

**CORPORATE GOVERNANCE IN PUBLICLY-OWNED CORPORATIONS: A
CASE STUDY OF THE SUGAR INDUSTRY IN KENYA**

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Declaration

I, MONICA NUNGARI MUCHAI, do hereby declare that this research is my original work and that to the best of my knowledge and belief; it has not been previously, in its entirety or in part, been submitted to any other university for a degree or diploma. Other works cited or referred to are accordingly acknowledged.

Signed: Monica.....
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This Research Proposal has been submitted for examination with my approval as University Supervisor.

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Harrison Mbori

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LIST OF STATUTES

The Capital Markets Act-Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015.

Sessional Paper No. 10 of 1965

State Corporations Act (Cap 446)

Sugar Act No 10 of 2001

Swynnerton Plan of 1954

LIST OF ACRONYMS AND ABBREVIATIONS

BMI	Business Monitor International
FAO	Food Agriculture Organization
KESGA	Kenya Sugar Growers Association
KESMA	Kenya Sugar Manufacturers Association
KESREF	Kenya Sugar Research Foundation
KSB	Kenya Sugar Board
OGI	Out-Growers Institutions
SONY sugar	South Nyanza Sugar Company Limited

ABSTRACT

Corporate governance is a framework used by a corporate entity to manage and control its functions. It is all about encouraging the corporate sector to be fair, accountable, transparent and responsible. Furthermore, the essence of corporate governance is to make sure that the key shareholder objective, i.e. wealth maximization is implemented. Consequently, good corporate governance is relevant to all industries because it ensures that organizational goals are realized through good stewardship of resources.

The aim of this research paper is to investigate corporate governance in publicly-owned corporations, specifically the sugar industry in Kenya. This research paper will highlight the current overview of the sugar industry, the principles of corporate governance and the challenges encountered in corporate governance. There is need to ensure good corporate governance is upheld by ensuring that regulatory bodies, internal mechanisms as well as the role of courts function efficient.

CHAPTER 1: INTRODUCTION OF THE PROBLEM AND PURPOSE OF THE STUDY

1.1 BACKGROUND OF THE STUDY

Corporate governance is a framework used by a corporate entity to control and manage its function.¹ It can be referred to as a set of rules and procedures that ensure that managers do indeed employ the principals of value-based management. Furthermore, the essence of corporate governance is to make sure that the key shareholder objective-wealth maximization is implemented. Corporate Governance has been defined in the Kenyan Capital Markets Act Cap 485A,as, ‘the process and structure used to direct and manage business affairs of the company towards enhancing prosperity and corporate accounting with the ultimate objective of realizing shareholder ultimate value while taking into account the interests of other stakeholders.’² Moreover, it seeks to encourage the effective use of resources, accountability in the use of power and stewardship and aligning the interests of individuals, corporations and society.³

Corporate Governance plays a more important role on public companies which have essential effects on social and economic life. The boards of directors of these public companies, which are in the highest level in organization also, have important sharing in applications of the principles of Corporate Governance. In this study we have examined that, how the boards of directors of public companies should be structured in accordance with Corporate Governance principles.

After Kenya gained independence in 1963, in a bid to ensure that the sugar industry was governed effectively the government’s plan of action was guided by the Swynnerton Plan of 1954 and the Sessional Paper No. 10 of 1965.⁴ The Swynnerton Plan of 1954 as well as the Sessional Paper No 10 of 1965 provided the framework which they were to use to

¹ Baland Jean-Marie, Moene Karl-Ove, Robinson .A. James, ‘Governance and Development,’ January 2009.

² The Capital Markets Act; Code of Corporate Governance Practices for Issuers of Securities to the Public (2015).

³ The Capital Markets Act; Code of Corporate Governance Practices for Issuers of Securities to the Public (2015).

⁴ Sessional Paper No. 10 of 1965.

restructure the agricultural sector including sugar-cane farming.⁵ The climatic conditions in Western Kenya and Coast favour the growing of sugar, the 5 out of 6 functioning sugar factories in Kenya are in the Western belt.⁶ The government intended to provide the citizens of the country living in this region with a source of livelihood.⁷

1.2 STATEMENT OF THE PROBLEM

A feeble legal corporate governance structure has had devastating effects on Kenya's Sugar Industry. As a result, reports carried out by the Food Agriculture Organization (FAO) and the Business Monitor International (BMI) made a forecast on the stagnation of sugar production on the 2014/15 level in 2015/16 at approximately 52,000 Metric Tonnes.⁸ The directors of State corporations are the pinnacle of the corporate governance structure. Consequently, by failing to carry out their duties effectively, the sugar industry in Kenya has been characterised by mismanagement, improper market procedures and lack of transparency.

1.3 JUSTIFICATION OF THE RESEARCH

The sugar industry plays a significant role in the Kenyan economy and is a source of income for millions of citizens. The government is committed to improving the living standards of the people, this enhances the legitimacy of the government in view of the many promises that the leaders make to the citizens. The government sets out a corporate governance framework to help control and manage the companies that produce sugar in the country; therefore, it is important to research on corporate governance in these corporations. There is a significant relationship between the performance of corporations and the application of the principles of corporate governance.

⁵ Swynnerton Plan of 1954.

⁶ <http://www.afrikareporter.com/kenya-sugar-industry-east-africas-bitter-sweet-story/> on 30 March 2015.

⁷ Kamau A.G.N, 'Corporate Governance in Kenya's State Corporations: A Critique on the Appointment and Dismissal of Directors of Boards of State Corporations, 2013.

⁸ <http://www.afrikareporter.com/kenya-sugar-industry-east-africas-bitter-sweet-story/> on 30 March 2015.

This study seeks to show this relation by looking into the corporate governance framework in the sugar industries. This findings and conclusions of this study will provide insight on corporate governance and how it works in the sugar industry in Kenya. Good corporate governance frameworks have financial repercussions on state corporations, i.e. they contribute significantly to their financial success. Moreover, good governance precedes any successful corporation.

1.4 STATEMENT OF OBJECTIVES

1.4.1 General objectives

The overarching objective of this research is to investigate corporate governance in publicly-owned corporations particularly corporations that are in the sugar industry. It aims at analysing whether there is a significant relationship between the performance of publicly-owned corporations and compliance with the principles of corporate governance. This research aims at looking into the corporate governance framework in sugar industries in Kenya. These specific objectives include:

1. To investigate the legal framework setting up corporate governance in sugar industries in Kenya.
2. To determine how corporate is being realised in the sugar industries and what can be done to improve its realisation.

1.5 RESEARCH QUESTIONS

The study will seek to answer the following research questions:

1. How is the concept of corporate governance being realised in the sugar industry in Kenya?
2. What problems have been encountered in the corporate governance frameworks in the sugar industry?
3. What are the effects of poor corporate governance in the sugar industry in Kenya?
4. Is there a significant relationship between the performance of publicly-owned corporations and compliance with the principles of corporate governance?

1.6 LITERATURE REVIEW

Scholars carry out various studies depending on their objectives in the field of corporate governance. Kegode in his study focuses on the economic governance reform in the sugar sub-sector. In a bid to analyse the importance of corporate governance on the performance of state corporations, Miring'u and Muoria have analysed the Effect of Corporate Governance on Performance of Commercial State Corporations in Kenya, this study examined how Corporate Governance affects financial performance in commercial state corporations in Kenya.⁹ As a result, this study did not investigate how the concept of corporate governance is being realised in the sugar industry. Musikali emphasises on the need for reviewing the laws affecting corporate governance in Kenya.¹⁰ His study does not focus on corporate governance in the sugar industry in Kenya, instead it focuses on Kenya's corporate governance legislation and its corporate governance code. Consequently, this research seeks to focus on corporate governance in the sugar industry in Kenya.

Kamau criticises the appointment and dismissal of Directors of Boards of State corporations.¹¹ However, this research seeks to investigate on the realisation of the concept of corporate governance in the sugar industry in Kenya as opposed to just focusing on the appointment and dismissal of Directors of Boards of State corporations.

Yvonne focuses on corporate governance problems facing Kenyan parastatals with the case study being the sugar industry in Kenya.¹² This research does not only focus on the corporate governance problems in the sugar industry rather it goes further and investigates on whether there is a significant relationship between the performance of publicly-owned corporations and compliance with the principles of corporate governance.

⁹ Miring'u Alice and Muoria Esther T. 'An analysis of the Effect of Corporate Governance on Performance of Commercial State Corporations in Kenya'. *International Journal of Business and Public Management*, (2012), 1(1): 36-41.

¹⁰ Musikali Lois M, 'The Law affecting Corporate Governance in Kenya: A need for Review, *International Company and Commercial Law Review*'. 2008.

¹¹ Kamau A.G.N, 'Corporate Governance in Kenya's State Corporations: A Critique on the Appointment and Dismissal of Directors of Boards of State Corporations', 2013.

¹² Atieno Awuor Yvonne: 'Corporate Governance Problems Facing Kenyan Parastatals: A case study of the Sugar Industry', Bucerius/WHU MLB Thesis, 17 July 2009.

Despite the numerous researches carried out, they have not adequately investigated how the concept of corporate governance is being realised in the sugar industry in Kenya, the effects of poor governance and whether there is a significant relationship between the performance of publicly-owned corporations and compliance with the principles of corporate governance. My research seeks to fill in these gaps. The literary works of these authors will serve as a basis for my writing.

1.7 THEORETICAL FRAMEWORKS

This study will be based on three theories which will serve as a basis for the concept of corporate governance. These theories will provide insight into the principles of corporate governance, its purpose, and relevance.

1. Stakeholder Theory

The stakeholder theory considers other stakeholder groups that the corporation is associated with.¹³ This theory insists that; certain management actions might have conflicting effects on various classes of stakeholders.¹⁴ The stakeholder theory has developed the thesis that the organisation has a moral relationship with groups other than shareholders. The Hampel committee in its final report stated that,

‘Corporate governance must contribute both to business and accountability. The purpose of those responsible for corporate governance is to safeguard the interests of shareholders. They also protect and promote the interests of other stakeholders. These stakeholders include, managers, employees, customers, suppliers, governments and the communities where the company operates’.¹⁵

2. Stewardship Theory

This theory suggests that the managers of corporations’ act as custodians who operate in a manner that will benefit the owners.¹⁶ There is a correlation between

¹³ Aikhafaji, A.F. ‘A Stakeholder Approach to Corporate Governance; Managing in a Dynamic Environment, Westport CT: Quorum Books, 1989.

¹⁴ Gibson K., ‘The moral basis of Stakeholder theory’, *Journal of Business Ethics*, Vol 26 pp 245-57, 2000.

¹⁵ Hampel Committee, ‘Corporate Governance,’ the Hampel Report on Corporate Governance, 1998, 15.

¹⁶ L Donaldson and J.H. Davis, *Stewardship Theory or Agency Theory: CEO Governance and Shareholder Returns*, *Australian Journal of Management*, 16, 49, 1991.

managers and the success of a corporation.¹⁷ When the managers satisfy the needs of the owners and the groups concerned, balanced governance is achieved.

3. Agency theory

Directors act as agents in exercising their governance functions.¹⁸ They carry out their mandate effectively by acting in the best interests of the shareholder.¹⁹ The corporate managers are well acquainted with the operations of the corporation. The skills they acquire over-time can cause them to make decisions that do not maximise shareholder value.²⁰ This theory focuses mainly on the governance structures. The main aim is safeguarding the shareholder's interests, reducing agency costs and maintaining the agency-principal relationship.²¹

1.8 HYPOTHESIS

1. This study will be based on the proposition that the progressive realization of the principles of corporate governance in publicly-owned corporations is necessary for their success.
2. This study will hypothesise that a good corporate governance framework will require directors who are accountable, transparent and good managers.
3. Lastly, they ought to carry out their duties in the best interests of the various stakeholders, this will ensure their effectiveness.

1.9 RESEARCH DESIGN AND METHODOLOGY

The research will employ both primary and secondary sources of collecting data. Primary sources of data will be questionnaires which will play a major role in acquisition of information from officials from the sugar industry. They are important because they will

¹⁷ J.H. Davis, Schoorman F.D and L. Donaldson: *The Distinctiveness of Agency Theory and Stewardship Theory*, 1997.

¹⁸ Berle A. Adolf and Means C. Gardiner: *The Modern Corporation and Private Property*, 1968.

¹⁹ Ulrich, P. *Integrative Economic Ethics: Foundations of a Civilized Market Economy*, Cambridge: Cambridge University Press, 2008.

²⁰ Fama F. Eugene and Jensen C. Michael: *Separation of Ownership and Control*, the University of Chicago Press, 1983.

²¹ J.H. Davis, Schoorman F.D and L. Donaldson: *The Distinctiveness of Agency Theory and Stewardship Theory*, 1997.

provide insight into the sugar industry because they are practical. Moreover, the quantitative data obtained can be used to develop hypotheses or theories. Secondary sources of data will majorly include desktop research. The research will focus on national legislation on corporate governance. Academic articles that focus on corporate governance, publicly-owned corporations and the sugar industry will also be useful in carrying out the research. Surveys and research done by organizations and academicians will also be important in the research. The information gathered will be important in determining the state of corporate governance in publicly-owned corporations such as the sugar industries in Kenya.

CHAPTER 2: THEORETICAL FRAMEWORK

2.1 INTRODUCTION

This study will be based on three theories which will serve as a basis for the concept of corporate governance. These theories will provide insight into the principles of corporate governance, its purpose and relevance. This chapter will look into the Stakeholder, stewardship and agency theories which serve as the theoretical basis of this research.

2.1.1 Stakeholder Theory

This theory is an outcome produced by the battles between Berle and Dodd. Dodd believed directors are the trustees of corporations because they must balance the interests of all constituents of companies and behave in a socially responsible behaviour. Furthermore, it is a doctrine that ensures companies as organizations are accountable to their stakeholders and balance divergent interests between stakeholders.²²

There are three aspects of this theory, they include:

1. Instrumental power-this aspect creates a framework for checking the connections between the practice of stakeholder management and the success of a corporation's performance;
2. Descriptive accuracy-it is used to describe particular corporations' behaviours;
3. Normal validity-it is the fundamental basis of the theory used to interpret the purpose of the companies. This aspect is the core of the theory because the objective of corporations is the key issue of corporate governances.²³

The stakeholder theory considers other stakeholder groups that the corporation is associated with.²⁴ This theory insists that; certain management actions might have conflicting effects on various classes of stakeholders.²⁵ The stakeholder theory has

²² Baumfield S. Victoria, 'Stakeholder theory from a Management perspective: Bridging the shareholder/stakeholder divide, 2016.

²³ Fontaine Charles, Haarman Antoine, Schmid Stefan, *The Stakeholder Theory*, 2006.

²⁴ Aikhafaji, A.F. 'A Stakeholder Approach to Corporate Governance; Managing in a Dynamic Environment, Westport CT: Quorum Books, 1989.

²⁵ Gibson K., 'The moral basis of Stakeholder theory', *Journal of Business Ethics*, Vol 26 pp 245-57, 2000.

developed the thesis that the organisation has a moral relationship with groups other than shareholders.²⁶ The Hampel committee in its final report stated that:

‘Corporate governance must contribute both to business and accountability. The purpose of those responsible for corporate governance is to safeguard the interests of shareholders. They also protect and promote the interests of other stakeholders. These stakeholders include, managers, employees, customers, suppliers, governments and the communities where the company operates.’²⁷

2.1.2 Stewardship Theory

This theory was developed by Donaldson and Davis, it is a new outlook to understand the existing relationship between ownership and management of the company.²⁸ This theory suggests that the managers of corporations’ act as custodians who operate in a manner that will benefit the owners.²⁹ There is a correlation between managers and the success of a corporation.³⁰ When the managers satisfy the needs of the owners and the groups concerned, balanced governance is achieved.³¹ This theory is also about the employment relationship between two parties, the principal and the steward. It suggests that stewards will behave in a pro-social manner.³² This behaviour is fostered by the quality of the relationship between the principal and steward, the environment and ideals of the organization.³³

²⁶J.H. Davis, Schoorman F.D and L. Donaldson: *The Distinctiveness of Agency Theory and Stewardship Theory*, 1997.

²⁷ Hampel Committee, ‘Corporate Governance,’ the Hampel Report on Corporate Governance, 1998, 15.

²⁸ Pastoriza David, ‘When Agents Become Stewards: Introducing Learning in the Stewardship Theory.’

²⁹ L Donaldson and J.H. Davis, *Stewardship Theory or Agency Theory: CEO Governance and Shareholder Returns*, *Australian Journal of Management*, 16, 49, 1991.

³⁰ J.H. Davis, Schoorman F.D and L. Donaldson: *The Distinctiveness of Agency Theory and Stewardship Theory*, 1997.

³¹ Pastoriza David, ‘When Agents Become Stewards: Introducing Learning in the Stewardship Theory.’

³² J.H. Davis, Schoorman F.D and L. Donaldson: *The Distinctiveness of Agency Theory and Stewardship Theory*, 1997.

³³ L Donaldson and J.H. Davis, *Stewardship Theory or Agency Theory: CEO Governance and Shareholder Returns*, *Australian Journal of Management*, 16, 49, 1991.

Maximum firm performance e.g. sales growth is the desired outcome of a stewardship perspective.³⁴ At the core of the stewardship theory is the assumption that the principal-steward relationship is based on a choice. Additionally, the choice of stewardship behaviour is impacted by both psychological and situational factors.³⁵ Furthermore, it applies personal power perspective, describing power based on interpersonal relationships that develop over time, which in turn empower steward managers.³⁶ Consequently, this theory suggests that involvement-oriented, collectivist, low-power distance cultures help influence the choice of stewardship behaviour.³⁷

The underpinning assumption of stewardship theory is based on the humanistic model of man due to its foundation in sociology and psychology. It assumes that individuals are motivated by higher order needs. In the principal-steward relationship, a steward will put the interests of the principal first before their own selfish interests.³⁸

In conclusion, this theory suggests that increase in performance is the outcome of the principal encouraging a governance structure that encourages pro-organizational behaviour of the steward, founded upon on the humanistic model of man. This behaviour is characterized by fewer monitoring and control mechanisms.³⁹

³⁴J.H. Davis, Schoorman F.D and L. Donaldson: *The Distinctiveness of Agency Theory and Stewardship Theory*, 1997.

³⁵J.H. Davis, Schoorman F.D and L. Donaldson: *The Distinctiveness of Agency Theory and Stewardship Theory*, 1997.

³⁶ J.H. Davis, Schoorman F.D and L. Donaldson: *The Distinctiveness of Agency Theory and Stewardship Theory*, 1997.

³⁷ Pastoriza David, Arino A. Miguel, 'When Agents become Stewards: Introducing Learning in the Stewardship Theory.'

³⁸ L Donaldson and J.H. Davis, *Stewardship Theory or Agency Theory: CEO Governance and Shareholder Returns*, *Australian Journal of Management*, 16, 49, 1991.

³⁹ J.H. Davis, Schoorman F.D and L. Donaldson: *The Distinctiveness of Agency Theory and Stewardship Theory*, 1997.

2.1.3 Agency theory

The first scholars to propose and begin the creation of this theory are; Stephen Ross and Barry Mitnick.⁴⁰

This theory is one of the most widely used theories in management. It examines the relationship between the principal and the agent from a behavioural and a structural perspective. Principals enact structural mechanisms that monitor the agent to curb opportunistic behaviour.⁴¹ The performance of a firm by way of cost minimization and greater efficiencies is the desired outcome of the agency theory perspective. When the ownership and management of a firm are separated, the theory suggests that agency problems are created, and agency costs are incurred to alleviate these problems; the principal delegates work to the agent and the agent is expected to act in the best interest of the principal.⁴²

This theory suggests the principal has two options for reducing agency problems such as moral hazard. The first option is to create a governance structure that enables the monitoring and evaluation of the actual behaviour of the agent. The second is to create a governance structure where the contract is based on the actual outcome of the agent's behaviour, e.g. compensation incentive pay, where pay is provided as an incentive for high performance. Risk is thus shifted to the agent, creating the motivation for the agent's behaviour to align with the principal's interest. Consequently, the underlying assumption of agency theory is based on the economic model of man.⁴³

This model assumes that individuals will seek to optimize their own utility. Directors act as agents in exercising their governance functions.⁴⁴ They carry out their mandate effectively by acting in the best interests of the shareholder.⁴⁵ The corporate managers are

⁴⁰ Mitnick M. Barry, 'Origin of the Theory of Agency: An Account by One of the Theory's Originators, 2013.

⁴¹ Gailmard Sean, 'Accountability and Principla-Agent Models, 2012.

⁴² Bonazzi Livia, 'Agency Theory and Corporate Governance: A study of the Effectiveness of board in their monitoring of the CEO, 2007.

⁴³ Oliviera B. Clara, Filho R. Joaquim, 'Agency problems in the public sector: The Role of Mediators between central administration of city hall and executive bodies, 2017.

⁴⁴ Berle A. Adolf and Means C. Gardiner: The Modern Corporation and Private Property, 1968.

⁴⁵ Ulrich, P. Integrative Economic Ethics: Foundations of a Civilized Market Economy, Cambridge: Cambridge University Press, 2008.

well acquainted with the operations of the corporation. The skills they acquire over-time can cause them to make decisions that do not maximise shareholder value.⁴⁶

The main aim is safeguarding the shareholder's interests, reducing agency costs and maintaining the agency-principal relationship.⁴⁷ In conclusion, this theory suggests that increase in performance is the result of the principal implementing governance structures to curb the opportunistic behaviour of the agent, based on the assumed economic model of man.

⁴⁶ Fama F. Eugene and Jensen C. Michael: Separation of Ownership and Control, the University of Chicago Press, 1983.

⁴⁷ J.H. Davis, Schoorman F.D and L. Donaldson: The Distinctiveness of Agency Theory and Stewardship Theory, 1997.

CHAPTER 3: LEGAL FRAMEWORK AND THE DETERMINANTS OF EFFECTIVENESS OF CORPORATE GOVERNANCE IN THE SUGAR INDUSTRY.

3.1 INTRODUCTION

This chapter aims at looking into the bodies or entities that determine the effectiveness of corporate governance in state corporations. These include, the shareholders, the board of directors, courts as well as additional groups such as auditors.⁴⁸

State corporations were established to fulfil the social objectives of the state rather than to maximize profits. Stakeholder suppositions have forced the government to reform the Corporate Governance systems of state corporations with expectations of improving their operations to reduce deficits and to make them tools in gaining national competitiveness.⁴⁹ The efficiency of state corporations such as corporations in the sugar industry is largely dependent on good corporate governance.

3.2 Legal Framework of Corporate Governance in The Sugar Industry.

3.2.1 The Sugar Act 2001

This is the main law governing the sugar industry. It was enacted in 2001. Additionally, it provides the framework for relationships for all the industry players, except for sugar consumers who have no representation in the Act. Furthermore, it provides for the roles and responsibilities of the Ministry of Agriculture, the Kenya Sugar Board, the Kenya Sugar Research Foundation (KESREF), Kenya Sugar Growers Association (KESGA), Kenya Sugar Manufacturers Association (KESMA), Out-Growers Institutions (OGI) and contracted farmers.

However, the Sugar Act no.10 Of 2001 requires amendment and the specific areas have been ably pointed out by stakeholders.

Stakeholders have cited the following the following key areas in their proposals to amend the Act. Firstly, there ought to be de-politicisation of the appointment of the chief executives of KSB and sugar mills. Secondly, farmers associations should be recognised

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⁴⁹ International Journal of Business and Commerce, 'Board Characteristics as a Determinant of Effectiveness of Corporate Governance in State Corporations in Kenya, 2016.

which will serve as a replacement of the Out-Grower Institutions (OGI) in the Sugar Act of 2001. Millers and farmers argue that out growers in Kenya perform very little function and have become a liability to farmers and millers.

3.3 Regulatory Framework

The sugar industry ensures food security improves rural lives and provides sustainable livelihoods for millions of Kenyans. The Kenya Sugar Board(KSB) is the regulatory body of the Sugar Industry, established on 1st April 2002, under the Sugar Act no.10 of 2001.⁵⁰ The mandate of the Kenya Sugar Board as stipulated in Section 4 (1) and 4 (2) of the Sugar Act 2001 is as follows:

- i. regulate, develop and promote the sugar industry;
- ii. co-ordinate the activities of individuals and organizations within the industry;
- iii. facilitate equitable access to the benefits and resources of the industry by all interested parties.⁵¹

The KSB is entrusted with the responsibility of regulating, developing and promoting the Kenya Sugar Industry. Its specific roles are to:

- (a) participate in the formulation and implementation of overall policies, plans and programs of work for the development of the industry;
- (b) act as an intermediary between the industry and the Government;
- (c) facilitate the flow of research findings to interested parties through the provision of effective extension services;
- (d) monitor the domestic market with a view to identifying and advising the Government and interested parties on any distortions in the sugar market;
- (e) facilitate the arbitration of disputes among interested parties;
- (f) facilitate the export of local sugar;

⁵⁰ Sugar Act (Act No. 10 of 2001).

⁵¹ Section 4(1) and 4 (2), Sugar Act (Act No. 10 of 2001).

- (g) promote and encourage the use of environmentally friendly technologies in the industry;
- (h) provide advisory services to growers, out-grower institutions and millers;
- (i) facilitate an equitable mechanism for the pricing of sugar-cane and appropriation of proceeds from the disposal of the by-products of sugar production between millers and growers as stipulated in the guidelines;
- (j) represent the industry in such organizations as are relevant for the promotion of the industry;
- (k) oversee the formulation of standard provisions governing the mutual rights and obligations of growers, millers and other interested parties;
- (l) collect, collate and analyse industry statistics and maintain a data base for the industry; (m) licence sugar mills;
- (n) promote the efficiency and development of the industry through the establishment of appropriate institutional linkages; and
- (o) perform such other functions as may, from-time to time, be assigned by the interested parties.⁵²

KSB represents the interests in the industry, including growers' representatives, millers' representatives and the Permanent Secretaries of the Ministry of Agriculture and Finance. Its accounts are audited by the Auditor General under the provisions of the State Corporations Act (Cap 446).⁵³

3.4 Determinants of the effectiveness of Corporate Governance

Corporate governance is inherently viewed as a function of three groups: the shareholders, the top management and the board of directors. However, additional groups involved in high-end policy-making, decision-making and problem-solving should also be considered. The consideration of corporate governance should include audit functions and the board audit committee who provide information for corporate-level critical-decision making. Additionally, such information can influence the board's decisions and perceptions. These

⁵² Sugar Act (Act No. 10 of 2001).

⁵³ State Corporations Act (Act No. 446 of 2016).

additional groups fall within the scope of the agency theory. Understanding the interdependence and interactions of these groups with each other is critical in assessing corporate governance effectiveness.⁵⁴

The underlying assumption is that the agent, i.e. the Chief Executive Officer is opportunistic and selfish in the pursuit of personal wealth whereas the owner's goal is the maximization of shareholder wealth. The owner reconciles these different goals through two types of control mechanisms: incentive alignment and monitoring. Furthermore, the incentive alignment enables the owner to design a CEO compensation contract that unites the interests of the owner with the agent.⁵⁵ Monitoring activities involve the direct observation of the agent's behavior by the board of directors. Consequently, monitoring the agent's behavior requires independent boards as well as the alignment of the board's interests with those of the owner.⁵⁶

In conclusion, each of the groups responsible for monitoring and decision-making acts as a check on the others, leading to the organization functioning in the best interests of the stockholders. Moreover, appropriate control mechanisms, monitoring and incentives can reduce the agency costs.⁵⁷

⁵⁴ White G. Craig, Silva Paula, Gerde W. Virginia, 'Corporate Governance Effectiveness, Balanced Relationships among External Auditors, Internal Auditors, the Board of Directors and Top Management,' 2002.

⁵⁵ Roberts John, 'Shareholder Interests, Human Capital Investment and Corporate Governance,' 2000.

⁵⁶ White G. Craig, Silva Paula, Gerde W. Virginia, 'Corporate Governance Effectiveness, Balanced Relationships among External Auditors, Internal Auditors, the Board of Directors and Top Management,' 2002.

⁵⁷ Roberts John, 'Shareholder Interests, Human Capital Investment and Corporate Governance,' 2000.

CHAPTER 4: CORPORATE GOVERNANCE IN KENYA'S SUGAR INDUSTRY

4.1 INTRODUCTION

Governance of an industry is not the same as good governance. Governance refers to the structures that an organization uses to direct and manage its general operations. Good governance is achieving desired results and achieving them in the appropriate manner.⁵⁸

Good corporate governance confronts the need for managers to act in the best interests of the firm's core stakeholders by ensuring that only actions that facilitate delivery of optimum returns and other favourable outcomes are taken always.

Good corporate governance requires that the State puts in place and maintains an enabling environment in which efficient & well-managed companies can thrive. Furthermore, good corporate governance dictates that the Board of Directors governs the corporation in a way that maximizes shareholder value & in the best interest of society.⁵⁹

Moreover, good corporate governance is relevant to all industries because it ensures that organizational goals are realized through good stewardship of resources. The organization of the management affects the companies' performance and its long-term competitiveness. The performance of the Kenyan economy deteriorated markedly in the 1980's and 1990's. There were serious weaknesses in institutions of governance which undermined competitiveness as well as investor confidence in Kenyan economy.⁶⁰

In 2006, the government of Kenya structured a reform strategy that seeks to address factors that have led to the underperformance of the 5 sugar companies which include; Muhoroni, Chemelil, Mumias, Nzoia and SONY sugar company over the years including poor infrastructure, uneconomical land sizes, low yield due to reliance on rainfed sugarcane and many incidents of poor governance. The reform aimed at improving governance to ensure efficiency, effectiveness and the creation of an enabling environment for sustainable growth and development.⁶¹

⁵⁸ United Nations Economic and Social Commission for Asia and The Pacific, 'What is Good Governance?'

⁵⁹ Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015 (the 2015 Code).

⁶⁰ Government of Kenya, 'Governance Strategy for Building A Prosperous Kenya,' November 2006.

⁶¹ Government of Kenya, 'Governance Strategy for Building A Prosperous Kenya,' November 2006.

Good corporate governance in the sugar industry is essential to create the climate of fairness, transparency and accountability. Consequently, Kenya needs well-governed and managed industries that can attract investments, create jobs, wealth and remain viable, sustainable and competitive in the global marketplace. It is therefore a prerequisite for national economic development.⁶²

4.2 Realisation of Corporate Governance in The Sugar Industry in Kenya

The prominence of the sugar industry has prompted the formation of the Kenya Sugar Board which is the apex regulatory organ for the sector. Additionally, corporate governance in the sugar industry is realised through this board.⁶³ Furthermore, its failure to carry out the mandate given to it in the Sugar Act of Kenya No. 10 of 2001 and the penetration of selfish interest groups in its management has motivated all the connected sugar institutions to similarly fail in their mandate.⁶⁴

4.3 Problems encountered in the corporate governance framework in the sugar industry.

Good corporate governance prescribes that the Board of Directors govern the corporation in a way that maximizes shareholder value in the best interest of society. State corporations were instituted to realize social objectives of the state and therefore the government supports its agencies through funding and training of Board of Directors on Good corporate governance.⁶⁵

However, there are problems that have been encountered in the corporate governance framework in the sugar industry. They include;

1. The President has a strong measure of control over appointments, the State Corporations Act (CAP 446) allows the president to provide for the management

⁶² United Nations Economic and Social Commission for Asia and The Pacific, 'What is Good Governance?'

⁶³ Nafuna M. Teresa, 'Challenges Faced by Kenya Sugar Board in Implementing Strategy on Service Delivery to Sugar Cane Millers in Kenya,' 2012.

⁶⁴ Nafuna M. Teresa, 'Challenges Faced by Kenya Sugar Board in Implementing Strategy on Service Delivery to Sugar Cane Millers in Kenya,' 2012.

⁶⁵ Ethics and Anti-Corruption Commission, 'Review of the Policy, Legal and Regulatory Framework for the Sugar Sub-Sector in Kenya, February 2010.

of every public corporation established under the Act and permits him to determine composition of the board of directors.⁶⁶ The political nature of appointments causes the boards of state corporations to be composed of mainly directors who are ex-civil servants and who act in the interests of their appointers rather than the corporation. The ineffective management of state corporations can be attributed, in some measure, to the appointment criteria, whose bedrock is political influence rather than relevant technical expertise.

2. The reasons for poor corporate governance are mostly coupled with fraudulent acts and other major malpractices. They include irregularities in accounts, non-compliance with law, nepotism and exploitation of minority shareholders.⁶⁷ Sugar firms have also had their share in corporate frauds and scandals.
3. Another common problem in parastatal boards is conflict of interest. Directors have a duty of loyalty and good faith among other duties. They conflict of interests' rule requires directors not to put themselves in a position where their duties and interests conflict.⁶⁸
4. Inadequate Shareholder rights, inadequate training and education of directors and shareholders and a lack of shareholder activism.⁶⁹

4.4 Effects of poor governance in the sugar industry in Kenya

Poor corporate governance weakens the sugar industry's potential and in worst cases can open the way for financial difficulties and frauds. Furthermore, it leads to difficulty in raising capital and in the long run they are less profitable and competitive which leads to low standards of governance. In addition, it leads to the stagnation of growth and development because of poor performance and returns which repels investors whose investments could help finance further growth and development. Lastly, poor corporate governance reduces integrity and efficiency of the industry as well as financial markets in which the corporations operate.⁷⁰

⁶⁶ State Corporations Act (Act No. 446 of 2016).

⁶⁷ Oto-Peralias Daniel, Romero-Avila Diego, 'Legal Traditions, Legal Reforms and Economic Performance: Theory and Evidence,' 2011.

⁶⁸ Ethics and Anti-Corruption Commission, 'Review of the Policy, Legal and Regulatory Framework for the Sugar Sub-Sector in Kenya, February 2010.

⁶⁹ Musikali M. Lois, 'The Law Affecting Corporate Governance in Kenya: A Need for Review,' 2008.

⁷⁰ Government of Kenya, 'Governance Strategy for Building A Prosperous Kenya,' November 2006.

4.5 Principles of Corporate Governance

The principles of corporate governance are likely to foster consideration in the development/amendment of new or existing codes. They provide criteria for measuring the effectiveness of a corporate governance code.⁷¹ Additionally, the present version of the principles covers 6 critical areas of corporate governance; one of them is the responsibility of the board & the board's accountability to the company & the shareholders. Moreover, the principles provide that the board is not only accountable to the company & its shareholders but also has a duty to act in their best interests. One of the elements of the accountability process is the opportunity for evaluation. This principles state that the board is accountable to the company & the shareholders, but it is not adequately clear as to how accountability is to be ensured. Consequently, they are intended to help policy makers evaluate and improve the legal, regulatory and institutional framework for corporate governance, with a view to support economic efficiency, sustainable growth and financial stability.⁷²

The principles are divided into categories. They include;

4.5.1 Board Operations and Control

Under this principle, every company shall be headed by an effective Board, which shall offer strategic guidance, lead and control the company. The Board shall put in place policies and procedures in place to ensure independence of its members.⁷³ Moreover, it ought to undertake an annual evaluation of its own performance, the performance of the Chairperson, its committees, individual members, the Chief Executive Officer and company secretary. The board shall also ensure that a governance audit is carried out at least annually. Consequently, it shall ensure that the corporation complies with all laws.⁷⁴

4.5.2 Rights of Shareholders

The Board shall recognize, respect and protect the rights of shareholders. It shall ensure that they are all treated equitably. They have a duty to ensure that the board is continually

⁷¹ Olivier Belinda, Financial Markets Journal, 'Corporate Governance.'

⁷² Organisation for Economic Cooperation and Development, 'Principles of Corporate Governance,' November 2015.

⁷³ Organisation for Economic Cooperation and Development, 'Principles of Corporate Governance,' November 2015.

⁷⁴ Pearse Trust, The Core Principles of Good Corporate Governance, Feb 2014.

held accountable and responsible for the efficient & effective governance of the corporation to achieve corporate objectives. Members or shareholders of the corporation shall jointly & severally protect, preserve & actively exercise the supreme authority of the corporation in general meetings. Ensure that only competent persons are elected/appointed to the Board of Directors. Finally, they ought to reconstitute a board that does not perform in conformity with the directives of the corporation.⁷⁵

4.5.3 Stakeholders Relations

The board shall proactively manage the relationship with stakeholders. It shall ensure effective communication with stakeholders. The board shall establish a formal process to resolve both internal and external disputes.⁷⁶

4.5.4 Ethics and Social Responsibility

The board shall set standards of ethical behaviour required of its members, senior executives and all employees and ensure observance of those standards. Furthermore, it shall ensure that the company's ethical issues are managed effectively. They shall also ensure that the company is and is perceived to be a responsible corporate. Consequently, corporates shall develop strategies and policies to guide their activities in becoming and remaining good corporate citizens.⁷⁷

4.5.5 Accountability, Risk Management and Internal Control

The issue for corporate governance is how to strengthen the accountability of Boards of Directors to shareholders. Therefore, a framework that independently substantiates and shields the integrity of the corporation ought to be put in place. Structures ought to be put in place to independently confirm and safeguard the integrity of the integrity of the financial reporting process. The board shall have an effective system on internal control. Finally, the corporation shall have an effective Audit Committee.⁷⁸

⁷⁵ Mukabwa James, 'Corporate Governance and Its Principles-Kenyan Context, August 2016.

⁷⁶ Mukabwa James, 'Corporate Governance and Its Principles-Kenyan Context, August 2016.

⁷⁷ Olivier Belinda, Financial Markets Journal, 'Corporate Governance.'

⁷⁸ Mukabwa James, 'Corporate Governance and Its Principles-Kenyan Context, August 2016.

4.5.6 Transparency and disclosure

The board shall promote opportune and balanced disclosure of all material information concerning the company.⁷⁹

In conclusion, for efficiency and profitability of the Sugar industry, the reform process should be geared towards developing and implementing policies that will ensure that the principles of good corporate governance are instilled and maintained.⁸⁰

⁷⁹ Pearse Trust, The Core Principles of Good Corporate Governance, Feb 2014.

⁸⁰ Kenya Sugar Board, 'Strategic Plan 2009-2014.'

CHAPTER 5: CONCLUSIONS AND RECOMMENDATIONS

5.1 CONCLUSIONS

Corporate governance comprises of relationships and the patterns of behaviour that emanate between different agents in a limited liability corporation, this is the behavioural side of corporate governance. It also refers to the set of rules that frame these relationships and private behaviours, thus shaping corporate strategy formation e.g. securities regulation. This is called the normative side of corporate governance.

Governance is all about encouraging the corporate sector to be accountable, fair, transparent and responsible. Companies today have established the concept of corporate governance which is characterized by major components that include company policies, rules and regulations, board of directors, role of CEO and chairman, stock holders, creditors, institutional investors and regulators reporting and maintaining overall transparency, fairness and accountability about the business operations.

Poor corporate governance has been a problem in the sugar industry.

The sugar industry as a major sub-sector that affects the employment and livelihoods of a significant population, there is unmatched political interference.

5.2 RECOMMENDATIONS

Considering the conclusions reached in this research the recommendations are as follows;

Review of Governance of publicly-owned corporations

Good corporate governance can be attained to if the managers, officials are appointed based on merit and professionalism. Political partiality ought not to be entertained. The government should commit to restructuring the sugar industry and introducing checks and balances in the sugar industry to ensure that there is no abuse of power and that there is accountability.

Publicly-owned corporations should be subjected to sanctions for non-compliance with corporate governance principles. Furthermore, there ought to be policies that are formulated in the sugar industry that aid in the implementation of these principles.

For efficiency and profitability of the sugar industry, the reform process should be geared towards developing and implementing policies that will ensure that the principles of good

corporate governance are instilled and maintained. This will ensure competitiveness and sustainability of the industry business enterprises and attract investment.⁸¹

There ought to be efficient internal mechanisms that are adhered to in practice. The role of the directors and every other company official ought to be clear and precise.

A complaints commission should be used to ensure any complaint with regards to governance is lodged and that action is taken to address such issues.

⁸¹ Kenya Sugar Board, 'Strategic Plan 2009-2014.'

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