Protection of Privately-Owned Companies: A Look into the Legal Framework

Governing Corporate Governance Regulations for Private Companies in Kenya

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By

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Declaration

I, RIITHO JONATHAN KISIA, 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: .....

Date: .....

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

Signed: .....

[Balla Galma]

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PRELIMINARIES

List of Legal Instruments

Capital Markets Act CAP 485, (2002).

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

Kenya Companies Act (No.17 of 2015).

South Africa Companies Act, (2009).

List of Reports

Financial Reporting Council, *Wates Corporate Governance Principles for Large Private Companies*, 2018.

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Private Sector Initiative for Corporate Governance, *Principles for Corporate Governance in Kenya*, 1999.

European Confederation of Directors' Associations (EcoDa), *Corporate Governance Guidance and Principles for Unlisted Companies in Europe,* 2010.

Australian Institute of Company Directors, *Governance Issues in Private Companies,* 2016.

List of Abbreviations

Capital Markets Authority – CMA

Nairobi Securities Exchange - NSE

United Kingdom- UK

Financial Reporting Council – FRC

Organisation for Economic Co-operation and Development – OECD

Confederation of British Industry – CBI

Institute of Directors – IoD

Chief Executive Officer- CEO

CHAPTER 1: INTRODUCTION

1.1. Background

Corporate governance refers to a set of rules and procedures that ensure that those at the heart of running the company adhere to a principle-based form of stewardship. It encompasses the authority to direct, organize, and control the corporate entity.[1] Corporate governance thus relates to the relationship between an organization's various legitimate stakeholders and makes certain that there is appropriate direction in the company for reasonable return on investments.

The corporate governance structure of an organization specifies the distribution of rights and responsibilities among different participants within the corporation such as, the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. These processes, policies and institutions direct the body corporate in the way it should be run in order to ensure maximum operational output.[2]

The Cadbury Report of 1992 in the United Kingdom provides the most commonly used definition of 'Corporate Governance' as "the system by which companies are directed and controlled so as to protect the interest of all stakeholders and ensure reasonable return on investments."[3] The Organisation for Economic Co-operation and Development (OECD) defines it as "the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, namely; board of directors, shareholders and other stakeholders and spells out the rules and procedures for making decisions on corporate affairs".[4] This is the most comprehensive definition accepted by most countries and multilateral organizations such as the World Bank and the United Nations. This so called system also provides the structure through which the company objectives are set and the means of attaining those objectives and monitoring performance.[5]

[1] Rupalelia R, Njuguna A, 'The Evolution of Corporate Governance and Consequent Domestication in Kenya', Volume 7 (No.5), International Journal of Business and Social Science, May 2016.
[2] Abdul-Qadir, A. B., and Kwanbo, M. L., 'Corporate Governance and Financial Performance of Banks in the Post-Consolidation Era in Nigeria', *International Journal of Social Science and Humanity Studies,* 2012, 29- < http://www.sobiad.org/ejournals/journal_ijss/arhieves/2012_2/ahmad_bawa.pdf> on 8th September, 2019.
[3] Sullivan J, 'The moral compass of companies : business ethics and corporate governance as anti-corruption tools', *IFC Corporate Governance FOCUS publication*, 2009.
[4] 'Annual Report: 2004', European Central Bank, July 2005- <https://stats.oecd.org/glossary/detail.asp?ID=6778> on 8th September 2019.
[5] Rupalelia R, Njuguna A, 'The Evolution of Corporate Governance and Consequent Domestication in Kenya', Volume 7 (No.5), International Journal of Business and Social Science, May 2016.

In the Kenyan context, Corporate Governance has been defined as,

> "*The process and structure used to direct and manage the business and affairs of a company towards enhancing business prosperity and corporate accountability with the ultimate objective of realising long-term shareholder value, whilst taking account of the interests of other stakeholders*."[6]

In Kenya, the push to embrace the principles of good corporate governance was seen as early as 2002 when the Capital Markets Authority (CMA) came up with the Principles of Corporate Governance for Public Listed Companies. These guidelines were developed as a response to the growing importance of corporate governance issues in both emerging and developing economies and for promoting growth in domestic and regional markets locally and across Africa.[7] The Capital Markets Authority in 2015 then issued the Code of Corporate Governance Practises to Issuers of Securities to the Public. The code sets out the principles and specific recommendations on structures and processes, which companies should adopt in making good corporate governance an integral part of their business dealings and culture for application by both listed and unlisted public companies.[8]

The Companies Act (No. 17 of 2015) discusses corporate governance within its provisions. The act requires quoted companies to set out corporate governance principles, establish policies and strategies of adopting them and assess the extent to which these policies have been adopted on an annual basis.[9]

Steps have therefore been taken within Kenya's legal framework governing company law to bring to life the idea of corporate governance and its importance. However, based on the notion that private companies do not usually disclose their affairs to the public and little is known about their internal workings, there is no substantive information seen in the Code of Corporate Governance Practises nor the Companies Act touching on privately owned corporations which possibly would benefit from to adherence to these principles as well.

6 Chapter 1.1.2, *Code of Corporate Governance Practices for Issuers of Securities to the Public*, 2015.
7 Rupalelia R, Njuguna A, 'The Evolution of Corporate Governance and Consequent Domestication in Kenya', Volume 7 (No.5), International Journal of Business and Social Science, May 2016.
8 Chapter 1.1, *Code of Corporate Governance Practices for Issuers of Securities to the Public*, 2015.
9 Section 770, *The Companies Act* (No.17 of 2015).

1.1.1. Statement of Problem

The current legal position in Kenya is that only companies that are issuers at the Nairobi Securities Exchange (NSE) are required by law to set out the corporate governance principles and best practices which are appropriate for the nature and scope of the particular company. [10] On compliance with good governance principles by private corporations there seems to be little if any protection within the legal framework. Good governance structures and principles serve to the benefit of a company. The lack of express protection of private companies interests through corporate governance principles within the law is what this dissertation seeks to examine; if there is a need to have corporate governance requirements for private companies within the law without distortion of their autonomy. Taking into consideration various factors such as: financial output, Accountability and stakeholder interests.

1.1.2. Research/Statement of Objective(s)

The overarching objective of this research is to assess corporate governance structures within private companies. The research objectives in specific include:

I. To assess the corporate governance legal framework and determine its viability for private companies.
II. To assess if there exists a need to have corporate governance regulations for private companies within the Kenyan legal framework and its importance.
III. To assess the extent to which the law can respond to the need of corporate governance regulations for private companies to establish good governance structures and how these regulations can be brought within the Kenyan legal framework.

1.1.3. Research Question(s)

The study will seek to answer the following research questions:

I. Are the governance interests of private companies adequately safeguarded by the legal framework as it is?
II. Why should private companies have good governance structures and adhere to them?

[10] Section 770, *The Companies Act* (No.17 of 2015).

III. How best can the legal framework governing corporate governance as it is be amended to safeguard the governance interests of private companies?

1.1.4. Hypothesis

I. There is a need to legislate corporate governance structures within private companies into law in order to guarantee their performance.

II. Private companies should have good corporate governance structures in place.

III. There is no law expressly requiring private companies to adhere to good governance principles and structures.

1.1.5. Significance of Study

The 'single overriding objective' of companies is the preservation and greatest practical enhancement over time of their shareholders investment. Corporate governance aims to achieve this objective by enabling the management to drive the enterprise forward free from undue constraint. Simply put, the company should operate freely under managerial stewardship exercising high effective accountability to enhance long-term performance. [11] Good governance codes can be considered as a set of best practices regarding the board of directors and other governance mechanisms within the company. This is done so by recommending a set of norms aimed at improving transparency and accountability among top managers and directors of a company.[12]

Corporate governance may be directly related to performance output of a company therefore, it may be beneficial to safeguard the interests of private companies through corporate governance.

1.1.6. Theoretical Framework

This dissertation is anchored in three theories of corporate governance namely: The agency theory, the stewardship theory and the stakeholder theory.

I. The Agency Theory

[11] Keasey K, Thompson S and Wright M, *Corporate Governance: Accountability, Enterprise and International Comparisons*, John Wiley & Sons, Ltd, 2008, 22.

[12] Zattoni A and Francesca F. 'Why Adopt Codes of Good Governance? A Comparison of Institutional and Efficiency Perspectives', Wiley Online Library, 4. <https://onlinelibrary.wiley.com/doi/full/10.1111/j.1467-8683.2008.00661.x>

This theory focuses on the principal/agent relationship that arises between the directors and the company. Directors act as agents of the company in exercising their governance functions. Agency theory is defined as "the relationship between the principals, such as shareholders and agents such as the company executives and managers". In this theory, shareholders who are the owners or principals of the company, hires the gents to perform work. Principals delegate the running of business to the directors or managers, who are the shareholder's agents and the shareholders expect the agents to act and make decisions in the principal's interest as the board is tasked with the duty of acting in good faith and in the best interests of the shareholders. [13]

II. Stakeholder Theory

The stakeholder theory suggests that certain management actions may have conflicting effects on various classes of stakeholders thus considers other stakeholder groups that the corporation is associated with.[14] This theory basically supports the notion that the company has a moral relationship with other individuals and entities within it and outside it as well. These other individuals and entities include the government, employees, customers, suppliers and the local community.

III. Stewardship Theory

This theory suggests that the managers of the company will act as custodians who operate in a manner that will benefit the owners as there exists a correlation between the managers and the success of the company.[15] When the managers satisfy the needs of the owners and other groups concerned, good governance is being achieved.

1.1.7. Legal Framework

The legal framework governing Corporate Governance in Kenya can be traced to the independence of Kenya. The statutory law governing corporate governance in public companies was seen in the 1962 Companies Act. The Companies Act dealt with directors' duties and shareholder protection among other matters pertaining to corporate governance in

[13] Abdullah H and Valentine B, 'Fundamental and Ethics Theories of Corporate Governance', *Middle Eastern Finance and Economics*, 2009, 89-<http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.320.6482&rep=rep1&type=pdf> on 11th September 2019.

[14] Gibson K., 'The moral basis of Stakeholder theory', Journal of Business Ethics, Vol26 pp 245-57, 2000.

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

Kenya. In 2002, the Capital Markets Authority released the Sample Code of Best Practice of Corporate Governance. [16]

The Code of Best Practice and the Companies Act were what enforced adherence to corporate governance principles in Kenya up until 2015 where we see enactment of the 2015 Companies Act (No. 17 of 2015) and the Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015 which have formed the new legal regime surrounding corporate governance here in Kenya. These will therefore form the major legal framework that this dissertation looks into.

[16]Musikali L, 'The Law Surrounding Corporate Governance in Kenya; A need for Review' International Company and Commercial Review, 2.

1.2. LITERATURE REVIEW

The potential positive benefit of effective corporate governance is the most overlooked opportunity in private companies. Similar to Kenya, in the UK only publicly quoted companies have had to select and report against a corporate governance code. However, from January 2019 regulations will also require the very largest private companies to state which corporate governance code, if any, has been applied and how. In January 2019, the Financial Reporting Council in the United Kingdom published the ***Wates Corporate Governance Principles for Large Private Companies***. These principles generally adopt the "apply and explain" approach requiring these private companies to publish which corporate governance principles they are applying and how they are applying them. In the event that the company does not adhere to a governance principle, then it is required to issue a valid statement on its reasons for not doing so.[17] This is owing to the fact that with regard to private companies, a "one size fits all" approach cannot be applied as this may limit autonomy within the company.[18] These regulations came into effect in the UK in the financial year beginning 1st January 2019.[19]

The Wates Corporate Governance Principles for Large Private Companies principles are[20]:

I. Corporate purpose and leadership
II. Board composition
III. Director responsibilities
IV. Opportunity and risk
V. Remuneration (including executive remuneration structures aligned to long term sustainable success)
VI. Stakeholder relations and engagement.

In a report on corporate governance in South Africa, Deloitte South Africa opines that private companies in that jurisdiction are subject to regulation that is less onerous than public

[17] Financial Reporting Council, *Wates Corporate Governance Principles for Large Private Companies*, 2018, <www.frc.org.uk/getattachment/31dfb844-6d4b-4093-9bfe-19cee2c29cda/Wates-Corporate-Governance-Principles-for-LPC-Dec-2018.pdf> accessed on 24th February 2019.
[18] Financial Reporting Council, *Wates Corporate Governance Principles for Large Private Companies*, 2018, <www.frc.org.uk/getattachment/31dfb844-6d4b-4093-9bfe-19cee2c29cda/Wates-Corporate-Governance-Principles-for-LPC-Dec-2018.pdf> accessed on 24th February 2019.
[19] Kate Higgins, 'UK Private Companies Now Have Their Own Corporate Governance Code', <https://www.mishcon.com/news/briefings/uk-private-companies-now-have-their-own-corporate-governance-code>, accessed on 24th February 2019.
[20] Financial Reporting Council, *Wates Corporate Governance Principles for Large Private Companies*, 2018, <www.frc.org.uk/getattachment/31dfb844-6d4b-4093-9bfe-19cee2c29cda/Wates-Corporate-Governance-Principles-for-LPC-Dec-2018.pdf> accessed on 24th February 2019.

companies. The report outlines the types of boards that are increasingly adopted by private companies in South Africa as an alternative to the board of directors, in a bid to have good governance structures in place. The types of boards include:

I. Board of Advisors- Their role is solely an advisory role and they provide suggestions and recommendations to the CEO and management team. This advice, unlike in the case of Board of Directors, is usually not binding but is generally given in the best interests of the company.
II. Family Council- These exist in the case of family-owned businesses and works in conjunction with the executive managers of the company. The role of this council is to oversee the family's interests. [21]

However, legal provisions require that the affairs of the companies are be run by a board which must comprise of at least one director.[22] Subject to the company's discretion during its formation, the board is required to have an audit committee and specific accountability mechanisms if it chooses to include it in its Memoranda of Incorporation.[23] As such, the laws governing companies within the South African jurisdiction have advanced the push for private companies to have good governance principles in place while still ensuring their autonomy, as they have the option to either opt in or out during formation; but if the company elects to opt in, then it must comply with the corporate governance laws.

Based on the above, there is a shift towards the need to provide a framework for good governance principles for private companies across various jurisdictions. Therefore, encouraging this notion within our jurisdiction may play a big role in the law safeguarding the interests of private companies.

[21] Deloitte LLP (ZA), *Corporate Governance for Private Companies*, 2016, 5.
[22] Section 66, *South Africa Companies Act*, 2009.
[23] Section 34 (2), *South Africa Companies Act*, 2009.

1.3. RESEARCH DESIGN

1.3.1. Research Design and Methodology

This dissertation looks into the need for private companies to establish good governance principles within its operational structure and highlight its importance. In addition, it looks into the current legal framework governing best practise principles here in Kenya for such companies, give an analysis on that legal position as to its sufficiency in relation to safeguarding the interests of these private companies and provides an analysis on whether there is a need to have corporate governance regulations for private companies within the legal framework.

After the legal framework, the dissertation looks into proposing suitable changes to the current legal framework. It first establishes the importance of having adequate corporate governance regulations in private companies followed by proposed amendments that can be made. The manner in which this shall be carried out will be mainly by looking into the plausibility of including private companies within the provisions of law governing corporate governance while ensuring that the law does not interfere with the autonomy of the privately-owned entity and assessing what other practices are happening on the international plane touching on this matter.

The primary method used to carry out the study is through desktop research. The nature of the study entails assessment of the current legal framework surrounding corporate governance for private companies in various jurisdictions vis-à-vis the legal framework provided for in Kenya. The research looks into the hard and soft law. The hard law being the relevant statutes governing company law and corporate governance, the soft law being commission reports such as: Cadbury, Greenbury Reports, the KING™ codes and other relevant reports from commissions and organisations such as the Financial Reporting Council and Institute of Directors that have shed light on good governance principles.

The research also involves obtaining information from secondary sources such as books, journals, published research papers and any reports that may as well show the financial implications brought about by having good corporate governance structures in place. Where possible, this dissertation also obtains information through carrying out interviews within private companies willing to disclose their internal affairs in furtherance of the idea that the dissertation seeks to bring out.

1.3.2. Assumptions

The following assumptions have been taken into consideration while conducting this study in order to effectively achieve the research objectives herein:

I. It is assumed that private companies have not implemented good corporate governance structures in place as a result of no requirement in law.
II. It is also assumed that the operational autonomy of the private company shall not be interfered with by the law when including private companies to the provisions of the law on corporate governance.
III. Finally, it is assumed that all reports used in this dissertation were conducted in a professional and accurate manner for provision of the most accurate information.

1.3.3. Limitations

The first limitation that is encountered is the inadequacy in literature/ research material on corporate governance for private companies in Kenya. Another limitation that has been encountered while conducting this study is that it may be difficult to secure interviews with relevant companies about their governance structures and obtain sufficient information from them. It also will require a lot of costs both money and time wise to visit various companies and interview the members.

1.3.4. Chapter Breakdown

The dissertation shall be broken down into the following chapters:

Chapter 1: Introduction

The Introductory chapter of this dissertation seeks to provide a comprehensive background of the study. It elaborates on key concepts by giving definitions of key terms that are relevant for the study. It shall also highlight the importance of the study and give an outline of the whole dissertation.

Chapter 2: Corporate Governance: Its Development and Application today

This chapter looks into the purpose that law seeks to achieve and in particular the effect that corporate governance seeks to achieve within a company. In determining this, then this chapter

then lays out the corporate governance structures in place today and draw a conclusion as to whether private companies should be entitled to the same extent of legal protection as public companies when it comes to corporate governance.

Chapter 3: Legal Framework on Corporate Governance in Kenya

This chapter goes into the legal framework of corporate governance in Kenya and the applicable laws. It establishes the scope of applicability of the laws with regard to companies as established in the Companies Act 2015 and the effect of its applicability. The study establishes a position and assesses if there exists a need for corporate governance regulations for private companies in Kenya.

Chapter 4: Adoption of Corporate Governance Regulations for Private Companies

This chapter constitutes an in-depth discussion based on the findings of the previous chapter that there exists a need to have a concise corporate governance framework for private companies. A discussion on the importance of corporate governance in private companies follows; with manners in which the legal framework could be amended to adopt corporate governance regulations for private companies being discussed. This has been done through assessment of what other jurisdictions have implemented in their legal systems and recommending how they could be inculcated in our legal system.

Chapter 5: Conclusion

The final chapter of the dissertation, this chapter, draws suitable conclusions based on the findings of the previous chapters. It gives a conclusion on the manner in which private companies can be protected by law through provisions on corporate governance and provides recommendations on how these provisions can be implemented.

CHAPTER 2: CORPORATE GOVERNANCE: ITS DEVELOPMENT AND APPLICATION TODAY

2.1. Introduction

Where the ownership of firms is separated from the control of the firm and managers need to raise external funds either because they have insufficient private funds to meet the companies needs or wish to cash in their investment in the firm, corporate governance may be viewed as a set of mechanisms which serve to ensure that potential providers of external capital are assured of a fair return on their investment to the company. Corporate governance mechanisms thus cut across the administration of a corporation and includes board structure, and the presence of an active market for corporate control within the company.[24]

It was after the series of UK corporate collapses such as Polly Peck, Bank of Credit and Commerce International and Robert Maxwell pension funds scandal in the early 1990s that corporate governance came to be.[25] These corporate scandals exposed the legal position of statutory auditors and prompted a reconsideration of the adequacy of corporate governance mechanisms.[26] In May 1991, the Financial Reporting Council, London Stock Exchange and the accountancy profession came together to create a committee that was tasked with the duty to examine the financial aspects of corporate governance that was chaired by Sir Adrian Cadbury.[27] This committee dealt with issues such as the structure and responsibilities of the board of directors, increasing the value and effectiveness of the audit, the relationship between the board and shareholders and the responsibilities of institutional shareholders. The final report was published in December 1992 and is known as the 'Cadbury Report'.[28] This was the advent of the notion of corporate governance and is the basis of which it has evolved over time to the legal frameworks in place governing corporate governance in various jurisdictions.

This Chapter discusses the development and state and of corporate governance today from the various committees formed, their recommendations and adoption into codes applicable to companies in the world today. By discussing the growth of corporate governance practices

[24] Dedman E, 'The Cadbury Committee recommendations on corporate governance- A review of compliance and performance impacts', Wiley Online Library, 3. < https://onlinelibrary.wiley.com/doi/epdf/10.1111/1468-2370.00091>.
[25] Lowry J and Reisberg A, *Pettet's Company Law: Company Law & Corporate Finance*, 4th ed, Pearson Publications, London, 2012, 207.
[26] Lowry and Reisberg, *Pettet's Company Law: Company Law & Corporate Finance,* 207-208.
[27] Lowry and Reisberg, *Pettet's Company Law: Company Law & Corporate Finance,* 207-208.
[28] Dedman E, 'The Cadbury Committee recommendations on corporate governance- A review of compliance and performance impacts', Wiley Online Library, 3. < https://onlinelibrary.wiley.com/doi/epdf/10.1111/1468-2370.00091>.

across the world and in Kenya. It also brings out the important aspects of corporate governance in a bid to justify the benefit it may bring to privately owned corporations.

2.2. Corporate Governance in the United Kingdom

2.2.1. The Cadbury Report (1992)

The Committee on the Financial Aspects of Corporate Governance also known as the Cadbury Committee published its report in December 1992 which contained a Code of Practise which aimed at achieving the highest standards of corporate behaviour. The sponsors of this committee were concerned at the perceived low level of confidence both in financial reporting and in the ability of auditors to provide the safeguards which the users of company reports sought and expected. The underlying factors were seen as the looseness of accounting standards, the absence of a clear framework for ensuring that directors kept under review the controls in their business, and competitive pressures both on companies and on auditors which made it difficult for auditors to stand up to demanding boards. The concerns about the working of the corporate system were heightened by some unexpected failures of major companies' and by criticisms of the lack of effective board accountability.[29]

The chief distinguishing feature of this report was its reliance mainly on self-regulation.[30] In order to adequately achieve the aim of an improvement in the quality of corporate governance, the report had three approaches. First was structural and functional alterations designed to spread the balance of power. This was enhanced by the recommendation that there should be a division of responsibilities at the head of the company in such that the role of the chairman of the board in principle should be different from that of the chief executive.[31] Second was increases in assumptions of responsibility in such that people within the governance structure knew where their responsibilities began and ended and that these responsibilities were discharged properly. It was recommended that there should be a statement of directors' responsibilities for the accounts and a counterpart statement by the auditors about their auditing responsibilities.[32] Lastly, enhanced quality of disclosure which the committee's

[29] The Committee on Corporate Governance, *Report of the Committee on the Financial Aspects of Corporate Governance*, December 1992, 14.
[30] Lowry and Reisberg, *Pettet's Company Law: Company Law & Corporate Finance*, 206.
[31] Lowry and Reisberg, *Pettet's Company Law: Company Law & Corporate Finance*, 210.
[32] The Committee on Corporate Governance, *Report of the Committee on the Financial Aspects of Corporate Governance*, December 1992, 25

recommendations were directed towards ensuring that they system of financial reporting and the audit function were working well.[33]

The report also contained recommendations on the essence of having non-executive directors within a company in a bid to bring about independence. The report stated that:

> *"An essential quality which non-executive directors should bring to the board's deliberations is that of independence of judgement. We recommend that the majority of non-executives on a board should be independent of the company in such that they should be free from any shareholdings, management, business or relationship that could materially interfere with their exercise of their judgement."*[34]

The report stated that 'boards should aim for the highest level of disclosure consonant with presenting reports which are understandable'. Improving transparency has therefore always been a goal of corporate governance in the UK.[35] In light of this, governance and reporting have gone hand in hand. Up until 2006, the number of companies whose governance sections were less than 5 pages long remained around the 50% of all the listed companies in the UK however, between 2006 and 2017 the average length of governance reports of listed companies had increased to a minimum of 55 pages.[36]

The committee recommended that a new committee should be appointed by the end of June 1995 to examine how far compliance with the Code has progressed, how far the other recommendations had been implemented, and whether the Code needed updating in line with emerging issues.[37]

2.2.2. The Greenbury Report (1995)

In January 1995, The Confederation of British Industry (CBI) set up the Study Group on Directors' remuneration chaired by Sir Richard Greenbury. The committee published its

[33] Lowry and Reisberg, *Pettet's Company Law: Company Law & Corporate Finance*, 210.
[34] The Committee on Corporate Governance, *Report of the Committee on the Financial Aspects of Corporate Governance*, December 1992, 21.
[35] Pilot S, 'Cadbury Report Was More Than A Product of its Time' The Chartered Governance Institute, 2017 - < https://www.icsa.org.uk/knowledge/governance-and-compliance/features/cadbury-report-legacy-25-years?utm_source=Mondaq&utm_medium=syndication&utm_campaign=View-Original> on 14th November 2019.
[36] Pilot S, 'Cadbury Report Was More Than A Product of its Time' The Chartered Governance Institute, 2017 - < https://www.icsa.org.uk/knowledge/governance-and-compliance/features/cadbury-report-legacy-25-years?utm_source=Mondaq&utm_medium=syndication&utm_campaign=View-Original> on 14th November 2019.
[37] The Committee on Corporate Governance, *Report of the Committee on the Financial Aspects of Corporate Governance*, December 1992, 17.

recommendations set out in a Code of Best Practice. [38] The aim of this committee was to consider issues relating to directors' remuneration and emoluments arising as a response to public and shareholder concerns about the pay and other remuneration of company directors.[39] At the time in the UK, remuneration levels for directors in the UK was within European practise and well below American levels.[40] The committee conceded that there would be a potential conflict of interest if directors would set their own remuneration packages. The committee recommended that a listed company to establish a remuneration committee made up of non-executive directors to determine policy on remuneration packages for executive directors.[41] Each company had to state, in its annual reports whether it had complied to the code and if it had failed, it ought to explain the reasons for the non-compliance.

2.2.3. The Hampel Report and the Combined Code (1998)

The Financial Reporting Council in November 1995, set up the Committee on Corporate Governance that was chaired by Sir Ronald Hampel.[42] The Hampel Committee was tasked with the duty to review the Cadbury Code and its implementation to ensure its purpose was being achieved, review the role of directors and pursue any matters arising from the Greenbury Report as had been recommended in the Cadbury Report.[43]

This committee issued its report in 1998 and it posited that too much stress had been laid on accountability and not enough emphasis had been laid on business prosperity.[44] The report stated that companies should include in their annual report a description of how corporate governance is being applied in relation to the business in question and produced a code that put together the work of the Cadbury, Greenbury and Hampel committees to give rise to the Combined code.[45] The rationale behind companies stating the mode of application of corporate governance was that previously, the two reports were treated as prescriptive rules in which shareholders would only be interested with whether the letter of the law had been followed. This resulted in a box-ticking approach which takes no accountability for the diversity of circumstances within a company and was seen to be an easier option than the diligent pursuit of corporate governance principles.[46] The combined code recommended a Nomination

[38] Bourne N, *Bourne on Company Law*, Routledge Publishers, New York, 2013, 202.
[39] Confederation of British Industry (CBI), *Directors Remuneration,* July 1995, 9.
[40] Confederation of British Industry (CBI), *Directors Remuneration,* July 1995, 10.
[41] Confederation of British Industry (CBI), *Directors Remuneration,* July 1995, 13.
[42] Lowry and Reisberg, *Pettet's Company Law: Company Law & Corporate Finance*, 211.
[43] Bourne N, *Bourne on Company Law,* 203.
[44] The Committee on Corporate Governance, *The Final Report,* January 1998, 7.
[45] Bourne N, *Bourne on Company Law,* 203.
[46] The Committee on Corporate Governance, *The Final Report,* January 1998, 10.

Committee to make recommendations to the board regarding appointments, Remuneration Committee comprising of independent directors to consider remuneration packages, Audit Committee made up of at least three non-executive directors and a proposal that each board to have a lead non-executive director who would be a focal point of contact for shareholders.[47] These were the recommendations of the Cadbury Committee on board appointments and non-executive directors to avoid conflict of duty; and the Greenbury Committee on remuneration for directors.

2.2.4. The Combined Codes (2006)

In 2005, following a review of the combined code of 2003, the FRC reviewed the implementation of the code of 2003 which resulted in changes that were incorporated in a newer version of the code that was published in 2006.[48] The implementation of the 2003 code was deemed to be erroneous for the smaller listed companies as those especially new to listing considered some of the provisions disproportionate or less relevant to them.[49] However, the main changes seen in this code included:

- Amendments to the restrictions of the chairman serving on the remuneration committee enabling him to do so considered independent on appointment as chairman
- Provision of a 'vote withheld' option on proxy appointments
- Recommendation that companies publish on their website the details of proxies lodged at an AGM.[50]

Following publication of the 2006 code, in the UK a new approach to application of corporate governance was first seen. The Listing Rules require listed companies to make a disclosure statement in two parts in relation to the Code. In the first part of the statement, the company has to report on how it applies the principles in the Code. This should cover both main and supporting principles. In the second part of the statement the company has either to confirm that it complies with the Code's provisions or where it does not, to provide an explanation. This 'comply or explain' approach has been in operation for over ten years and the flexibility it offers has been widely welcomed both by company boards and by investors. [51]

[47] Bourne N, *Bourne on Company Law*, 203-204.
[48] Financial Reporting Council, *The UK Corporate Governance Code*, June 2006, 1.
[49] Financial Reporting Council, *The UK Corporate Governance Code*, June 2006, 1
[50] Lowry and Reisberg, *Pettet's Company Law: Company Law & Corporate Finance*, 214.
[51] Financial Reporting Council, *The UK Corporate Governance Code*, June 2006, 1.

2.2.5. The UK Corporate Governance Code (2010)

This is the Code of corporate governance that is in use today in the United Kingdom, the 2003 and 2006 Codes remain the main building blocks within the current code on corporate governance. However, following the financial crisis in 2008/9 the corporate governance systems were seen to have failed to alleviate it causing reappraisal in the UK and internationally of corporate governance systems.[52] Sir David Walker who was the Chair of Barclays PLC was charged with the task of reviewing the governance of banks and other financial institutions which had been commissioned by the government as a result of the financial crisis.[53] The FRC decided to bring forward the Code review scheduled for 2010 so that corporate governance in other listed companies could be assessed at the same time with the financial institutions. The report recommended that more attention needed to be paid to following the spirit of the code as well as its letter because the nexus between shareholders and the board of directors was of essence and ought to be enhanced by better interaction.[54] This is because the Code is of necessity limited to being a guide only in general terms to principles, structure and processes. It cannot guarantee effective board behaviour because the range of situations in which it is applicable is much too wide, therefore the boards have a lot of room within the framework of the Code and must think deeply and on a continuing basis to keep the spirit of the code alive.[55]

The FRC published this code which would now be known as the UK Corporate Governance Code in June 2010. This Code is still in use today with the most recent publication by the FRC being in 2016. The UK Corporate Governance Code retains the traditional approach known as the 'comply or explain' and is consistent with the flexibility of the code. It is made up of principles which are the core contents of the code and are broken down into the following:

> **Section A- Leadership:** Every company should be headed by an effective board which is collectively responsible for the long-term success of the company
>
> **Section B- Effectiveness**: The board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively.

[52] Financial Reporting Council, *The UK Corporate Governance Code*, 2016.
[53] Financial Reporting Council, *The UK Corporate Governance Code*, 2016.
[54] Bourne N, *Bourne on Company Law*, 203.
[55] Financial Reporting Council, *The UK Corporate Governance Code*, 2016.

Section C- Accountability: The board should present a fair, balanced and understandable assessment of the company's position and prospects.

Section D- Remuneration: Executive directors' remuneration should be designed to promote the long-term success of the company. Performance-related elements should be transparent, stretching and rigorously applied.

Section E- Relations with shareholders: There should be a dialogue with shareholders based on the mutual understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place.[56]

2.3. Organisation for Economic Co-operation and Development (OECD)

Promulgated in 1999, the aim of the OECD principles was to provide a framework that governments could adopt to improve the legal, institutional, and regulatory framework for corporate governance.[57] The OECD principles are not legally binding, and adherence is voluntary, since they only act as a broad-based framework that can be used by a country in developing its own corporate governance codes. They are intended to help policymakers evaluate and improve legal, regulatory and institutional framework for corporate governance.[58]The principles that were released by OECD have received worldwide recognition as an international benchmark for what a good corporate governance system ought to look like. The principles were revised in 2004 and advanced to capture developments on emphasis on shareholder rights and value maximization has been strengthened providing a good foundation to ensure that disclosures are done in a transparent manner that ensures accountability.[59] In 2015, the principles were reviewed at the G20/ OECD Forum and later in the same year were endorsed as the G20/ OECD Principles of Corporate Governance. The report is broken down into the following principles:

- Ensuring the basis for an effective corporate governance framework
- The rights and equitable treatment of shareholders and key ownership functions
- Institutional investors, stock markets and other intermediaries

[56] Financial Reporting Council, *The UK Corporate Governance Code*, 2016.
[57] Organisation for Economic Co-operation and Development, *OECD Principles of Corporate Governance, 1999.*
[58] Organisation for Economic Co-operation and Development, *G20/ OECD Principles of Corporate Governance*, 2015, 9.
[59] Manawaduge A, 'Corporate Governance practices and their impacts on corporate performance in an emerging market: The case of Sri Lanka', 2012.

- The role of stakeholders in corporate governance
- Disclosure and transparency
- The responsibilities of the board.[60]

2.4. Corporate Governance in Sub- Saharan Africa

2.4.1. King I (1994)

Corporate Governance developments in Africa was first well-established in 1992 following the establishment of the King Committee on Corporate Governance chaired by Mervyn King in South Africa. This committee came up with a report which was known as the King I report. Since 1992, this committee has sat another three times, chaired by the same person although its composition has changed. The resultant effect has been the King II, King III and King IV reports which was published as recent as 2016. King reports form the basis of corporate governance and are aimed at promoting good corporate governance in South Africa. [61]

This report was published in November 1994 and was the advent of corporate governance in South Africa. The main aim of the report was to encourage the highest standard of corporate governance in South Africa by recommending standards of conduct for directors and emphasizing the need for responsible corporate conduct.[62] It represented a significant milestone in the development of corporate governance as it was the first of its kind in South Africa at the time and served as a point of reference for policy makers in the development of legal and regulatory frameworks for corporate governance.[63] King I was instrumental in raising awareness of what constitutes good governance, both in the private and public sectors. It offered to companies, and state-owned enterprises, for the first time, what constituted a coherent governance framework relevant to local circumstances. Apart from the financial and

[60] Organisation for Economic Co-operation and Development, *G20/ OECD Principles of Corporate Governance*, 2015, 5.
[61] Mashamaite K & Raseala P, 'Transgression of Corporate Governance in South Africa's State-owned Enterprises', *Bangladesh e-Journal of Sociology*, 2019, 126, <https://www.researchgate.net/profile/Alfred_Eboh/publication/331608610_Bangladesh_e-Journal_of_Sociology_Bangladesh_Sociological_Society/links/5c82db40299bf1268d486536/Bangladesh-e-Journal-of-Sociology-Bangladesh-Sociological-Society.pdf#page=124>.
[62] Mashamaite K & Raseala P, 'Transgression of Corporate Governance in South Africa's State-owned Enterprises', *Bangladesh e-Journal of Sociology*, 2019, 126, <https://www.researchgate.net/profile/Alfred_Eboh/publication/331608610_Bangladesh_e-Journal_of_Sociology_Bangladesh_Sociological_Society/links/5c82db40299bf1268d486536/Bangladesh-e-Journal-of-Sociology-Bangladesh-Sociological-Society.pdf#page=124>.
[63] Mashamaite K & Raseala P, 'Transgression of Corporate Governance in South Africa's State-owned Enterprises', *Bangladesh e-Journal of Sociology*, 2019, 126, <https://www.researchgate.net/profile/Alfred_Eboh/publication/331608610_Bangladesh_e-Journal_of_Sociology_Bangladesh_Sociological_Society/links/5c82db40299bf1268d486536/Bangladesh-e-Journal-of-Sociology-Bangladesh-Sociological-Society.pdf#page=124>.

regulatory aspects, the report encouraged an integrated approach to good governance in the interests of a wide range of stakeholders and showing regard for the fundamental principles of good financial, social, ethical and environmental practice[64]. The code achieved this by adopting the unitary board structure in South Africa rather than a management and supervisory- board structure. The unitary board structure provides greater interaction among all board members, when dealing with matters such as strategy, planning, performance, resources, standards of conduct and communication with stakeholders.[65]

2.4.2. King II (2002)

King I advocated an integrated approach to good governance in the interests of a wide range of stakeholders. Although novel at the time, the evolving global economic environment together with recent legislative developments, have necessitated that King I be updated. In light of this, the King Committee on Corporate Governance developed the King Report on Corporate Governance for South Africa, 2002 (King II). Without deviating from its predecessor, King II was more focused on introducing the idea of corporate citizenship and the notion of a triple bottom line which embraces the economic, environmental and social aspects of a company's activities.[66] In the words of the committee:

> *"...successful governance in the world in the 21st century requires companies to adopt an inclusive and not exclusive approach. The company must be open to institutional activism and there must be greater emphasis on the sustainable or non-financial aspects of its performance. Boards must apply the test of fairness, accountability, responsibility and transparency to all acts or omissions and be accountable to the company but also responsive and responsible towards the company's identified stakeholders…"*[67]

In this version of the King Report, we see no major recommendations however the committee recommended that South African companies should maintain the unitary board structure. This

[64] Moloi T & Adelowotan M, 'Corporate Governance Principles and Practices Disclosed In The South African Technical Vocational Education and Training College's Annual Reports', *Journal of Legal, Ethical and Regulatory Issues*, 2019, 2, < https://www.abacademies.org/articles/Corporate-governance-principles-and-practices-disclosed-in-the-South-African-technical-vocational-education-and-training-colleges-annual-reports-1544-0044-22-3-330.pdf>.

[65] Institute of Directors, *The Code of Corporate Practices & Codes*, 1994,1. < https://ecgi.global/sites/default/files//codes/documents/king_i_sa.pdf>

[66] Hendricks P & Wyngaard R, 'South Africa's King III: A Commercial Governance Code Determining Standards of Conduct for Civil Society Organizations', *The International Journal of Not-for-Profit Law*, 2010, <http://www.icnl.org/research/journal/vol12iss2/art_1.htm>.

[67] Institute of Directors, *King Report on Corporate Governance for South Africa*, March 2002.

should comprise executive and non-executive directors, preferably with a majority of non-executive directors, of whom a sufficient number should be independent of management in order to ensure the protection of minority shareholders' interests.[68]

2.4.3. King III (2009)

Following the enactment of the Companies Act (No.71 of 2008) and changes in international governance trends which arose from trying to remedy the effects of the financial crisis there was a necessity for a new code on corporate governance.[69] The report laid new recommendation placing new emphasis on: Alternative Dispute Resolution where the report proposed the adoption of mediation in disputes as it is a good management tool.[70] It also laid recommendations on Risk based internal audit; it should be risk-based and every year the internal auditors should furnish an assessment to the board generally on the system of internal controls and to the audit committee specifically on the effectiveness of internal financial controls. The audit committee must report fully to the board on its conclusions arising from the internal audit assessment.[71] In addition, Evaluation from the board was recommended as it was a trend recognised internationally where the board committees and members (including the Chair) was subject to evaluation.[72] A key distinguishing factor that arose in the King III report was on the application of the code. It boldly declared that it applies to all entities regardless of the manner and form of incorporation or establishment, whether in the public, private sectors or non-profit sectors and every company was encouraged to report when there was non-compliance with any governance measure that was recommended by the King III report.[73]

2.4.4 King IV (2016)

The King IV report of 2016 was necessitated following shifts in the corporate world at the time. These shifts formed the basis for the founding concepts of the KING IV report. These concepts were ethical leadership, organization in society, corporate citizenship, sustainable development, stakeholder inclusivity and integrated thinking and responsibility.[74] The first

[68] Cliff Decker Attorneys, *King Report for Corporate Governance 2002: What it means for you*, 2, <https://www.mervynking.co.za/downloads/CD_King2.pdf>.
[69] Institute of Directors in Southern Africa, *King III Report on Governance for South Africa,* 2009, 5.
[70] Institute of Directors in Southern Africa, *King III Report on Governance for South Africa,* 2009, 14.
[71] Institute of Directors in Southern Africa, *King III Report on Governance for South Africa,* 2009, 15.
[72] Institute of Directors in Southern Africa, *King III Report on Governance for South Africa,* 2009, 15.
[73] Mashamaite K & Raseala P, 'Transgression of Corporate Governance in South Africa's State-owned Enterprises', *Bangladesh e-Journal of Sociology*, 2019, 126, <https://www.researchgate.net/profile/Alfred_Eboh/publication/331608610_Bangladesh_e-Journal_of_Sociology_Bangladesh_Sociological_Society/links/5c82db40299bf1268d486536/Bangladesh-e-Journal-of-Sociology-Bangladesh-Sociological-Society.pdf#page=124>.
[74] Institute of Directors in Southern Africa, *King IV Report on Governance for South Africa,* 2016, 3.

shift seen is the departure from financial capitalism to inclusive capitalism as inclusive capitalism takes account of employment, transformation and provision of all sources of capital.[75] The next shift was from shot term capital markets to long term sustainable markets arising from the need to have sustainable value creation. The performance of all- inclusive value should be assessed over the longer term.[76] The next shift was with regard to departing from siloed reporting to integrated reporting as this was consistent with the concept of an inclusive, sustainable capital market system in this era of radical transparency.[77]

The King IV report is more strongly principle-based, focussing more intensely on corporate social responsibilities towards communities and the environment, rather than just on the rules that govern the ethical practises or profitability of the company.[78] The report is built around four themes: the establishment of an ethical culture, the continuous measurement of performance and the creation of value for all stakeholders, the establishment of measures to secure adequate and effective control and the establishment of trust, good standing and legality.[79]

A distinguishing feature that the report highlighted was the requirement that all governing bodies to apply the recommendations and explain too; a departure from the "apply or explain" to "apply and explain" whilst reducing the 75 principles in the King III to 17 basic principles all in a bid to substantiate that good governance is being practised within a governing body.[80]

2.4.5. Kenya

Kenya's economy underwent an overhaul and was liberalised in the 1990s which was characterised by privatization of government corporations as accountability in the public sector had diminished and was lacking. This lack of accountability was replicated in the private sector and led to inefficiency which became institutionalized and was compounded by

[75] Institute of Directors in Southern Africa, *King IV Report on Governance for South Africa*, 2016, 3.
[76] Institute of Directors in Southern Africa, *King IV Report on Governance for South Africa*, 2016, 4.
[77] Institute of Directors in Southern Africa, *King IV Report on Governance for South Africa*, 2016, 5.
[78] Mashamaite K & Raseala P, 'Transgression of Corporate Governance in South Africa's State-owned Enterprises', *Bangladesh e-Journal of Sociology*, 2019, 126, <https://www.researchgate.net/profile/Alfred_Eboh/publication/331608610_Bangladesh_e-Journal_of_Sociology_Bangladesh_Sociological_Society/links/5c82db40299bf1268d486536/Bangladesh-e-Journal-of-Sociology-Bangladesh-Sociological-Society.pdf#page=124>.

[79] Lombard M, Mpinganjira M & Wood G, 'South African Corporate Ethics Codes: Establishment and Communication', European Business Review, 2019, <https://www.emerald.com/insight/content/doi/10.1108/EBR-08-2017-0150/full/html#sec001>.
[80] Institute of Directors in Southern Africa, *King IV Report on Governance for South Africa 2016*, 2016, 7.

the lack of an efficient corporate governance framework. [81] With senior government officials owning shares in the few publicly listed companies, the government was not keen to enforce securities laws with the boards of many listed companies consisting of friends and relatives of government associates. [82] The first step taken to ensure corporate governance for companies in Kenya was seen in 1999 by the Private Sector Initiative for Corporate Governance when it issued the Principles for Corporate Governance in Kenya and a Sample Code of Best Practice for Corporate Governance. The Private Sector Initiative for Corporate Governance was established to formulate and develop a code of best practice for corporate governance in Kenya and in October 1999, formally adopted a national code of best practice for Corporate Governance to guide corporate governance in Kenya.[83] The need to institutionalize the principles of corporate governance in Kenya resulted in the promulgation of the guidelines on principles of corporate governance for public listed companies by the Capital Markets Authority (CMA).[84] The guidelines were developed and published first in 2002 and in a later version published in 2015 taking into account the work by various jurisdictions through task forces and committees on matters corporate governance in the United Kingdom, South Africa and OECD principles and were as a response to the growing importance of the corporate governance issues in developing countries such as Kenya. The primary objective of the guidelines is to strengthen corporate governance practices by publicly listed companies in Kenya and to promote the governance standards in line with international trends. It does so by listing out the principles of good corporate governance, the recommendations which companies are expected to adopt and guidelines which help companies in understanding the recommendations.[85]

The code provided for a unitary board structure separating the role of the Chair and the CEO. It also provided that at least one-third of the board should be non- executive directors including the Chair of the board. In addition, the audit and nomination committees are required to have independent non-executive directors. [86] This code was in use up until the CMA released an updated version in 2015. The scope of application is the major difference in

[81] Ruparelia R, Njuguna A, 'The Evolution of Corporate Governance and Consequent Domestication in Kenya', 159.
[82] Ruparelia R, Njuguna A, 'The Evolution of Corporate Governance and Consequent Domestication in Kenya', 159.
[83] Private Sector Initiative for Corporate Governance, *Principles for Corporate Governance in Kenya,* 1999, 6.
[84] Ruparelia R, Njuguna A, 'The Evolution of Corporate Governance and Consequent Domestication in Kenya' 159.
[85] Chapter 1, *Code of Corporate Governance Practices for Issuers of Securities to the Public 2015,*2015
[86] Ruparelia R, Njuguna A, 'The Evolution of Corporate Governance and Consequent Domestication in Kenya' International Journal of Business and Social Science, 159.

the two codes. There is a shift from the "Comply or Explain" approach which is more rule based to the "Apply or Explain" approach which is more principle based and shall be discussed later on in this paper. [87] Based on the various aspects brought out by the various developments in various jurisdictions, we see the emerging global trends which have been adopted such as gender diversity within boards, board evaluation and corporate social responsibility.

From these practices emerge two approaches; the first one is the 'comply or explain' approach which apply to premium listed companies and secondly the 'the apply and explain' approach seen in the King committee which applies to all companies within the private and public sector regardless of listing of equity shares. This approach is of mandatory adoption and these best governance practises prescribed by law would be beneficial to any company regardless of its type at incorporation. Mandatory application and explanation of why governance principles have been applied enhances board accountability in which private companies would benefit from. In Kenya, the 'apply and explain' approach is yet to be implemented within the legal framework governing corporate governance with the same scope of applicability as the KING IV does in South Africa.

[87] Chapter 1, *Code of Corporate Governance Practices for Issuers of Securities to the Public 2015,*2015

CHAPTER 3: LEGAL FRAMEWORK SURROUNDING CORPORATE GOVERNANCE IN KENYA

3.1. Introduction

The notion of corporate governance was brought to life in the 1990s following the lack of accountability and efficiency which was guaranteed even further by the lack of an efficient corporate governance framework within the laws of Kenya. The first step was the establishment of the Capital Markets Authority in 1990. This however did not bring major changes to the state of corporate governance in Kenya which resulted in the desire to institutionalize principles of corporate governance in Kenya which led to the promulgation of the guidelines for public listed companies by the CMA in 2002.[88]

The 2002 Code was focused on self-regulation mechanisms in companies. In addition, it had a prescriptive and non-prescriptive approach to allow flexibility in companies by setting minimum standards for corporate governance.[89] From 2002, there were reforms pertaining to the legal framework surrounding corporate governance leading to the corporate governance regime we have in place today, these mainly being captured in the 2015 Code. This chapter points out the importance of having corporate governance regulations for private companies within a jurisdiction's legal framework. This chapter then looks into the legal framework surrounding corporate governance in place today, the effects it has brought about and lastly brings out the need to address corporate governance regulations for private companies in Kenya.

[88] Ruparelia R, Njuguna A, 'The Evolution of Corporate Governance and Consequent Domestication in Kenya', 159.
[89] Capital Markets Authority, *Guidelines on Corporate Governance Practices by Public Listed Companies in Kenya*, 2002.

3.2. Importance of Corporate Governance in Private Companies

In the recent years, many countries have adopted corporate governance codes; many of them mirroring the OECD principles earlier discussed in the second chapter. However, almost all of these codes relate to listed companies. Without specific reference/provisions relating to private companies, there is a danger that unlisted companies will refrain from developing an appropriate governance framework which may have negative effects on their long-term effectiveness and success. Private companies simply adopting the principles applicable to the listed companies may not be a viable solution owing to the fact that corporate governance challenges of listed companies may vary from those of private companies.[90]

The nature of most private companies is that they are owned and controlled by single individuals or a group of insiders for example a family. In most cases, owners continue to play a significant direct role in their management. Therefore, with regard to private companies, good governance in this context is not a question of protecting the interests of absentee shareholders rather it is concerned with coming up with a framework of policies and processes that add value to the business and ensure the long-term success of the company. [91] In light of this, private companies face greater corporate governance challenges than listed companies as much of the governance framework of listed companies may be externally imposed by various forms of regulations and formal listing requirements cast in the law while private companies have greater scope in the law to define their own governance strategy owing to the less onerous requirements applicable to them.[92]

[90] European Confederation of Directors' Associations (EcoDa), *Corporate Governance Guidance and Principles for Unlisted Companies in Europe,* 2010, 12. < http://ecoda.org/uploads/media/GUIDANCE_-_2010_CG_for_Unlisted_-_EU.pdf>.
[91] European Confederation of Directors' Associations (EcoDa), *Corporate Governance Guidance and Principles for Unlisted Companies in Europe,* 2010, 12. < http://ecoda.org/uploads/media/GUIDANCE_-_2010_CG_for_Unlisted_-_EU.pdf>.
[92] European Confederation of Directors' Associations (EcoDa), *Corporate Governance Guidance and Principles for Unlisted Companies in Europe,* 2010, 12. < http://ecoda.org/uploads/media/GUIDANCE_-_2010_CG_for_Unlisted_-_EU.pdf>.

A good corporate governance framework consists of the following elements:

- A set of relationships between a company's management, its board, its shareholders and other stakeholders.
- A structure through which the objectives of the company are set and the means of attaining those objectives and monitoring performance are determined.
- Proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders.[93]

Having an effective governance framework that defines the firms approach to each of the above issues is of equal importance to both private and listed companies. The importance of private companies concerning themselves with corporate governance can be seen in many aspects.

First, Performance and Internal efficiency. Corporate governance is concerned with the decision-making processes and procedures that assist the company in achieving its objectives. Consequently, as the firm seeks to improve the sustainability of its activities, it ought to give greater thought to issues of governance. Governance also becomes an increasing issue for unlisted companies as they develop new sources of finance. In the event they turn to banks and the likes for financial assistance, this will necessitate the implementation of a more explicit governance framework as external financiers seek assurance that their investments will be well managed.[94] Managing patient capital and illiquidity risk is another importance of private companies concerning themselves with corporate governance. Shareholders in private companies are restricted in terms of their ability to sell their ownership within the company. These restrictions may be imposed by the shareholders themselves. As a result, the shareholders of unlisted companies may find themselves being "captive" owners of a company. An effective corporate governance framework provides shareholders in unlisted companies with some reassurance that their interests will continue to be safeguarded by the board and the company management despite the fact that there's no easy exit from their ownership stake.[95]

[93] Organization for Economic Cooperation and Development, *OECD Principles of Corporate Governance*, 2004, 11.
[94] Institute of Directors, *Corporate Governance Guidance and Principles for Unlisted Companies in the UK*, 2010, 10. <https://ecgi.global/sites/default/files/codes/documents/cg_principles_unlisted_companies_iod_uk_nov2010_en.pdf>
[95] Institute of Directors, *Corporate Governance Guidance and Principles for Unlisted Companies in the UK*, 2010, 11. <https://ecgi.global/sites/default/files/codes/documents/cg_principles_unlisted_companies_iod_uk_nov2010_en.pdf>

In addition, private companies ought to build corporate reputation in line with societal expectations. Private companies have to operate within a social context in which there is a growing public scrutiny of corporate behaviour. In assessment of whether companies are governing themselves appropriately, public opinion is unlikely to pay regard to nuances such as whether an enterprise is a private company or is listed. Private companies may even be viewed with greater suspicion due to their lower levels of transparency. Good governance can play a crucial role in gaining the respect of external stakeholders such as potential financiers.[96]

The legal framework helps to define and determine the internal and external mechanisms of corporate governance. In an International Experts Meeting on Corporate Governance of Non-listed Companies organised by the OECD, it was widely acknowledged by the participants that a proper legal framework can influence behaviour of managers and shareholders.[97] To show the crucial role played by the legal framework for example, within the boundaries of company law, businesses have the discretion through contracts to adopt their own governance structure. In order to influence contractual flexibility, corporate governance codes based on the OECD reflecting best practices of corporate governance arose. These codes focus mainly on listed companies, but it was argued in the meeting that these codes also provide a useful framework for improving corporate governance in private companies and that the adoption of these standards will increase trust and investment opportunities for them.[98]

Owing to the nature of private companies, it would be fair to note that there exist some challenges when it comes to corporate governance for private companies. Due to small size or close family inter-relationship between shareholders, directors and executives within the company, governance often is applied with an informal approach. This, to the detriment of the company as the needs of the company will change as it evolves. As a company grows and its operations increase, a more disciplined and structured governance framework will be required.[99] Governance structures within a firm may vary in importance depending on the phase of a firm's life cycle. For instance, at start up especially where ownership and management

[96] Institute of Directors, *Corporate Governance Guidance and Principles for Unlisted Companies in the UK*, 2010, 11. <https://ecgi.global/sites/default/files/codes/documents/cg_principles_unlisted_companies_iod_uk_nov2010_en.pdf>.
[97] Organization for Economic Cooperation and Development, *Corporate Governance of Non Listed Companies*,2005, 13. <https://www.oecd.org/corporate/ca/corporategovernanceprinciples/37190767.pdf>.
[98] Organization for Economic Cooperation and Development, *Corporate Governance of Non Listed Companies*,2005, 13. <https://www.oecd.org/corporate/ca/corporategovernanceprinciples/37190767.pdf>.
[99] Australian Institute of Company Directors, *Governance Issues in Private Companies*, 2016, 2. <https://aicd.companydirectors.com.au/-/media/cd2/resources/director-resources/director-tools/pdf/05446-3-3-mem-director-gr-issues-private-companies_a4-web.ashx>.

overlap extensively, the firm may not need a strict mode of governance. Given that resources in start-ups tend not to be in abundance, a governance system which provides a boost in resources and knowledge could be quite useful to the start-up firm.[100] For a company on the verge of going public, greater accountability to external shareholders and a more professionalized governance system may be essential to attract new investors.[101]

Another challenge which corporate governance for private companies may be faced with may be substantiated by the legislated reporting and disclosure requirements for private companies are lower than those for listed companies.[102] This acts as a hinderance to private companies exhibiting total accountability and transparency. As a result of this, young privately-owned companies are often typified by the lack of formal information systems, with much information being in the head of the founder. As stated, the life cycle of a private firm may alter the form of governance required by the company however the professionalization phase of the company in its life cycle generally brings the opportunity of the firm to improve its auditing, financial reporting and accounting systems. In addition, the ownership structure within the company has an impact on the reporting requirements of the company. Companies where the private equity firms hold a minority of shares are likely to have better financial reporting systems than those whose majority shareholding is held by private entity firms. In the former case, the minority shareholder as a private entity firm would want more protection of its interests by requiring tougher standard of governance that ensure accountability.[103]

Governance in private companies is of importance as it is needed to ensure the smooth running and growth of the company. Growth and flourishing of a company are the ultimate goal of any shareholders or stakeholders within a firm. It has been seen that as a private company grows, part of what attracts investors towards it is having a good governance system in place. The legal framework governing company law thus cannot be silent on corporate governance for private companies.

[100] Uhlaner L, Wright M, Huse M, 'Private Firms and Corporate Governance: An integrated Economic and Management Perspective', *Small Business Economics*, Volume 29, Issue 3, 232-233 - <https://link.springer.com/article/10.1007/s11187-006-9032-z> on 9th January 2020.
[101] Uhlaner L, Wright M, Huse M, 'Private Firms and Corporate Governance: An integrated Economic and Management Perspective', 233
[102] Australian Institute of Company Directors, *Governance Issues in Private Companies*, 2016, 2. <https://aicd.companydirectors.com.au/-/media/cd2/resources/director-resources/director-tools/pdf/05446-3-3-mem-director-gr-issues-private-companies_a4-web.ashx>.
[103] Uhlaner L, Wright M, Huse M, 'Private Firms and Corporate Governance: An integrated Economic and Management Perspective', 234

3.3. Legal Framework surrounding Corporate Governance in Kenya

3.3.1. The Constitution of Kenya, 2010.

Promulgated in 2010, this brought a new constitutional dispensation in Kenya. The Constitution of Kenya is the supreme law of the Republic and is binding to all persons.[104] In addition, each person has an obligation to respect and uphold the Constitution.[105] In light of this, a company acts in its capacity as an artificial person has the duty to uphold the rule of law. The rule of law denotes that nobody is above the law and it ought to be applied equally.[106] This applying to companies too, they are thus under constitutional obligation to adhere to any existing lawa relating to corporate governance; this being the first guarantee of corporate governance principles within Kenya's legal framework.

3.3.2 The Companies Act (No.17 of 2015)

Kenya embarked on a journey to modernise its company laws as the laws governing company laws had not been overhauled since the colonial period. In 2015 Kenya enacted into law a new Companies Act ("The Act") which drew heaving on the Companies Act, 2006 of the United Kingdom [107]. The Act did not bring in a whole new code for corporate governance in Kenya however it does introduce a much heavier regime requiring substantial compliance even relating to corporate governance.[108]

The principle of the rule of law states that nobody is above the law, the regime on substantial compliance is seen in one of the significant amendments relating to corporate governance is the codification of directors' common law duties. The Act imposes a duty on the directors to act within powers in accordance with the constitution and for the purposes they are conferred.[109] The directors are also required to exercise independent judgement, manage the affairs of the company with reasonable skill and to act in the best interest of the company.[110] In the event of breach or threatened breach of general duties of the director this would result

[104] Article 2, *Constitution of Kenya,* 2010.
[105] Article 3, *Constitution of Kenya,* 2010.
[106] 'The Rule of Law' Lexis Nexis <https://www.lexisnexis.com/en-us/rule-of-law/default.page >
[107] Harney R, 'The New Companies Act 2015 has Come into Operation in Kenya' Bowman Gilfillan Africa Group's Coulson Harney, 2016, 1. < http://www.bowmanslaw.com/wp-content/uploads/2016/08/The-New-Companies-Act-2015-Has-Come-into-Operation-In-Kenya.pdf>
[108] Harney R, 'The New Companies Act 2015 has Come into Operation in Kenya' Bowman Gilfillan Africa Group's Coulson Harney, 2016, 1. < http://www.bowmanslaw.com/wp-content/uploads/2016/08/The-New-Companies-Act-2015-Has-Come-into-Operation-In-Kenya.pdf>
[109] Section 142, *The Companies Act (No.17 of 2015),* 2015.
[110] Sections 143-147, *The Companies Act (No.17 of 2015),* 2015.

in civil consequences and the resultant effect of this is to ascertain an element of accountability by the directors.[111] In addition to the accountability implications placed on directors, the act goes on to capture the importance of transparency amongst the directors within the board in its provisions. Directors are required to declare an interest if any in existing transaction.[112]

The Act also places a duty on the audit committee of a quoted company to set out the corporate governance principles that are appropriate for the nature and scope of the company's business, establish polices and strategies for achieving them. The committee shall on an annual basis assess the extent to which the company has observed those policies and strategies.[113]

From the above, we can see that there has been good progress made in the new Companies Act to ensure compliance with good corporate governance principles. However, the Act faces few challenges in doing so for all companies which shall be addressed.

3.3.3. The Code of Corporate Governance Practices for Issuers of Securities to the Public 2015

In exercise of the powers conferred by sections 11 (3) (v) of the Capital Markets Act, the Capital Markets Authority issued the Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015 ("The Code"), for application by both listed and unlisted public companies in Kenya. This Code succeeds the Guidelines on Corporate Governance Practices by Public Listed Companies in Kenya, 2002. The Code sets out the principles and specific recommendations on structures and processes, which companies should adopt in making good corporate governance an integral part of their business dealings and culture.[114] It advocated for the adoption of standards that go beyond the minimum prescribed by the Companies Act. The Code has moved away from the "Comply or Explain" approach to "Apply or Explain". This approach is principle-based rather than rule-based and recognizes that a satisfactory explanation for any non-compliance will be acceptable in certain

[111] Sections 143-147, *The Companies Act (No.17 of 2015),* 2015.
[112] Section 151, *The Companies Act (No.17 of 2015),* 2015.
[113] Section 770, *The Companies Act (No.17 of 2015),* 2015.
[114] Chapter 1, *Code of Corporate Governance Practices for Issuers of Securities to the Public 2015,*2015.

circumstances therefore boards are required to fully disclose any non-compliance with the Code. [115]

It applies to all companies that issue both debt and equity securities to the public regardless of whether or not they are listed otherwise known as issuers. The Boards of issuers are required to formulate additional internal policies and strategies that will not only enable their companies to grow but also protect the interests of shareholders and stakeholders.[116]

The 2015 Code enhances the 2002 guidelines by addressing some of its shortcomings. Undefined terms such as conflict of interest and stakeholders are now clearly defined. It also provides for previously unmentioned but important issues such as stakeholder engagement, legal compliance and ethical compliance audits to supplement financial audits.[117] Similar to the Companies Act, it thoroughly provides for conflict of interest arsing at all management levels and the roles and duties of directors. The code also requires more disclosure by issuers improving transparency and tackles the issue of efficiency and effectiveness of boards by introducing mandatory professional training and development for directors and mandates professional training for directors.[118]

The 2015 Code has moved corporate governance standards in Kenya one step closer to international corporate standards however has a key weakness on its application. Emerging international corporate standards which emerged after publication of the Code by virtue of the KING IV report, there is departure from "Apply or Explain" approach to the "Apply and Explain" approach which guarantees more accountability from the board. We see no major attempt to amend this within the provisions of the code.

[115] Chapter 1, *Code of Corporate Governance Practices for Issuers of Securities to the Public 2015,*2015.
[116] Mweti C.K, 'Kenya's Corporate Governance Practices Code,2015', Bowman Gilfillan Africa Group's Coulson Harney, 2016, 1. < http://www.bowmanslaw.com/wp-content/uploads/2016/08/Kenyas-Corporate-Governance-Practices-Code-2015.pdf>
[117] Mweti C.K, 'Kenya's Corporate Governance Practices Code,2015', Bowman Gilfillan Africa Group's Coulson Harney, 2016, 1. < http://www.bowmanslaw.com/wp-content/uploads/2016/08/Kenyas-Corporate-Governance-Practices-Code-2015.pdf>
[118] Chapter 2, *Code of Corporate Governance Practices for Issuers of Securities to the Public 2015,*2015.

3.4. The need for a Legal Framework surrounding Corporate Governance Framework for Private Companies in Kenya

The first step taken to ensure corporate governance for private companies in Kenya was seen in 1999 by the Private Sector Initiative for Corporate Governance when they issued the Principles for Corporate Governance in Kenya and a Sample Code of Best Practice for Corporate Governance. The Private Sector Initiative for Corporate Governance was established to formulate and develop a code of best practice for corporate governance in Kenya and on October 1999, formally adopted a national code of best practice for Corporate Governance to guide corporate governance in Kenya.[119]

One of the key features that the new Companies Act brought with its enactment to legislation was clearly drawing the distinction between public and private companies. A public company is one that provides within its articles an allowance for its members the right to transfer their shares in the company, does not prohibit invitations to the public to subscribe for shares or debentures and its certificate of incorporation states that it is a public company.[120]

On the other hand, a private company is one that its articles restrict a member's right to transfer shares, limits the number of members to fifty and prohibits invitations to the public to subscribe for shares or debentures of the company. In this case "member" excluding an employee of a company.[121]

As mentioned above, the 2015 Code applies to companies that issue both debt and equity securities to the public whether or not they are listed on the Nairobi Securities Exchange (NSE); a shift from the 2002 Code which was for application for publicly listed companies. From the definitions above, only public companies are permitted by law to have the public to subscribe for shares or debentures therefore the Code is essentially of mandatory application only to public companies.

The distinction between private and public companies by the Companies Act created a small companies regime whose aim to reduced the operational costs for 'small companies'. The Act defines a small company as one which has a turnover of less than fifty million Kenya Shillings (Ksh. 50,000,000/=) or its total net value of its assets does not exceed twenty million Kenya Shillings (Ksh. 20,000,000/=).[122] Public companies, a group of companies in which a public

119 Private Sector Initiative for Corporate Governance, *Principles for Corporate Governance in Kenya,* 1999, 6.
120 Section 10, *The Companies Act (No.17 of 2015),* 2015.
121 Section 9, *The Companies Act (No.17 of 2015),* 2015.
122 Section 624, *The Companies Act (No.17 of 2015),* 2015.

company is part of, or a public listed company are exempted from the small companies regime.[123] The small companies regime is the closest form of corporate governance regulations for private companies we have within our legal framework as most private companies would fall within the provisions the Act gives to meet the requirements of a small company.

This regime impacts on financial reporting and auditing of companies as the Act exempts small companies from several requirements imposed on other companies. Small companies are exempted from issuing concise financial reports and from auditing. They may issue abbreviated financial statements without necessarily including an auditor's report. This regime impedes on economic growth as for example, financial institutions and shareholders that may want to provide capital to small companies may require audited financial statements to assist them to make a decision or not on whether or not the company in question is worth their investment.[124] The exemption of small companies from auditing makes it possible for them to file fraudulent financial reports in a bid for the companies to understate their reports. The resultant effect of this is that the company keeps incurring low operational costs therefore resulting in the lack of an effective accountability mechanism. In addition, there is need for concise guidelines for small companies to prevent abuse of the exemptions they are accorded by the directors of such companies relating to director duties to protect the other stakeholders within the company. [125]

From the analysis above, we see that there have been steps taken by the legal framework of Kenya to take into account the importance of corporate governance for private companies but has not been fully enshrined within the provisions of the law which as stated may impede on economic growth and growth of private or "small" companies.

[123] Section 625, *The Companies Act (No.17 of 2015),* 2015.
[124] Mukoma J, 'A Comprehensive Review of the Corporate Governance Legislative Framework Encompassed in the Companies Act 2015 in Kenya' 2013.
<https://pdfs.semanticscholar.org/e075/9d71714c654c98a325ad3bdf1adaca44cd11.pdf> on 19th November.
[125] Mukoma J, 'A Comprehensive Review of the Corporate Governance Legislative Framework Encompassed in the Companies Act 2015 in Kenya' 2013.
<https://pdfs.semanticscholar.org/e075/9d71714c654c98a325ad3bdf1adaca44cd11.pdf> on 19th November.

CHAPTER 4: ADOPTION OF CORPORATE GOVERNANCE REGULATIONS FOR PRIVATE COMPANIES

4.1. Introduction

The scope of what may constitute a private company is wide and comprises start-ups, family businesses, private equity-owned companies and joint ventures provided that it restricts a member's right to transfer shares, it limits the number of members to fifty and it prohibits invitations to the public to subscribe for shares of the company.[126] According to the OECD, good corporate governance practises amongst unlisted companies have the potential to significantly boost productivity growth and job creation in both developing and developed economies.[127]

However, the governance of private companies is often a neglected area of corporate governance recommendations.[128] This is true owing to the findings of the previous chapter that have shed light on the need to have a more comprehensive framework governing corporate governance regulations for private companies in Kenya.

Kenya thus would benefit from borrowing corporate governance principles applicable to privately owned companies in other jurisdictions that have more developed corporate governance structures such as South Africa and the United Kingdom. This chapter seeks to draw a manner in which Kenya's legal framework can respond to the need brought out in the previous chapter. The chapter discusses ways in which the legal framework in place could be employed to respond to the shortcomings of the Kenyan corporate governance regime with regard to regulations for private companies. This shall be done by comparing and proposing practises in place in other jurisdictions relating to corporate governance for private companies.

126 Section 9, *The Companies Act (No.17 of 2015),* 2015
127 European Confederation of Directors' Associations (EcoDa), *Corporate Governance Guidance and Principles for Unlisted Companies in Europe,* 2010, 11. < http://ecoda.org/uploads/media/GUIDANCE_-_2010_CG_for_Unlisted_-_EU.pdf>.
128 European Confederation of Directors' Associations (EcoDa), *Corporate Governance Guidance and Principles for Unlisted Companies in Europe,* 2010, 11. < http://ecoda.org/uploads/media/GUIDANCE_-_2010_CG_for_Unlisted_-_EU.pdf>.

4.2. Amending Kenya's Legal Framework Surrounding Corporate Governance to include Private Companies

Governance has a key role to play in the flourishing of a company as its importance has been illustrated above. Having established that the legal framework surrounding corporate governance regulations for private companies may have room for improvement to reflect better governance standards and have a good structure in place.

The following are manners in which Kenya's legal framework on corporate governance regulations for private companies could be amended in response in response to its existing shortcomings:

Amendment of the Small Companies Regime

With regard to inclusion of Private Companies

The Companies Act creates a small companies' regime which applies to ideally 'smaller companies' and gives the requirements to be one in Section 624. The Act further goes on to list that public companies, group of companies where one is a public company or anybody corporate that issues securities on securities exchange in Kenya are exempted from being part of the small companies regime.[129] From this, we see that only private or unlisted companies are eligible to fall within this category of small companies however this can only be arrived at through inference and deduction of the legal provisions of the Companies Act. An amendment to the Act proposing the express inclusion of private companies within the small companies' regime would guarantee that at the most elementary level, all private companies will have to comply with the governance requirements that are applicable to the regime.

With regard to Financial Reporting and Audit

The small companies' regime through the Act exempts small companies from being audited. They may issue abbreviated financial statements without necessarily including an auditor's report and does not have to give a business review in the director's report.[130] The effect that this has as discussed in Chapter 3 is that it impedes on economic growth. Despite the Act requiring companies to lodge financial reports with the registrar in Section 688, the exemption of small companies from auditing makes it possible for them to file fraudulent reports in a bid

[129] Section 626, *The Companies Act (No.17 of 2015),* 2015.
[130] Section 655, *The Companies Act (No.17 of 2015),* 2015.

to always fall within the small companies regime.[131] Locally, there have been no such instances however the loophole in law is present for abuse. Accurate reporting and accounting systems assist majorly in growth of a private company and that increases accountability within a company. In light of this, this position in the law may require to be amendment. Therefore, while taking account of the nature and size of such companies, the reporting requirements in the small companies regime ought to be strict enough to safeguard its interests as a small company. The legal provisions governing financial reporting of small companies could be amended requiring them to issue more accurate statements and give room for allowance for audit in certain instances.

In the event that financial reporting requirements may be too financially grave for small companies, Kenya could borrow from the trend set in the UK in 2018 through the Wates Corporate Governance Principles for Large Private Companies issued by the Financial Reporting Council (FRC). This development came about when the House of Commons' Business, Energy and Industrial Strategy Committee in its report in 2017 noted that arguments in favour of greater transparency and accountability for companies with a significant presence in the community should be required to report on financial and non-financial matters for the benefit of employees and other stakeholders.[132]

The financial reporting requirements vary as per the size and influence in which a company held in society as there could be extremely influential companies whose demise or failure would be to the detriment of the society. An example for this in Kenya would be Nakumatt. Although reliable information about the events that led to its demise as a leading retailer in East Africa are yet to be made public, Mr. Atul Shah, the founder and CEO in an article by the Business Daily Africa following an interview stated that the company was expanding too fast on borrowed money whose supply cut when the interest cap was enacted into law in 2016. If this was actually the case, that was an issue caused by poor governance structures within the company as a diverse board and audit committee would have most probably advised against the rampant borrowing of funds during the period the interest rate cap was law. The board

[131] Mukoma J, 'A Comprehensive Review of the Corporate Governance Legislative Framework Encompassed in the Companies Act 2015 in Kenya',2013.
<https://pdfs.semanticscholar.org/e075/9d71714c654c98a325ad3bdf1adaca44cd11.pdf> on 24th November 2019.

[132] Financial Reporting Council, *The Wates Corporate Governance Principles for Large Private Companies, 2018,4.*

would also most probably have assessed the accurate financial position of the company, enabling the company to assess its debt liability accurately.

Inclusion of Private Companies to the Scope of Application of the 2015 Code

The governance code in application today in Kenya released by CMA set guidelines that are the minimum standards that issuers must implement.[133] This brings into effect that for private companies, adherence to the Code is not mandatory but would be beneficial. In this case, amendments could be made to reflect the position in South Africa. As discussed in the second chapter of this paper, the KING IV code in South Africa applies to all companies registered in the jurisdiction to adhere to the guidelines stated in the code owing to the "apply and explain" approach developed in the code. The core principles in the KING III were compressed making it easier in terms of application to different public and private companies of different sizes in the KING IV report which was issued in 2016. It is to be applied to all companies depending on the company's objectives and adopts an 'apply and explain' approach in its implementation.[134] The effect that this has is that, it basically is a code of mandatory application to all companies. Companies also are obliged to state how and why provisions have been applied.

The 2015 code could therefore extend its application through its provisions to include all companies regardless of incorporation and shift towards the "apply and explain" approach as opposed to the "comply and explain" approach. The net effect that this would have is that all companies would be required to have a corporate governance structure in place that is relevant to the company's needs. In the long run, this would result in the potential betterment and growth of the company owing to the importance that governance structures have within any company seen in the previous sub-chapter.

Adoption of a Corporate Governance Guidance Code for Private/ Unlisted Companies in Kenya

The legal framework governing corporate governance in Kenya could respond to the trend set by the United Kingdom and adopt a guidance code for private companies. In 2010, the Corporate Governance Guidance Code for Private/ Unlisted Companies was released, and it

133 Chapter 1, *Code of Corporate Governance Practices for Issuers of Securities to the Public 2015,*2015
134 Institute of Directors, *KING IV Report on Corporate Governance*, 2016.

was noted that good corporate governance is particularly important to the shareholders of unlisted companies as they have limited ability to sell their ownership stakes. Therefore, they are committed to staying with the company for the medium to long term.[135] Key stakeholders in the corporate governance sector and from the private sector should come together and explore the possibilities of Kenya coming up with its own version of a corporate governance guideline for private companies.

In conclusion, it is clear that there are ways in which changes could be instituted in the legal system to effectively bring out stronger regulations for corporate governance of private companies. However, the challenge is in the implementation. Implementation of a corporate governance framework should also take account of the firm's objectives concerning its own development. It should be proportionate and realistic as it is not an end in itself but a means of adding value and providing continuity.[136]

[135] Institute of Directors, *Corporate Governance Guidance and Principles for Unlisted Companies in the UK*, 2010,19,<https://ecgi.global/sites/default/files/codes/documents/cg_principles_unlisted_companies_iod_uk_nov2010_en.pdf>.

[136] Institute of Directors, *Corporate Governance Guidance and Principles for Unlisted Companies in the UK*, 2010,19,<https://ecgi.global/sites/default/files/codes/documents/cg_principles_unlisted_companies_iod_uk_nov2010_en.pdf>.

CHAPTER 5: CONCLUSION

5.1. Introduction

This dissertation sought to establish a case for the introduction of corporate governance regulations for privately owned companies within the legal framework governing company law in Kenya. The position that this paper brings out is that, indeed, the law ought to be amended to factor in privately owned companies ambit its provisions. Thus, based on the first four chapters, this chapter shall conclude the paper by giving a synopsis of the key findings of the study and recommendations.

5.2. Restating the problem

Corporate Governance was brought into life in the 1990s following the corporate failures at the time as described in the introduction of this paper. It begun with implementation of the recommendations by the various committees within companies that were publicly listed. Over time, the importance of corporate governance begun to be seen and it spread over to privately owned companies. This was evidenced by corporate governance codes requiring their application to include private companies or the issuance of corporate governance guidelines for private companies. In as much as steps had been taken to advance corporate governance within private companies, here in Kenya the legal framework on corporate governance within private companies is dismal and goes to the extent of requiring less from private companies than listed companies with regard to certain governance issues. This paper sought to look into the plausibility of reforming the legal framework on corporate governance within private companies in Kenya; this being the case in jurisdictions such as South Africa whose corporate governance code is to be applied by all companies. It was therefore on this basis that various proposals discussed in the previous chapter were arrived at in a bid to incorporate private company corporate governance within our legal regime.

5.3. Research Findings

This dissertation was inspired by the South African legal framework on corporate governance for private companies. The framework was viewed by the author as one that was the most advanced in Africa and could be one that could be emulated in Kenya. Therefore, in a bid to look into how our legal framework could respond to the research problem, the author asserted the hypotheses that private companies could hugely benefit from having good corporate governance structures in place and that the laws requiring private companies to adhere to good governance structures was insufficient. The paper sought to propose manners in which the legal

framework could be amended to factor in corporate governance for private companies to ensure their sustenance and growth. The study sought to answer the following questions:

1. Are the governance interests of private companies adequately safeguarded by the legal framework as it is?
2. Why should private companies have good governance structures and adhere to them?
3. How best can the legal framework governing corporate governance as it is be amended to safeguard the governance interests of private companies?

5.3.1. Are the governance interests of private companies adequately safeguarded by the legal framework as it is?

The first concern for this study was to look into whether the legal framework on corporate governance is sufficiently safeguarding private companies to ensure that they have good governance structures in place. In addressing this question, it was established that indeed the legal framework was rather insufficient as it minimally had provisions requiring private companies to adhere to good governance structures this in a bid to ensure their operational autonomy and prevent interreference by the law. However, the provisions did little to ensure good governance.

This brought out the fact that the need to reform the legal framework exists. The 2015 Code of Issuers of Security to the Public and the Companies Act, 2015 needed to be amended in order to factor in private companies as the small companies regime is the closest the Companies Act had in its provisions with regard to corporate governance for companies other than publicly listed companies. Even within this small companies' regime, the governance requirements for these companies are still less demanding of them.

5.3.2. Why should private companies have good governance structures and adhere to them?

Another question which this paper sought to answer is whether good governance within private companies is of any importance and what benefit it may bring to the company. In answering this question, the paper established that owing to the nature of private companies, corporate governance is of utmost importance as corporate governance in private companies is not a question of protecting the interests of absentee shareholders rather it is concerned with coming up with a framework of policies and processes that add value to the business and ensure the

long-term success of the company. This requiring private companies have greater scope in law to define their own governance strategies.

In addition, it was also established that corporate governance was of importance with regard to increasing performance and internal efficiency. Potential growth of a private company depends on attraction of investors towards the company and good governance structures is a key factor that attracts potential investors. Good governance in a private company was seen in this paper to be of importance in reference to the owners of a company. Shareholders in private companies are restricted in terms of their ability to sell their ownership within the company. These restrictions may be imposed by the shareholders themselves. As a result, the shareholders of unlisted companies may find themselves being "captive" owners of a company. An effective corporate governance framework provides shareholders in unlisted companies with some reassurance that their interests will continue to be safeguarded by the board.

5.3.3 How best can the legal framework governing corporate governance as it is be amended to safeguard the governance interests of private companies?

The preceding questions aimed at justifying the need for reforms in the legal framework on corporate governance. This question aimed at bringing out a manner in which the legal framework can respond to the aforementioned justification for the need for reforms. This paper answered this question by formulating probable solutions to the problem and propose manners in which the legal framework could be amended mirroring from various other jurisdictions practises with regard to implementation of corporate governance practises in private companies.

5.4. Summary of Recommendations

Following the research carried out, the following were the recommendations this dissertation proposed in a bid to have private companies be brought within the ambit of the laws relating to corporate governance. They were as follows:

1. Amend the Small Companies Regime which was created by the Companies Act, 2015 to:
    - Expressly include privately owned companies and avoid including them through inference and analysis criteria set for a company to fit in the regime.

- Make the financial reporting and audit requirements for companies within this regime more stringent. This will ensure more accountability and transparency within the company.

2. Inclusion of privately-owned companies within the scope of application of the 2015 Code of Issuers to the Public in a similar manner that South Africa applies the KING IV code to all companies in that jurisdiction.
3. Adoption Corporate Governance Guidance Code for Private/ Unlisted Companies in Kenya

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