



**SCHOOL OF COMPUTING AND ENGINEERING SCIENCES**  
**BACHELOR OF SCIENCE: INFORMATICS & COMPUTER SCIENCE**  
**END OF SEMESTER EXAMINATION**  
**ICS 4212/CNS 4202: CORPORATE GOVERNANCE AND SUSTAINABILITY**

**DATE:** Wednesday, 18<sup>th</sup> December 2024

**TIME:** 15:30 – 17:30

**Instructions**

Answer Question **ONE** and any Other **TWO QUESTIONS**

**QUESTION ONE**

Read the case study below and answer all the questions asked on it.

As a listed company in the Nairobi Securities Exchange (NSE), CB Bank has to comply with the Capital Markets Authority (CMA) listing rules. As a bank, it has also to comply with corporate governance regulations and guidelines issued by the Central Bank of Kenya (CBK).

**Ownership Structure of CB Bank**

CB Bank's founding Shah family owns a substantial shareholding of 34% of the total issued ordinary shares through Shah Trust Ltd. The other substantial ordinary shareholders, apart from the Shah Family, are Mountain Asset Management PLC with 17.01% of the ordinary shares and Aberdares Asset Management Limited with 16.19% of the ordinary shares. The rest of the shares are owned by individual shareholders. Although CB Bank is a listed company, the Shah family controls the majority voting rights enabling them to make key strategic decisions. The interest of the Shah's family is represented on the 10-member board by Patel Shah, 79 years old, Shital Shah, 58 years old and Zera Shah, 38 years old. Patel and Shital are the second generations of the Shah's Family while Zera belongs to the third generation of the Shah's family. Patel Shah is the Chairman of the Board of Directors of the Bank, the position he inherited from his late father in 1996. Patel is also the chairman of the Board's Audit and Nominating Committees. Zera Shah does not have an interest in the banking business as the previous generations even though he has previously served in senior positions at CB Bank. He was first appointed to the board on April 2013 and is currently an Associate Professor at a local University.

**Board of Directors**

Based on the 2019 Annual Report, CB Bank's Board of Directors comprised of 10 board members – one executive director (CEO, Shital Shah), 5 Non-Executive Directors who include the board Chairman, Patel Shah, and 4 Independent Non-Executive Directors including Zera Shah. The board as a group comprised of members with core competencies in areas such as accounting, finance, business and management. Among the Independent Non-Executive Directors are Patrick Kach, who has served the board since 2006, Kumal Shah, who joined the board in 2008 and has experience in the banking industry, and Robert Walai, a former Managing Partner of CB Bank's external auditors. All the Directors have to be approved by the

Shah's family before they are presented to the shareholders for election during the Annual General Meeting (AGM). The Board has five committees - Audit Committee (AC), Nominating Committee (NC), Remuneration Committee (RC), Risk Management Committee (RMC) and Executive Committee (EC). All the board committees are chaired by members of Shah's family. Within the AC, only Robert Walai has had accounting experience although he stopped practising as an Accountant upon his retirement in 2010.

**Required:**

- a) Evaluate the board composition and structure for CB Bank and discuss its weaknesses according to the Capital Markets Authority (CMA)'s provisions of good Corporate Governance. **(10 marks)**
- b) The Shah family approves all board members before their election at the AGM, maintaining tight control over the board. Under Stewardship Theory, which assumes that those in control act in the best interests of all stakeholders, explain how CB Bank could ensure that minority shareholders and other stakeholders trust that their interests are being represented effectively, even with concentrated family influence. **(6 marks)**
- c) Distinguish between Independent Non-Executive Directors and Non-Executive Directors and evaluate whether Zari Shah is an Independent Non-Executive Director as provided by CB's 2019 Annual report. **(4 marks)**
- d) Highlight the main duties and responsibilities of nomination committees of the board of directors. **(6 marks)**
- e) Identify **two** principles of Corporate Governance that the Board of CB Bank has failed to comply with. **(4 marks)**

**(Total 30 Marks)**

## QUESTION TWO

Lum Co is a family business that has been wholly-owned and controlled by the Lum family since 1920. The current chief executive, Mr. Gustav Lum, is the great grandson of the company's founder and has himself been in post as CEO since 1998. Because the Lum family wanted to maintain a high degree of control, they operated a two-tier board structure: four members of the Lum family comprised the supervisory board and the other eight non-family directors comprised the operating board.

Despite being quite a large company with 5,000 employees, Lum Co never had any non-executive directors because they were not required in privately-owned companies in the country in which Lum Co was situated. The four members of the Lum family valued the control of the supervisory board to ensure that the full Lum family's wishes (being the only shareholders) were carried out. This also enabled decisions to be made quickly, without the need to take everything before a meeting of the full board.

Starting in 2008, the two tiers of the board met in joint sessions to discuss a flotation (issuing public shares on the stock market) of 80% of the company. The issue of the family losing control was raised by the CEO's brother, Mr. Crispin Lum. He said that if the company became listed, the Lum family would lose

the freedom to manage the company as they wished, including supporting their own long-held values and beliefs. These values, he said, were managing for the long term and adopting a paternalistic management style. Other directors said that the new listing rules that would apply to the board, including compliance with the stock market's corporate governance codes of practice, would be expensive and difficult to introduce.

The flotation went ahead in 2011. In order to comply with the new listing rules, Lum Co took on a number of nonexecutive directors (NEDs) and formed a unitary board. A number of problems arose around this time with NEDs feeling frustrated at the culture and management style in Lum Co, whilst the Lum family members found it difficult to make the transition to managing a public company with a unitary board.

Gustav Lum said that it was very different from managing the company when it was privately owned by the Lum family. The human resources manager said that an effective induction programme for NEDs and some relevant continuing professional development (CPD) for existing executives might help to address the problems.

### **Required**

(a) Compare the typical governance arrangements between a family business and a listed company and assess Crispin's view that the Lum family will 'lose the freedom to manage the company as they wish' after the flotation. **(10 marks)**

(b) Distinguish between unitary and two-tier boards and discuss the difficulties that the Lum family might encounter when introducing a unitary board. **(5 marks)**

**(Total 15 marks)**

### **QUESTION THREE**

(a) Sometimes in the workplace, what the policy states and what people are doing are two different things".

In relation to the above statement, explain how adherence to a code of ethics at the workplace could help to address the mismatch in the two behavioural observations. **(6 marks)**

(b) In context of corporate governance, evaluate **FOUR** responsibilities of shareholders **(4 marks)**

(c) Evaluate **FIVE** situations where board members are expected to disclose conflict of interest while conducting an organization's business. **(5 marks)**

**(Total 15 marks)**

### **QUESTION FOUR**

Companies are increasingly asked to provide innovative solutions to deep-seated problems of human misery, even as economic theory instructs managers to focus on maximizing their shareholders' value. The organizational scholarship has been seeking to reconcile corporate social initiatives with seemingly

inhospitable economic logic. Depicting the hold that economics has had on how the relationship between the firm and society.

**Required:**

- a) Discuss what Corporate Citizenship is and construct argument/s for and against Corporate Citizenship. **(8 Marks)**
  - b) Explain sustainability and discuss the key aspects of the triple bottom line. **(7 Marks)**
- (Total 15 marks)**

**QUESTION FIVE**

After a recent financial crisis in the country of Oland, there had been a number of high profile company failures and a general loss of confidence in business. As a result, an updated corporate governance code was proposed, with changes to address these concerns.

Before the new code was published, there was a debate in Oland society about whether corporate governance provisions should be made rules-based, or remain principles-based as had been the case in the past. One elected legislator, Martin Mung, whose constituency contained a number of the companies that had failed with resulting rises in unemployment, argued strongly that many of the corporate governance failures would not have happened if directors were legally accountable for compliance with corporate governance provisions. He said that 'you can't trust the markets to punish bad practice', saying that this was what had caused the problems in the first place. He said that Oland should become a rules-based jurisdiction because the current 'comply or explain' was ineffective as a means of controlling corporate governance.

Mr Mung was angered by the company failures in his constituency and believed that a lack of sound corporate governance contributed to the failure of important companies and the jobs they supported. He said that he wanted the new code to make it more difficult for companies to fail.

The new code was then issued, under a principles-based approach. One added provision in the new Oland code was to recommend a reduction in the re-election period of all directors from three years to one year. The code also required that when seeking re-election, there should be 'sufficient biographical details on each director to enable shareholders to take an informed decision'. The code explained that these measures were 'in the interests of greater accountability'.

**Required**

- a) Examine how sound corporate governance can make it more difficult for companies to fail, clearly explaining what 'corporate governance' means in your answer. **(7 Marks)**
- b) Martin Mung believes that Oland should become a rules-based jurisdiction because the current 'comply or explain' approach is ineffective as a means of controlling corporate governance. Explain the difference between rules-based and principles-based approaches to corporate governance regulation and argue against Martin Mung's belief that 'comply or explain' is ineffective. **(8 Marks)**

**(Total 15 marks)**