelines on Corporate Governance Practises for Public Listed Companies in Kenya (2002), and the Mwongozo Code of Governance for State Corporations (2015).³³
- iv. Promotion of stakeholder participation and engagement in corporate governance, such as shareholders, employees, customers, suppliers, creditors, regulators, civil society, media, and academia; and enhancement of capacity building and awareness raising on corporate governance among board members, managers, staff, investors, and the public.³⁴

2.3 Mwongozo: The Code of Governance for State Corporations

The foundation and guiding ideas of an effective corporate governance law are found in the Kenyan Constitution. Article 10 lays down the national concepts and principles of governance, whereas Article 232 outlines the objectives and tenets of public service.

such as merit, fair competition, and equal opportunity for public appointments. Equity, good governance, accountability, transparency, integrity, and sustainable development. Conversely, Cabinet Secretaries are obligated by Article 153(4) to operate in conformity with the Constitution. The code mostly builds upon and borrows from the governance-related articles of the constitution.

Kenyan laws, namely the State Corporations Act, Cap 446, provide the Mwongozo's legal foundation. The President may issue regulations to guarantee State Corporations operate as profitably as feasible, according to Section 30 of the Act. The passage claims:

“The President may make regulations generally for the better carrying into effect of the provisions of this Act and the powers conferred by this section may be assigned in accordance with section 18 of the Constitution.”

³² Sessional Paper No.4 of 1991 on Development and Employment in Kenya. Government printer. Nairobi Kenya

³³ MWONGOZOCODEOFGOVERNANCE.Pdf

<<https://wasreb.go.ke/downloads/MWONGOZOCODEOFGOVERNANCE.pdf>> accessed 5 August 2023.

³⁴ Mugo (n 7).

A government circular (Executive Order No. 7 of 2015), issued April 28, 2015, was used to execute the Mwongozo. In January 2015, the Public Service Commission (PSC) and the State Corporations Advisory Committee (SCAC) jointly released the Mwongozo after the President had promulgated it in December 2014. The Code seeks to guarantee corporate governance that complies with the Constitution's tenets and to improve State Corporations' leadership, governance, and management of public resources.³⁵

The purpose of this code is to enhance the governance and management of state businesses in Kenya. It addresses a range of corporate governance-related subjects, including the function and makeup of the board of directors, how information is disclosed to the public, how state corporations are held accountable, how risks are managed and controlled, how leaders act ethically and responsibly, and how state corporations contribute to the society.

The Mwongozo code influences corporate governance in Kenya by providing a common and consistent framework for state corporations to adhere to. It also aims to enhance the efficiency, effectiveness, and accountability of state corporations in delivering public services and contributing to national development.³⁶ The constitution's guiding concepts and values—such as honesty, democracy, human dignity, equity, social justice, and the protection of the weak and marginalized—are likewise aimed at advancing by the code.

Kenya would embrace the fundamental ideas outlined by the OECD by putting the Code into practice.³⁷ Among the fundamental ideas of the Mwongozo code are:

- i. **The Board of Directors:** This principle covers the roles, responsibilities, composition, appointment, induction, evaluation, remuneration, and removal of board members, as well as the board committees and board charter.
- ii. **Transparency and Disclosure:** This principle requires state corporations to disclose relevant and accurate information on their performance, governance and how it may affect the interests of stakeholders.
- iii. **Accountability, Risk Management, and Internal Control:** To protect public resources and assets, this principle makes sure state businesses have efficient internal control and risk management mechanisms in place in addition to holding them accountable for their decisions and actions.

³⁵ Mwongozo the code of governance for the state corporation

³⁶ Githiri (n 12).

³⁷ G20/OECD, 'Principles of Corporate Governance'.

- iv. iv. Ethical Leadership and Corporate Citizenship: This concept encourages social responsibility and environmental sustainability in state corporations, as well as ethical behavior, integrity, and anti-corruption measures among board members, management, personnel, and other stakeholders.

However, the Mwongozo code specifically calls for the use of an implementation strategy known as "comply or explain." Two methods are used to regulate corporations: statutory regulation and self-voluntary regulation. Self-voluntary regulation, also known as the "comply or explain" technique, is defined as an idea that requires businesses to follow a predetermined code of conduct; if they don't, they must disclose this in their annual director's report and provide an explanation. The justifications for deviations ought to be precise, succinct, and unambiguous.³⁸ They should also offer substitutes or courses of action that adhere to the goals and tenets of the code.

State companies are given flexibility to modify their corporate governance to fit their specific industry, scale, and ownership structure under the "comply-or-explain" approach.³⁹ They must, therefore, also be open and responsible to the public as well as their stakeholders. The code further stipulates that several agencies, such as the public service commission, the auditor general, the state corporate advisory council, the national treasury, and the ethics and anti-corruption commission, would keep an eye on and assess adherence to its rules. This approach increases the directors' decision-making flexibility and gives the shareholders the ability to evaluate them, increasing their accountability.⁴⁰

2.3.1 Summary of pillar 1 of the Mwongozo Code

The board of directors is a state corporation's main decision-making body and it is addressed in the first pillar of the Mwongozo code. The 2010 Kenyan Constitution and other pertinent laws should mandate that the board members fulfill the standards of honesty and leadership. The Constitution under leadership and integrity gives State officers a fiduciary duty to use their

³⁸ Iain MacNeil and Xiao Li, "Comply or Explain": Market Discipline and Non-Compliance with the Combined Code' (2006) 14 Corporate Governance: An International Review 486.

³⁹ *ibid*

⁴⁰ Mugo (n 7).

authority in a accordance with the Constitution and respects the people, their office, and the public trust.⁴¹

2.3.1.1 Appointment, composition, and size

Article 27 of the Kenyan Constitution should be followed in the appointment of the Board. The President will name the Board Chairperson, and the Parent Ministry's Cabinet Secretary will appoint the remaining board members via a gazette notice and an appointment letter.⁴² Alternatively, the CEO would be appointed by the Board generally following a competitive procedure in compliance with Article 232's equal chances concept. The tenure would be for three years, renewable upon the Board's evaluation of the CEO's performance.

In *Anne Kinyua v. Nyayo Tea Zone Development Corporation & 3 Others*, Aboudha J. reached a conclusion that the public service ideals and values found in the Constitution ought to direct the renewal of appointments in the public sector.⁴³

In the context of composition and size, the board should have at least one financial expert and no more than nine members, chosen through an open, merit-based nomination process. Moreover, a third of the board should consist of independent members possessing a variety of abilities or knowledge to ensure that no single person or small group of people can control the board's decision-making processes. In addition, for the board to effectively perform its responsibilities, a well-rounded blend of knowledge, experience, diversity, and skills has to be present. The CEO will be allowed to participate but not cast a ballot.

In terms of committees, the board ought to include a minimum of three committees: one for audit and risk management, one for human resources and compensation, and one for governance, which should have a board charter outlining its purpose, jurisdiction, and operating guidelines.

Furthermore, as to Mwongozo's Clause 1.8.3, a quorum of five members is required for Board meetings in cases where the total membership is eight to nine, and four members are required in cases where the total membership is seven or fewer.

⁴¹ Article 73, The Constitution of Kenya, 2010.

⁴² Government Circular Ref. No. OP/SCAC.9/73A (48) of 4th May, 2020

⁴³ *Anne Kinyua v Nyayo Tea Zone Development Corporation & 3 Others* [2012] eKLR

2.3.1.2 Roles and Functions

Each board member is obligated under the Code to act fiduciarily, which includes using good judgment, acting with care and skill, avoiding conflicts of interest, and continuously updating their skills. The law also describes the responsibilities and obligations of the board, including disclosing in its annual report its compensation plans, including incentives to the board. In accordance with Clause 1.18 of the Mwongozo Code, it also assigns the board the authority to name the CEO.

According to Mwongozo's clause 1.19, the CEO of a state corporation is responsible for overseeing daily operations, providing managerial guidance, and acting as a crucial mediator between the board and management. The functions and responsibilities of the chairman and CEO are also described in depth in order to ensure an appropriate check and balance system and a balance of power and authority. Moreover, an individual occupying a chairman role in a publicly traded corporation is not permitted to hold more than two positions in separate listed firms concurrently.

2.3.1.3 Evaluation and remuneration

The board should evaluate its own performance annually, and every three years, an unbiased external review should be conducted. The chief executive officer's and other top managers' performance should also be assessed by the board. The effectiveness of the board, identifying areas for improvement and development, and forwarding the results and recommendations to the relevant authorities. The remuneration of the CEO and board members ought to be performance-based, transparent, equitable, and reasonable.

2.3.1.4 Term limits

As per the statement, the appointment to the Board may be extended for a maximum of five years under Section 6(2) of the State Corporations Act. However, a chief executive officer may hold a position on a board for up to six years, split into two terms of three years each. According to the statement, Section 6(2) of the State Corporations Act permits the appointment to the Board to be prolonged for a maximum of five years. A CEO may, however, hold board positions for a maximum of six years, split into two terms of three years each.

2.4 Conclusion

The objective of this Chapter was to lay basis for the research paper by providing the historical context of the Mwongozo Code. It further highlighted the key clauses that will be subject to further analysis in this study. The objective of the chapter was met.

CHAPTER THREE

INTERROGATING THE EFFECTIVENESS OF THE IMPLEMENTATION OF THE PILLAR ON BOARD OF DIRECTORS BY STATE CORPORATIONS IN KENYA

3.1. Introduction

This Chapter examines the effective implementation of the pillar on board of directors, and particularly the challenges arising from the implementation of this pillar. This chapter acknowledges that this pillar is central to effective corporate governance and its successful implementation should be a precursor to the successful implementation of the entire Mwongozo Code.

In an attempt to achieve this objective, this chapter will consider the challenges that have come with the efforts towards implementation of this pillar which features various elements such as appointments composition, size, term limits, conflict of interest, board independence, multiple directorships, succession planning among others. The chapter will also highlight examples of such challenges that have made it difficult to implement this pillar to the latter.

3.2. The Pillar on Board of Directors

In Kenya, parastatals are established for a number of purposes, such as promoting joint ventures that attract foreign direct investment, addressing the regional economic imbalance, and quickening the pace of economic and social development.⁴⁴ Meeting these objectives requires a stable and robust governance structure. In the past, Kenyan parastatals have suffered massive mismanagement practices ranging from among other factors, corruption to lack of accountability. As a countermeasure, different legislations have been enacted, including the Constitution, to

⁴⁴ Government of Kenya, 'Sessional Paper No. 04 of 1991 on Development and Employment in Kenya' [1991] repository.kippra.or.ke
<<https://repository.kippra.or.ke/handle/123456789/1461#:~:text=This%20Sessional%20Paper%20is%20the>>
accessed 27 August 2023.

provide a framework for the management and governance criteria of parastatals. In response to the elements of malfeasance above, the Mwongozo Code was enacted. The Code is backed by the Constitution and borrows greatly from the constitutional provisions that touch on governance.⁴⁵ The Code's Chapter 1 covers governance in general and establishes the parameters for the composition, number, and other aspects of parastatals' boards of directors. Despite these provisions, the implementation of Chapter 1 of the Code is still met with various challenges. This analysis acknowledges the unfortunate state of governance within Kenyan parastatals and consequently addresses those challenges. Additionally, this analysis addresses the challenges that impact the general implementation of the Mwongozo Code.

The goal of Chapter 1 of the Code is to set up a system of efficient Board of Directors governance. It emphasizes the importance of a diverse and capable Board of Directors that leads a parastatal strategically, exercises accountability, and acts responsibly toward stakeholders. The Chapter also outlines principles like diversity in gender and skills, underscores the need for a transparent appointment process, and highlights the role of the Committees. It specifies term limitations for the Board members in order to maintain new viewpoints on the Board and fully describes the responsibilities of each member, including the crucial function of the Chairperson. Further, the Chapter addresses the significance of continuous skills development, the creation of a Board Charter, the need for regular evaluations, and the issues of separation of the roles between the Board and members. Overall, this Chapter provides an overarching framework to achieve transparent, accountable, and efficient governance within state parastatals.

3.3. Challenges Facing Board Composition in State Parastatals in Kenya

One of the biggest challenges still facing Kenyan State Parastatals is getting a balanced board makeup. One such difficulty is the absence of diversity. The Board shall take into account the variety of gender, age, experience, education, competencies, and abilities in corporate governance, as mandated by Chapter 1 of the Code. Numerous academics have stressed the need of variety in state parastatal governance. State parastatals should take into account regional factors in addition to demographic ones when promoting diversity, ensuring that

⁴⁵ Articles 10, 73, and 232, Constitution of Kenya 2010.

underrepresented groups are included in the public sector.⁴⁶ In her thesis, Kemunto delves deeply into the topic of gender diversity in state parastatals' board composition in Kenya. She makes the argument that discussions underlying corporate governance have provided a framework against which gender diversity has evolved throughout time.⁴⁷ This situation was exacerbated by the male dominance in the Boards of many corporate and state parastatals the world over. Despite such realizations, a lack of diversity within the demographic and regional contexts continues to plague Kenyan state Parastatals.⁴⁸ In a study conducted on the Kenya Revenue Authority (KRA), one of the state parastatals in Kenya, to find out the challenge of diversity management, it was established that the authority faces various aspects of diversity challenges in the Board management including resistance to diversity initiatives, stereotypes, fairness concerns, and implementation of diversity policies.⁴⁹ Such manifestations show that despite the existence of the Mwongozo Code on the governance of state parastatals in Kenya, diversity is yet to be fully achieved in Board compositions of state parastatals.

Political interference is yet another challenge that faces state parastatals in Kenya contrary to Mwongozo Code requirements on board independence. Board members are more often than not appointed based on political affiliations rather than merit, which can lead to conflicts of interest and poor decision-making. This challenge persists within the public sector, including the appointment procedures in state parastatals.⁵⁰ The court made its decision in *Community Advocacy and Awareness Trust & Others v. Attorney General & 6 others*, clearly saying the following:

“[73] 27th August 2010 ushered in a new regime of appointments to public office. Whereas the past was characterised by open corruption, tribalism, nepotism, favouritism, scrapping the barrel and political patronage, the new dispensation requires a break from the past. The Constitution signifies the end of ‘jobs for the boys’ era. Article 10 sets out the values that must be infused in every decision-making process including that of making appointments.”

⁴⁶ Yvonne Atieno, ‘Corporate Governance Problems Facing Kenyan Parastatals: A Case Study of the Sugar Industry’ (Thesis2009) 30.

⁴⁷ Omenta Kemunto, ‘Corporate Governance: The Challenges Facing the Implementation of Gender Diversity in the Board Composition of State Corporations in Kenya’ (Thesis2017) 88.

⁴⁸ *Ibid.*

⁴⁹ Lazarus Letasina, ‘Challenges of Diversity Management at Kenya Revenue Authority’ (Research Paper2016) 59.

⁵⁰ Petition No 243 of 2011; [2012] eKLR

This case stressed on the need to consider competence and suitability in the appointments of board members over tribalism, nepotism or favoritism. It supports the need for competent and diverse board that are independent of the appointing authorities. In the past, people were appointed to public offices depending on their affiliations with the ruling political party. This nature of the appointment did not consider skills or competencies. However, the reality of political influence in the appointive positions of state parastatals is worrying. The very existence of such cases in various courts in Kenya shows the persistence of political interferences in the appointment of the Boards of state parastatals.

Tied to the previous arguments, it is apparent that some parastatal heads and board members hold other positions, which can lead to divided attention and conflicts of interest. Chapter 1.1(8) of the Mwongozo Code requires that a Board Member must not hold any other office or be related in any way to a member of the public service commission. Further, Chapters 1.6.1 and 1.6.2 prohibit multiple directorships both by the Chairperson and any other Board Member to ensure effective participation in the Board. In Kenya, the poor performance of Board Directors has been attributed to multiple positions held by different board members⁵¹, a situation that perpetrates the conflict of interests.

The makeup of Kenyan parastatals' boards is also impacted by the absence of accountability and openness. There are concerns about transparency and accountability in parastatals, which can lead to corruption and mismanagement. This problem is worsened by the appointment of unskilled people with inadequate competence within State Parastatals.⁵² The International Transparency Report of 2011 observes that Kenyan Parastatals are ridden with unethical behavior including corruption and lack of accountability.⁵³ Consequently, there is a need for the government to dedicate resources and priorities to establishing sound appointment procedures to uphold transparency and accountability within the Boards of state parastatals in Kenya.⁵⁴

⁵¹ Joseph Mwaura, 'The Failure of Corporate Governance in State Owned Enterprises and the Need for Restructured Governance in Fully and Partially Privatized Enterprises: The Case of Kenya' (2007) 31 *Fordham International Law Journal* 34.

⁵² Joseph Nyerere Kimia, 'Interrogating Problems Facing Parastatals in Kenya' (2019) 6 *International Journal of Economics and Management Studies* 92.

⁵³ Transparency International, 'Annual Report 2011 - Publications' (*Transparency.org* 12 July 2011) <<https://www.transparency.org/en/publications/annual-report-2011>> accessed 27 August 2023.

⁵⁴ Joseph Nyerere Kimia, *Supra* Note 9.

There are also concerns about procurement management in parastatals, which can lead to inefficiencies and wastage. This is a long-shot challenge tied to the ineffective composition of board members of state parastatals. More importantly, it is tied to the concerns of transparency and accountability addressed earlier. In this sense, it is reported that budgetary allocations are often misappropriated and mismanaged by board members of various parastatals.⁵⁵ This was quite evident in the report of the budget outlook paper of 2014/2015 where it was discovered that 30% of the budgetary allocations were misappropriated by public servants in the course of implementing the budget, through the activities of procurement of goods, works, and services to deliver relevant political manifestos.⁵⁶ Overall, the challenges facing board composition in state parastatals in Kenya are complex and multifaceted. They require a concerted effort from all stakeholders to address them and ensure that parastatals operate effectively and efficiently.

3.4 Challenges Facing the Appointment of Board Members for State Parastatals in Kenya

Similar to the makeup of the Board, there are a number of difficulties in Kenya when it comes to appointing board members to state parastatals. One such difficulty is keeping track of and monitoring appointments due to the absence of a national register. Likewise, there isn't a separate oversight organization in place to keep track of every nominated board member. Rather, what is available is a list of appointments that is either kept up to date on the State Corporations Advisory Committee's website or on privately managed websites.⁵⁷ A basic issue is that not all parastatals have websites, and those that do frequently don't have a current roster of board members.

Political interference seriously compromises state parastatals' board member nomination processes. In the recent past, appointive positions have been allocated to people as political rewards for being loyal to the ruling regime. Consequently, loyalty is rewarded over meritocracy.⁵⁸ People with skills and competencies in corporate governance are denied board positions, which are graciously awarded to others without necessarily considering their skill levels.

⁵⁵ *Ibid.*

⁵⁶ The National Treasury, 'Budget Review and Outlook Paper (BRON) 2015' (The National Treasury 2015).

⁵⁷ David Irwin and Mercy Kyande, 'Interest Group Representation on Government Committees in Kenya' [2022] Interest Groups & Advocacy.

⁵⁸ *Ibid.*

Julius Waweru Karangi and 128 other parties (Interested Parties) in Katiba Institute & others v. Attorney General & others this topic was discussed in great length. In that instance, the Katiba Institute filed a lawsuit with the court to challenge the appointment of 129 people to various positions in parastatals and state businesses as directors and chairpersons.⁵⁹ The Public Service Commission is not constitutionally permitted to appoint the chairman and board members of state parastatals; instead, the President and Cabinet Secretaries are. This was decided by the court. The reason for this is that state parastatals are not employed by the government. The Court further pronounced that although this mandate is left to the President and Cabinet secretaries, it must be executed in a way that promotes fairness, justice, and transparency pursuant to the constitutional provisions. The courts stated that:

“[112] Without complying with transparency, fair competition, and merit, the appointments cannot be said to have met the constitutional standard in Article 232(1). It is plain that the President and Cabinet Secretaries made the appointments without regard to the Constitution and the statute; a move that also violated national values and principles of governance in Article 10 of the Constitution.”

Overall, the court in this case demonstrated that appointive positions must not be rewarded for loyalty, but rigorous constitutional processes like advertisement and interviews must be adopted to achieve meritocracy.

Another set of issues with state parastatals' board member appointments include corruption and a lack of openness. Transparency is lacking in Kenya's parastatal board appointment procedure.⁶⁰ To guarantee equity and consistency, a well-defined structure is required for the recruitment, choice, appointment, and orientation of board members. Because of their lack of transparency, state parastatals serve as havens for corruption. The Court went into great detail on this matter in the aforementioned petition filed by Katiba Institute.⁶¹ The Court made clear that no appointment made to the Boards of state parastatals could be considered to have fulfilled the constitutional requirement outlined in Article 232(1) of the Constitution, which outlines the ideals and

⁵⁹ [2021] eKLR

⁶⁰ Article 19, 'Kenya: Concern over Appointment of Directors of State Corporations' (*ARTICLE 19* 14 October 2015) <<https://www.article19.org/resources/kenya-concern-over-appointment-of-directors-of-state-corporations/>> accessed 27 August 2023.

⁶¹ *Katiba Institute & another v Attorney General & another; Julius Waweru Karangi & 128 others (Interested Parties)* [2021] eKLR.

standards of public service, if it did not adhere to transparency, fair competition, and merit. The result of an opaque and distorted appointment process is corruption. Incompetent appointees to state parastatals' boards frequently engage in corruption and embezzlement of public monies, adding to the parastatals' general lackluster performance.⁶² In *Re Benham & Co. I*⁶³ the court mentioned that corruption begins with the isolated dishonest acts of the board directors; that “benefits procured through corruption by directors amount to breach of their fiduciary duty.” Therefore, addressing corruption begins with addressing the levels of transparency of individual board members of state parastatals.

Appointments that are biased and tribal present another difficulty. Concerns have been raised over biased and ethnic appointments in Kenyan parastatals and government organizations. This can lead to a lack of diversity and representation, undermining the effectiveness and legitimacy of these boards. In early 2023, the Government of Kenya headed by President William Ruto was under attack from the public for the claims of making skewed and tribally imbalanced appointments to key state corporations and parastatals.⁶⁴ In all discussions, tribal appointments do not promote the diversity and inclusion of all Kenyans. This includes diversity in skills and competence. Ultimately, state parastatals stand to suffer from poor governance. Closely tied to skewed and tribal appointments is the challenge of inefficiency in governance. The MWONGOZO Code outlines the Board as the primary governing body of state parastatals. It further outlines the government parameters⁶⁵ including the appointment and inclusion criteria to the Board. It is undisputed that inefficiency in the boards of parastatals can arise due to the appointment of board members by public officials who may not prioritize qualifications and expertise. This can result in mismanagement and issues with corporate governance. Overall, the challenges related to appointments, although multi-faceted, are equally intertwined. For example, appointments pegged on political rewards or tribal favors lack transparency, which breeds corruption. Eventually, state parastatals are inefficiently managed and the cycle of corruption and mismanagement of public funds ensues. These challenges highlight the need for reforms in the appointment process for board members of parastatals in Kenya. Transparency, fairness, and

⁶² Elijah Njagi, ‘Assessment of Problems Facing State Owned Enterprises in Kenya’ (2016) 6 International Journal of Business <https://www.ijbhtnet.com/journals/Vol_6_No_4_December_2016/6.pdf> accessed 27 August 2023.

⁶³ (1853) 25 Ch. 572.

⁶⁴ Citizen TV Kenya, ‘DAY BREAK | Uproar over Skewed and Tribal Appointments in Parastatals and Government Institutions’ (www.youtube.com/2023) <https://www.youtube.com/watch?v=GLnJ_HjIPkY> accessed 27 August 2023.

⁶⁵ Clause 1.1, MWONGOZO Code of Governance.

merit-based criteria should be prioritized to ensure the effectiveness and accountability of these institutions.

3.5 Challenges Facing succession planning attempts for State Parastatals in Kenya

The succession management strategy's implementation in state parastatals has difficulties as well. One such challenge is a lack of a well-defined talent management policy. In a study, it was discovered that many state parastatals and by extension civil service of Kenya, do not have a clear strategy for identifying talent.⁶⁶ The consequence is that planning for succession within the parastatals is crippled. Additionally, people who are appointed to the managerial committees do not have the required expertise to effectively manage their docket. Until parastatals implement an effective talent management system, state parastatals run the risk of mismanagement. Another challenge connected to this is that many state parastatals do not have effective capacity-building programs to groom potential leaders.⁶⁷ This poses a great challenge since the grooming of leaders can be done in-house through coaching and mentoring. With respect to term limits, board members have a cumulative of two terms. This short duration requires an effective succession plan.⁶⁸

The succession plan should make sure that the age factor is taken into account and that new ideas are introduced to the management team. This was the situation in the case of *Kenya Revenue Authority Board of Directors & 2 others v. Okiya Omtatah*. The CEO of a state-run company (KRA) was at issue in this case since his contract was about to expire. The petitioner contended that the government's policies and rules, which mandate a 60-year retirement age for public employees, were broken by the CEO's contract extension. The petitioner argued that the contract renewal was unlawful since the CEO should have retired on December 19, 2017, which was when he turned 60. The petitioner relied on government circulars and policies, such as the "Review of the Mandatory Retirement Age for Public Servants" and the "Code of Governance for State Corporations (Mwongozo)," which emphasized the mandatory retirement age of 60 for CEOs of state corporations. The respondent, on the other hand, argued that the CEO's contract

⁶⁶ Musyoki Muthini, 'Challenges Facing Effective Implementation of Succession Management Strategy in the Civil Service in Kenya' (Research Project 2019) 85.

⁶⁷ Ibid

⁶⁸ [2018] eKLR

was governed by the Kenya Revenue Authority (KRA) Act and was a contractual agreement between two parties. They argued that the contract was enforceable and exempt from the government's circulars pertaining to the required retirement age. The legal basis for the CEO's appointment and employment conditions was established under the KRA Act. The court ultimately ruled that the CEO's contract renewal was not in violation of the Constitution, the KRA Act, or government circulars. It held that the contract was consistent with the law, and the CEO's appointment was governed by the terms of the contract and the KRA Act.

It is important to note from the case that although the Mwongozo Code outlines the succession plan for board members, the courts have argued that the same does not affect succession of CEOs of parastatals, and that what matters is the contractual agreement between the individual and the state corporation. This poses a challenge to the implementation of Mwongozo Code in succession planning of state corporations.

3.6 Challenges Facing strict adherence to term limits for board of directors for State Parastatals in Kenya

Regarding term limits, the application of the MWONGOZO Code has been called into question, especially whether its effect applies retrospectively. In *Ben Chikamai & another v Peter Macithi Muigai & 2 others*⁶⁹ the case centered on the reappointment of Ben Chikamai for a third term as the Executive Director of KEFRI by the 2nd appellant, the Board of Directors. Peter Macithi Muigai, the 1st respondent, challenged Chikamai's reappointment on several grounds, including that it was unlawful due to a violation of the Code of Conduct for State Corporations ("Mwongozo"), which stipulated a maximum of two terms (6 years) for CEOs of state corporations. On the other hand, the appellants argued that Mwongozo was not applicable retrospectively and that Chikamai's reappointment adhered to the laws and procedures in place at the time. The court found that Mwongozo was applicable to the reappointment process, as it was implemented before the commencement of Chikamai's third term. The court also held that the 1st appellant's reappointment was inconsistent with Mwongozo and therefore unlawful. It ordered Chikamai to vacate office, appoint an acting CEO for a maximum of six months, and reconstitute the board.

⁶⁹ [2020] eKLR

In this case, courts argue that the Mwongozo Code does not apply retrospectively but from the point of its inception. Consequently, any appointments made after its enactment must adhere to its principles.

3.7 Why the effective implementation of Pillar 1 of the Mwongozo remains elusive for State Parastatals in Kenya

Although the MWONGOZO Code of Governance lays out the fundamental foundational basis for the management of state corporations and parastatals, it nonetheless, is faced with a myriad of challenges during implementation. First, it lacks a legal status. While it is a state document, the lack of legal status means that it is not legally binding. The power to make a law in Kenya is vested in the legislature.⁷⁰ For an instrument to be considered legal, hence legally binding to all, it must follow the right procedure. A bill must be introduced in parliament and go through the following steps: committee stage, report stage, first reading, second reading, third reading, and presidential assent.⁷¹ It is only after the president signs the bill into law can it be considered legally binding to all. However, MWONGOZO Code is merely a set of rules advocating for what governance practices that should be adopted in managing state corporations. It is not a statute in any way. Additionally, an enforcement framework backs a legal instrument.⁷² However, the Code does not specify any enforcement framework. This creates a lot of doubts in its validity and authority. Its adoption by state bodies may thus be seen as non-binding.

One of the main obstacles to the Code's acceptance is gender diversity. Despite Kenya's implementation of the relevant rules, such as the State Corporations Act, the Constitution, and Mwongozo, the state corporation code of governance, achieving gender diversity in the makeup of state corporate boards remains a difficulty.⁷³ The first governance concept outlined in the Code mandates a gender-diverse board.⁷⁴ Kemunto notes that state parastatals haven't followed this rule, though, in recent years. This is mostly because men have historically dominated state

⁷⁰ Article 109, Constitution of Kenya 2010.

⁷¹ Parliament of Kenya, 'How Law Is Made' (The Clerk of the National Assembly 2017)

<http://www.parliament.go.ke/sites/default/files/2018-04/2_How_Law_is_Made.pdf> accessed 28 August 2023.

⁷² Erik Berglöf and Stijn Claessens, 'Enforcement and Good Corporate Governance in Developing Countries and Transition Economies' (2006) 21 The World Bank Research Observer 123

<<https://www.jstor.org/stable/40282345>>.

⁷³ Githiri Christine Njeri, 'A CRITIQUE of the APPLICATION and EFFECTIVENESS of the MWONGOZO CODE of GOVERNANCE among STATE CORPORATIONS in KENYA' (Research Project Proposal 2016) 91.

⁷⁴ Omenta Kemunto, *Supra Note 4*.

corporation management. However, there are also other reasons including nepotism and political influence in the appointment processes. The dangers of a board composition that is not gender-diverse are many. One of them is the lack of a diverse set of skills, experience,⁷⁵ and competence. Secondly, the lack of a gender-diverse board makes representation of all people difficult. For example, it is not risky to say that men may represent issues regarding men well, and so many women. In a gender-diverse Board, issues of both genders can be articulated in a comprehensive representation framework.

Finally, the MWONGOZO Code of Governance's implementation is affected by an inadequate compliance mechanism. Ensuring compliance with the law and regulations, fair/just treatment, objectivity in decision-making and action, independence of directors, and ethical behavior are some of the challenges faced in implementing the MWONGOZO code of Governance. The backbone of a good governance system is its compliance with the law and codes of conduct. Non-compliance with the Code has been exacerbated by the fact that it lacks an enforcement mechanism arising from the fact that it is not a legal instrument.⁷⁶ If the Code was backed by a robust enforcement mechanism, the issues of non-compliance could be easier to deal with. Equally, it could be easier to institute judicial interventions upon violation of any clause within the Code. Addressing this issue will involve the revision of the Code to include an enforcement clause within.

3.8 Conclusion

Kenya has made great progress in putting the MWONGOZO code of governance for state enterprises into practice, in spite of these obstacles. For example, an abridged report on the implementation of the code shows that progress has been made in areas such as board composition, risk management, and performance management.⁷⁷ However, more is still required with regard to compliance with the Code. Necessarily, a recommendation is made that every parastatal should submit a compliance report regularly to ensure that the Code is well adhered to within state parastatals. With this, the objective of this chapter to highlight the said challenges and illustrate with examples has been met. The next chapter will consider comparative study of

⁷⁵ *Ibid.*

⁷⁶ *ibid*

⁷⁷ Danson Kimani and others, 'Abridged Report on the Implementation of the Mwongozo Code of Governance for State-Owned Corporations in Kenya' (Institute of Certified Secretaries 2022).

the best international practice towards implementation of similar pillars on board of directors for state corporations.

CHAPTER FOUR

COMPARATIVE STUDY: INTERNATIONAL BEST PRACTICES ON CODES ON CORPORATE GOVERNANCE WITH RESPECT TO BOARD OF DIRECTORS FOR STATE PARASTATALS

4.1. Introduction

The previous section examined the primary barriers to the board of directors' pillar and its many components in respect to the Mwongozo Code's implementation. This Chapter shall be premised on comparative studies including an analysis of case law and precedents and international best practices. Our jurisdictions of focus shall be the United Kingdom (UK) and South Africa as justified in the Chapter outline. The objective shall be to pick out how best the jurisdictions under study have dealt with similar challenges and implemented such aspects of board of directors for their state owned entities.

4.2. The UK Corporate Governance Code

One of the highly advanced corporate governance systems in the world oversees businesses in the UK.⁷⁸ The Companies Act, 2006 (the "Companies Act"), the Listing Rules, the Disclosure Guidance and Transparency Rules (the "DTRs") published by the Financial Conduct Authority (the "FCA"), and the UK Corporate Governance Code (which serves as the primary regulatory framework with an emphasis on governance) all have an impact on the corporate governance environment in the UK. In this chapter, we shall concentrate on the UK Corporate Governance Code.⁷⁹

4.2.1. History of the UK Corporate Governance Code

The Cadbury Report, the nation's first all-inclusive code with the best practices for corporate governance, was published in the early 1990s, which is when the UK Corporate Governance Code originally took shape. Sir Adrian Cadbury's Cadbury Report was inspired, among other commercial scandals and failures of the late 1980s and early 1990s, by the deaths of Maxwell,

⁷⁸ Adrian Cadbury, *Report of the committee on the financial aspects of corporate governance* 1992

⁷⁹ Sebastian V Niles and others, 'The International Comparative Legal Guide to: Corporate Governance 2019' [2019] Corporate Governance.

BCCI, and Polly Peck. The report recommended a clear division of responsibilities between the board and management, a balance between executive and non-executive directors, and increased transparency and accountability to shareholders. It also suggested forming an independent audit committee.⁸⁰ The committee considered over 200 reports in the process of creating the Cadbury Report, demonstrating a substantial level of public involvement. In contrast, the Mwongozo code was enacted after a small number of people debated its acceptability and validity without the general public being involved.

The UK's later corporate governance regulations and reports were built upon the Cadbury Report. For instance, the "comply or explain" strategy, which permits firms to depart from the code as long as they give shareholders sufficient justification,⁸¹ was suggested by the Hampel Report (1998), which was issued by the Greenbury committee, which looked at compensation-related concerns. Following the Enron scandal and other corporate scandals, the UK corporate governance codes (2012), (2014), and (2016)—the most recent of which is the UK governance code (2018)—were implemented. These codes, along with the Walker Review (2009) and the Higgs Report (2003), which looked at the role and effectiveness of non-executive directors, were designed to examine corporate governance.

The code's publication and management are within the purview of the Financial Reporting Council (FRC).⁸² Enforcing accounting and audit standards, establishing guidelines for reporting and auditing, and promoting excellent corporate governance are among the responsibilities assigned to the FRC.

The code is issued and managed by the Financial Reporting Council (FRC).⁸³ The FRC is in charge of enforcing compliance with accounting and auditing standards, establishing standards for reporting and auditing, and promoting the use of strict corporate governance guidelines.⁸⁴

The UK Code 2018, shifted from a shareholder-focused approach to a stakeholder-oriented perspective as it emphasizes the importance of engaging with stakeholders and upholding their interests.⁸⁵

⁸⁰ Jude R Ochieng, 'Incorporating Principles of Corporate Governance in the Management of State Corporations in Kenya: A Critique of the "Mwongozo" Code of Governance for State Corporations'.

⁸¹ Confederation of British Industry (CBI), Directors Remuneration.

⁸² The FRC is the UK's independent regulator for corporate reporting and governance.

⁸³ The FRC is the UK's independent regulator for corporate reporting and governance.

⁸⁴ '2018-UK-Corporate-Governance-Code-FINAL.Pdf' <<https://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.pdf>> accessed 27 September 2023.

Moreover, the 'comply or explain' principle, the cornerstone of UK corporate governance, is the basis of the UK code. This implies that businesses have two options: either follow the guidelines and implement the concepts, or provide an explanation in their annual reports if they have not.⁸⁶ This is only applicable to unlisted businesses, though, since premium listed businesses must adhere to the laws, report to shareholders, and apply the principles as required by the listing guidelines. The FRC makes periodic revisions to the code.⁸⁷ This teaches us that it's critical to update company governance standards on a frequent basis to account for a variety of external influences, including shifting societal norms, shifting economic conditions, and global best practices.⁸⁸ Kenya ought to implement this since no reviews or revisions have been made since the Mwongozo code was established.

4.2.2. Provisions under the UK code speaking to board leadership

Task separation, audit, risk, and internal control; board leadership and corporate purpose; composition, succession, and assessment; and remuneration are the five sections that make up the UK Code.⁸⁹ The company's mission and the board's leadership are covered in the first section of the code. In essence, the board should decide on the organization's goals, objectives, and strategy and ensure that they are consistent with the organization's culture. Furthermore, as required by section 172 of the Companies Act of 2006, it encourages participation from all relevant parties.

The second section of the code addresses the division of responsibilities. The main contention is that different tasks and responsibilities should be assigned to the executive leadership of the business's operations and the board leadership. The proportion of executive and non-executive (NED) directors on the board ought to be balanced. everybody apart from the chairman who

⁸⁵ Langford Rosemary, 'The Role of Other Duties' in Rosemary Teele Langford (ed), *Company Directors' Duties and Conflicts of Interest* (Oxford University Press 2019) <<https://doi.org/10.1093/oso/9780198813668.003.0010>> accessed 27 September 2023.

⁸⁶ Section 172, the Companies Act (2006).

⁸⁷ '2018-UK-Corporate-Governance-Code-FINAL.Pdf' (n 8).

⁸⁸ Christine Githiri, 'A Critique of the Application and Effectiveness of the Mwongozo Code of Governance among State Corporations in Kenya'.

⁸⁹ '2018-UK-Corporate-Governance-Code-FINAL.Pdf' (n 8).

holds the positions of CEO and chairman separately.⁹⁰ The case *Re Oracle Corp. Derivative Litigation* also establishes these fundamental requirements for the independence of directors.⁹¹

The code's third portion addresses evaluation, succession, and composition. The basic tenet is that the independence of the board members should be allocated correctly. expertise, experience, and commercial savvy. It should also ensure that the formal, strict, and open procedure for selecting new directors is adhered to. In terms of the time constraint, the chair should serve in that capacity for a maximum of nine years, with the option to serve a longer term under specific conditions to enable adequate succession planning. Each of the surviving directors is running for reelection.

Every year, the board's performance should be formally and comprehensively evaluated by the chair.

The code's fourth section addresses internal control, risk, and audit. To achieve the organization's long-term strategic objectives, the board should select what sorts and how much of the major risks it is willing to take on, as well as establish risk management rules in this area and oversee the internal control system.

The code's fifth section addresses compensation. In this case, pay-related policies and processes ought to be created in order to bolster the plan and encourage steady, long-term achievement. Executive compensation need to be based on the achievement of the organization's long-term plan and in line with its purpose and core values. At the end of every fiscal year, the directors are required by the Companies Act to write and submit a pay report. An annual report from a listed firm must contain information on the diversity and inclusion policy and how it is being implemented.⁹²

It is noteworthy that there are similarities between the UK Code and Mwongozo Code. In both cases, the first chapter discuss the issue of board and leadership. They both address how boards should be appointed, the size and term limit. In fact, the Mwongozo Code borrowed partly from the UK Code. The most glaring difference come in the aspect of implementation. The UK Code is premised on the mandatory principle of comply or explain and comes with consequences for failure to do so. The other difference is the deliberate and periodic review of the UK Code to respond to the always changing needs of state corporations and business dynamics.

⁹⁰ The code provides a set of criteria that disqualifies a person as “independent” non-executive directors.

⁹¹ in *re Oracle Corp. Derivative Litigation*, 2003 WL 21396449 (Del. Ch. June 17, 2003)

⁹² Niles and others (n 2).

4.3. South Africa - King IV Report for Corporate Governance for South Africa

Corporate governance in South Africa is currently governed by the Companies Act of 2008 and the King IV Report for Corporate Governance for South Africa, sometimes referred to as the "King IV Report". "The exercise of ethical and effective leadership by the governing body towards the achievement of... ethical culture, good performance, effective control, and legitimacy" is how the King IV report defines corporate governance. The paradigm changes that occurred in corporations and society led to its adoption. The following are the main tenets of King IV's philosophy: sustainable development, corporate citizenship, ethical and effective leadership, the company's social duty, inclusive and responsive stakeholder engagement, integrated reporting, and integrated thinking.⁹³

4.3.1 Historical Context and Evolution of Corporate Governance in South Africa

In the early 1990s, South Africa underwent a political and economic transformation from the apartheid period, where South African corporations were characterized by a lack of diversity in leadership with a focus on profit maximization, to the democratic period which served as the historical backdrop and beginning of the evolution of corporate governance.

The King Report on Corporate Governance (King I) from 1994 provided a framework for corporate governance reforms. Judge Mervyn E. King led a group that launched it, and its core principles were accountability, transparency, equity, and protecting stakeholders' rights. The King II Report on Corporate Governance (King II), which was released, which balanced the interests of the economy, society, and environment while taking an open approach to stakeholders, was the second major event of 2002.

The "comply or explain" premise served as the foundation for the King II report as well, but it was enlarged to cover all entities, regardless of how they were incorporated.⁹⁴

The King III Report on Corporate Governance (King III) was released in 2009. modified the corporate governance landscape after King II by taking into account governance frameworks that

⁹³ 'SABTip_October_2016_KingIV.Pdf' <https://www.nexia-sabt.co.za/wp-content/uploads/2016/11/SABTip_October_2016_KingIV.pdf> accessed 28 September 2023.

⁹⁴ King Report on Corporate Governance for South Africa <https://www.mervynking.co.za/downloads/CD_King2.pdf>

aligned with international best practices.⁹⁵ It introduced the "apply or explain" approach, where companies must either adhere to the Code or explain their deviations. The report contained 75 principles after introducing new principles and practices on governance structures, board committees, remuneration, assurance, compliance, dispute resolution, and information technology.

The release of the King IV Report on Corporate Governance (King IV) in 2016 represents the fourth and most recent iteration.⁹⁶ The code was reorganized into 208 suggested behaviors and 17 guiding principles with the goal of achieving four objectives: legitimacy, high performance, ethical culture, and effective control.⁹⁷ Organizations are now required to take steps to apply the principles and report how they have done so in order to comply with the new "apply and explain" premise of the code. By providing stakeholders with additional knowledge on corporate governance, this strategy enables meaningful stakeholder participation.

4.3.2. Overview of Key Principles and Provisions of King IV

According to Principles 1 and 2, businesses must maintain an ethical culture that encompasses the values of competence, fairness, responsibility, accountability, integrity, and transparency in both the organization and its leadership.

A South African company's board is unitary by nature, not distinguishing between executives and non-executives; nevertheless, it does have a fiduciary duty to act in each director's best interests and in good faith.⁹⁸ A varied blend of executive and non-executive directors should make up the governing board, with the majority of its members being independent. Among them should be the chair, the CFO, and the CEO.⁹⁹ Members ought to be chosen on the basis of merit

⁹⁵ Corporate Governance and King III <https://assets.kpmg/content/dam/kpmg/pdf/2016/07/Corporate_Governance-and-King-III.pdf>

⁹⁶ The King IV was published in November 2016 and became effective on 1st April 2017.

⁹⁷ King IV Report on Corporate Governance for South Africa.

⁹⁸ Section 75 and 76, The Company's Act .2008

⁹⁹ Note; independence is determined holistically on a 'substance over form' basis, which takes into consideration various interests, positions and relationships listed in the Companies Act and the King Code that might reasonably call the integrity or objectivity of the director into question.

through an official, open process (principle 7).¹⁰⁰ If they can demonstrate that they work in the company's best interests, non-executive members may hold office for longer than nine years.¹⁰¹ It is mandatory to have an audit committee¹⁰² and a social ethics committee. However, principle 8 encourages cross-membership between committees but with a balanced distribution of power to mitigate undue influence in decision-making. Corporations to have effective succession planning policies which should be renewed annually to enhance the smooth continuity of executive leadership.¹⁰³

In addition, the governing body need to be held responsible for the governance of organizations and subject to periodic reviews of its efficacy and performance (Principles 5 and 7). Furthermore, the code places a strong emphasis on active involvement with stakeholders under principles 4 and 16. Under principle 12, the King IV report demonstrates rapid adaptability to a changing world by recognizing the significance and impact of information technology in the economy.

The code under principle 14 requires that remuneration policies be transparent and responsible aligning executive pay with performance and is to be disclosed using a remuneration report tabled yearly in accordance with the Companies Act.¹⁰⁴ As a result, the organization now operates with greater accountability and transparency, and stakeholder participation has increased.

From the illustration above, it can be deduced that the Mwongozo Code and King IV are similar in the sense that their first pillars stress the need for an ethical culture that encompasses the values of competence, fairness, responsibility, accountability, integrity, and transparency in both the organization and its leadership. The major difference is in the implementation mechanisms. King IV adopts the UK model of comply or explain which has consequences attached to the same. The other difference is that King IV puts stakeholders including the public at the center of board governance through accountability and public participation.

¹⁰⁰ Part 5.3.31. King IV Report on Corporate Governance for South Africa, 2016.

¹⁰¹ Part 5.3.29.

¹⁰² Section 66(3), Companies Act

¹⁰³ Part 5.3.81.

¹⁰⁴ Company Act 71 of 2008.

4.4 The lessons that Kenya can learn from the UK Code and King IV frameworks

The Mwongozo code hasn't been reviewed since it was adopted in 2015, unlike the UK code and the King IV Report. Laws, regulations, and other policies should be modified to accommodate societal needs. For instance, the rapid growth of information and technology has changed how people see the economy because of scientific discoveries. To reflect the best practices and standards in the local and global context, Kenya should continuously examine and update its own corporate governance framework as it's an ever-changing and evolving field.

Implementation of the 'Apply and explain' approach - this will give stakeholders and the government a clear understanding of the internal workings of a state corporations making it easier to hold organizations accountable.

Kenya should implement public participation and education on matters involving corporate governance. This will encourage state corporations to develop a mentality that views corporate governance as a strategic instrument that may improve the performance, sustainability, and reputation of organizations for value generation rather than a box-ticking task.

Kenya should create an ethical and organizational culture of promoting stakeholder inclusivity and responsiveness in addition to board and management. Respect will increase as a result, and it will assist in managing the justifiable needs, goals, and expectations of each and every participant in SCs. Kenya ought to adopt sustainable practices and incorporate governance, social, and environmental factors into decision-making.¹⁰⁵

4.5. Conclusion

This chapter has examined the UK and South African codes with a view of establishing best practices that Kenya could borrow in light of Mwongozo code. It is evident then that a lot needs to be done to ensure not only strict compliance with the Mwongozo Code but also improve it to keep up with the societal changes. With that, we note that the objective for this chapter has been achieved. The next chapter shall discuss overall conclusion and recommendations.

¹⁰⁵ Githiri (n 12).

CHAPTER FIVE

CONCLUSION AND RECOMMENDATIONS

5.1. Introduction

The corporate governance frameworks of South Africa and the United Kingdom (UK) were compared in the previous chapter. Two nations with some of the most advanced state-owned corporation governance systems. The management pillar and board of directors received particular attention. This chapter's goal is to present the study's findings and offer suggestions that will enhance corporate governance in Kenya and the way state-owned enterprises are run by their respective boards to guarantee growth and effective service delivery to the country's citizens.

5.2. Conclusions of the study

In Kenya, parastatals are established for a number of purposes, such as promoting joint ventures that attract foreign direct investment, addressing the regional economic imbalance, and quickening the pace of economic and social development.¹⁰⁶ Meeting these objectives requires a stable and robust governance structure. In the past, Kenyan parastatals have suffered massive mismanagement practices ranging from corruption to lack of accountability. As a countermeasure, different legislations have been enacted, including the Constitution, to provide a framework for the management and governance criteria of parastatals. In response to the elements of malfeasance above, the Mwongozo Code was enacted. The Code is backed by the Constitution and borrows greatly from the constitutional provisions that touch on governance.¹⁰⁷ Chapter 1 of the Code addresses broadly the issues of governance, laying the foundational basis for the appointment, size, and related components of the Board of Directors of parastatals. Despite these provisions, the implementation of Chapter 1 of the Code is still met with various challenges.

¹⁰⁶ Government of Kenya, 'Sessional Paper No. 04 of 1991 on Development and Employment in Kenya' [1991] repository.kippra.or.ke
<<https://repository.kippra.or.ke/handle/123456789/1461#:~:text=This%20Sessional%20Paper%20is%20the>>
accessed 27 August 2023.

¹⁰⁷ Articles 10, 73, and 232, Constitution of Kenya 2010.

This study has demonstrated that the very challenges that Mwongozo was crafted to solve have continues to exist if not getting even worse. State corporations in Kenya face several challenges from a board and governance perspective. Among these difficulties is the inefficiency of state corporation boards, which results from the agents (public officials) who have the authority to designate board members and give managerial instructions not always acting in the best interests of the corporations but rather in the interests of voters who have the power to remove them from office.

The majority of boards are overly large, and their members are unskilled and unaware of their responsibilities as directors. A lack of commitment from management can result in the inability of a corporate governance strategy to be implemented and in the absence of gender diversity in the makeup of state corporation boards.

It was the finding of this paper that the pillar on board appointment, composition, and size has faced myriad of implementation challenges at different state Corporations. It further established that there exist a few advantages and a lot of difficulties resulting from the pillar's implementation with regard to board sizes, compositions, and appointments and that these difficulties in continue to prevent state firms from reaching their goals for corporate governance.

The paper finds that whereas efforts have been put in place to ensure the mwongozo success, the lack of legal force behind it remains a challenge. Until aggressive changes are made and this Code is made into a law with consequences for non-compliance, the situation might not change anytime soon.

5.3 Recommendations

The Mwongozo Code of Governance for State Corporations in Kenya was created with the intention of establishing best practices in corporate governance as well as ingraining public service ideals and values. The challenges that the Mwongozo Code was meant to address continue to exist and state corporations continue to struggle, which struggles are more often than not directly associated with poor governance emanating from the board and management.

To address these challenges, this study gives a raft of recommendations that if considered and implemented shall aid in the much needed good corporate governance practices by the board of state corporations.

Short term recommendations

- a) In order for board members, CEOs, senior managers, and shareholders to completely comprehend and value corporate governance—and in particular, the Mwongozo code—at the time of appointment to the board of state corporations, there is a need for capacity building and awareness raising. These trainings should include clear indication of expectations and have a board evaluation KPIs to measure performance of the board against such expectations. The training should be organized by the management and corporation secretary to the boards.
- b) Appointing professional board members with well-defined skill sets is crucial for improving corporate governance. This can be achieved by recruiting individuals with relevant experience and expertise in the specific industry or sector. The appointment criteria should be considered by the appointing authorities under the law.
- c) Two-Tier Board Structure: Kenya should adopt the two-tier board structure to improve corporate governance practices within state corporations. This structure separates the supervisory board from the management board, allowing for better oversight and accountability. This should be implemented by the board members as part of their operations oversight role.
- d) Clear Framework for Recruitment and Selection: State corporations in Kenya lack a clear framework for recruitment, selection, appointment, and induction of boards. Establishing a clear framework for these processes can help ensure that board members are selected based on merit and relevant experience.
- e) Professional Boards: Mwongozo acknowledges that the appointment of professional boards with clearly defined skill sets is the most crucial instrument for enhancing corporate governance.

- f) Transparency and disclosure: The code further expounds on matters such as transparency and disclosure, accountability, risk management, internal controls, ethical leadership, and good corporate citizenship, just as enshrined in Article 232 of the Constitution of Kenya 2010.
- g) Review: It was envisaged that the code would be reviewed after five years. Therefore, it is essential to review the code periodically to ensure that it is up-to-date and relevant to the current corporate governance landscape.
Long term
- h) Legal status: The code's legal standing presents a significant implementation issue. The code is a governmental document, but it is not a law or regulation, and although its contents are compelling, a person cannot rely on them to assert a right.

5.4 Conclusion

The Mwongozo Code of Governance for State Corporations is a crucial tool for improving corporate governance in Kenya. To guarantee that it is contemporary and applicable to the present corporate governance environment, it is necessary to tackle the implementation's obstacles.

It is therefore important to note that improving the board and management of state corporations in Kenya requires a multifaceted approach that includes appointing professional board members, providing governance training, adopting a two-tier board structure, establishing a clear framework for recruitment and selection, promoting board diversity, and improving internal controls and risk management shall rid the challenges and improve the implementation of this Code.

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