



**IMPLEMENTATION OF DIRECTORS' DUTIES IN THE STRIVE FOR
SOUND CORPORATE GOVERNANCE IN KENYA.**

Lessons from Uchumi Supermarkets Limited

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Declaration

I, Vanessa Gathoni Mungai, 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:.....

Dr. Joy Malala

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Abstract

This research was conducted with the main objective of establishing the implementation mechanism available in Kenya to ensure sound corporate governance within the markets regulatory by assessing the level of accountability of company directors when dispensing their section 143 duty of promoting the success of the business as a whole. The methods of research adopted the use of archived information, interviews and questionnaires by specific groups. The underlying corporate governance theories were utilized in the study. It was established that our code and governance structure and model must be based on our national, economic and social environment so as to meet the needs of the Kenyan market, this is the only way effective implementation will be achieved.

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CHAPTER ONE

INTRODUCTION

Background

Corporate Governance is not a novel concept, up until today it is still being developed and improved on. The main reason for its development over the years is due to the vast number of fraudulent scandals and the need for deeper investor protection as well as confidence in the market¹. The phrase has no universally accepted definition and it is for this reason that it has commonly been misinterpreted as the solution for all corporate ills.²

Corporate governance comprehends a framework of rules and processes within and by which corporate authority is exercised and controlled for the benefit of all stakeholders.³

Corporate governance is the structured process used to direct business affairs of the company towards enhancing prosperity with the ultimate objective of realizing shareholders long-term value while taking into account the interest of other stakeholders.⁴ It can also be broadly defined as the distribution, exercise and implications of corporate control.⁵

In the past, financial scandals have shown that Kenya is unable to cope with the self-regulation of its corporations through established corporate governance codes such as the Goldenberg scandal, 1993⁶. In 2015 Uchumi fired its chief executive officer and chief financial officer for "misconduct and gross negligence."⁷

Directors are key ingredients to any corporate governance system employed and as such are made accountable for their actions through the traditional directors' duties in common law.

¹ Dougherty T, *The Political Economy Of Corporations: Varying Approaches To Corporate Governance Around The World*, 2006, 256-57

² Young A, 'Frameworks in Regulating Company Directors: Rethinking the Philosophical Foundations to Enhance Accountability' 12 *Sweet & Maxwell* (2009), 30

³ Organization for Economic Co-operation and Development, '*Corporate Governance: Frequently Asked Questions about the OECD Principles of Corporate Governance*', < http://www.oecd.org/faq/02583,en_2649_37439_31717413_1_1_1_3473900.html> , accessed on 24th November 2016 .

⁴ Section 1.2, The Capital Markets Act (*Cap. 485a*) Guidelines On Corporate Governance Practices By Public Listed Companies In Kenya, (2002)

⁵ Kevin Keasey, Steve Thompson, Michael Wright, 'Corporate Governance: Accountability, Enterprise and International Comparisons', 2005, 209

⁶ Warutere P, 'The Goldenberg Conspiracy' 117 *Institute for Security Studies Papers* (2005), 23

⁷ Business Daily, '*Uchumi sacks Ciano, CFO for 'gross misconduct, negligence'*', Business Daily, 15 June 2015, <http://www.businessdailyafrica.com/Corporate-News/Uchumi-CEO-sacked-for-gross-misconduct--negligence/-/539550/2752488/-/f5k06gz/-/index.html>, on 24 February 2016

A country's legal system plays a significant role in determining the success of its corporate governance system. The statutory law governing corporate governance in Kenya is contained in the Companies Act 2015, Capital Markets Authority Act 2002, Nairobi Stock Exchange (NSE) Regulations, Penal Code Section 63, Guidelines on Corporate Governance Practices by Public Listed Companies in Kenya among others.

The old Companies Act 1959 had numerous loopholes⁸ contrastingly, the 2015 Companies Act, though a progression in terms of codification, has presented a new set of problems. A classic and self-evident example is the direct adoption of the UK Companies Act which codified directors' common law duties.

Section 172 of the UK Act reads 'The duty of a director to act in good faith in a way that will most likely promote the success of the company for the benefit of its members as a whole.'⁹ This section is verbatim as Section 143 of the partially enacted 2015 Companies Act. In the UK this section is the most controversial due to its ambiguity. It provides directors with a 'get out of jail free card'¹⁰ when their actions are challenged in court.

Additionally, our legal system is requires greater capacity building so to aid in implementing the law and therefore handle corporate fraud better. Currently, directors walk away without facing the full consequences of their actions as evidenced by the case of Rebecca Mwikali Nabutola v Republic.¹¹ We need to move away from adopting shelf made foreign laws and instead adopt stronger legal systems which are customized to our society and will be better equipped to handle corporate fraud in Kenya.

⁸ Musikal L, 'The law affecting corporate governance in Kenya: a need for review' *International Company and Commercial Law Review* (2008),24

⁹ Section 172, UK Companies Act c 46 (2006)

¹⁰ Keay A, 'The duty to promote the success of the company: is it fit for purpose?' *University of Leeds School of Law, Centre for Business Law and Practice Working Paper* (2010), 35

¹¹ *Rebecca Mwikali Nabutola v Republic* [2012] eKLR.

Statement of the problem

“The current corporate governance implementing mechanisms in Kenya are inadequate, leading to insufficient accountability by directors when fulfilling their duty of promoting the success of the company as a whole”

Justification of the study

This study is key in showing how we can better implement codes of corporate governance, improve our precedent on fully decided fraud cases and customize our laws to ensure they are suited to our needs.

Governance practices exhibited by various scandalous companies¹² have caused the low ranking¹³ for Kenya. The World Economic Forum’s annual Global Competitiveness Report indicates a clear perception that Kenya’s investor protection and corporate governance framework lags behind other countries.¹⁴

In exercise of the powers conferred by the Capital Markets Act¹⁵, the Capital Markets Authority set out in the corporate governance guidelines, for observance by public listed companies in Kenya, in order to enhance corporate governance practices but these guidelines are unenforceable.

Companies Act 2015 has been partially enacted, new legislature presents an excellent opportunity to implement foundational law. However, section 143¹⁶ presents an opportunity for a drawback. If it was tried and failed in the UK can we handle the same loophole based on

¹² Goldenberg scandal, 1993; In June 2015, Uchumi; In October 2015 Imperial Bank

¹³ Professor Schwab K, The Global Competitiveness Report 2015-2016, *World Economic Forum*, http://www3.weforum.org/docs/gcr/2015-2016/Global_Competitiveness_Report_2015-2016.pdf, accessed 8 January 2017, 25

¹⁴ Professor Schwab K, The Global Competitiveness Report 2015-2016, *World Economic Forum*, http://www3.weforum.org/docs/gcr/2015-2016/Global_Competitiveness_Report_2015-2016.pdf, accessed 8 January 2017

¹⁵ Section 11(3)(v) and Section 12, Capital Markets Act (Act No. 48 of 2013)

¹⁶ Section 143, *Companies Act* (Act No. 17 of 2015)

our current corporate governance framework? Sections taken verbatim that have been tested and failed shouldn't be incorporated into our law

Statement of Objectives

The main objective of this research is to establish the implementation mechanism available in Kenya to ensure sound corporate governance within the markets regulatory by assessing the level of accountability of company directors when dispensing their section 143 duty of promoting the success of the business as a whole.¹⁷

Research Questions

This research seeks to find answers on the following research questions

- a) What is the availability and adequacy of the legislative and implementation framework on corporate governance in Kenya?
- b) The section 143 duty 'The duty of a director to act in good faith in a way that will most likely promote the success of the company for the benefit of its members as a whole',¹⁸ is it viable in the strive for sound corporate governance in Kenya?

Scope and Limitations of the study

The scope of this study is limited to listed companies offering security to the public. Thereafter the main implementing body Capital Markets Authority, hereafter CMA, will be examined including the methods they use to implement the law and guidelines. The study faces the following limitations;

Time

Precision in tackling the research questions is time consuming due to the large amount of content on corporate governance.

Costs of Research Resources

Some of the research resources are costly. High transportation costs were also incurred during the interview period.

¹⁷ Section 143, *Companies Act* (Act No.17 of 2015)

¹⁸ Section 143, *Companies Act* (Act No.17 of 2015)

Consent from the participants;

The interviews being conducted require prior consent by the participants. Communicating with interviewees where some are not receptive; others delay in communicating, while others have extremely busy schedules.

Assumptions

1. All information given by the interviewees and participants is a true and fair representation of the corporate field.
2. The materials used and relied upon haven't been repealed or amended at the time of conducting the research. Indeed, law is dynamic, however an assumption made is that all materials are up to date.
3. There is an assumption made that if laws are taken without customization to our Kenyan context and have failed in the UK then the reality will be similar here.
4. Axiology¹⁹: The research being conducted is a qualitative analysis as opposed to a quantitative one. There is the assumption of underlying principles of integrity and good governance as values aimed at throughout the entire conduct of research. This isn't a value free research; it is based on principles of morality, business ethics and integrity in leadership.

¹⁹ Fischer B and Gray M, *Dissertation Guides Workbook* Capella University Chapter 1,2009

CHAPTER 2

THEORETICAL FRAMEWORK AND METHODOLOGY.

2.THEORETICAL FRAMEWORK

Corporate governance, has over the years been developed as a response to the economic climate within a nation. This climate has various underlying factors which in turn shape the corporate governance scene. The first are the corporate governance theories. Secondly, the actors in the market such as directors, shareholders and stakeholders. The third is the law enacted, while the fourth is the body politic.²⁰

The chapter will commence with an in-depth analysis into the various theories that have developed corporate governance throughout the years, linking them with directorship duties specifically the section 143 duty of promoting the success of a company as a whole. Thereafter a look into the law primarily the CMA corporate governance guidelines, Directorship duties specifically section 143²¹and section 172²².Then finally the role that politics has to play in the corporate governance scene in Kenya shall be analyzed.

2.1 CORPORATE GOVERNANCE THEORIES

These theories act as the focal point of this proposal. They shall aid in establishing how best to ensure laws can be effective and suited to the Kenyan context.

2.1.1 Agency theory:

This theory was established by Alchian and Demsetz in 1972²³. It is defined as “the relationship between the principal shareholders and agents such as the company executives and managers”²⁴ The agency theory presumes that ownership and control of the corporation

²⁰ Harvey A, *Body politic: political metaphor and political violence* Cambridge Scholars Publishing, 2007

²¹ Section 143, *Companies Act* (Act No.17 of 2015)

²² Section 172, UK *Companies Act* c 46 (2006)

²³ Alchian, Armen Harold D, ‘Production, information costs, and economic organization’ 62.5 *The American economic review*, (1972), 777-795.

²⁴ Abdullah and Benedict V, *Fundamental and Ethics Theories of Corporate Governance* 4th edn *EuroJournals Publishing*, (2009), 2

are separate.²⁵ The principal in this theory are the shareholders, they delegate duty and responsibility to the directors who are the agents. The underlying expectation of this theory is that the directors will act and make decisions within the realm of the principal's interests.

The principles of common law and equity sought to limit the authority that the directors in their capacity as agents could act, so as to minimize situations that would lead to opportunistic, self-interest objectives overriding the shareholders' interests.

Critiques on the agency theory

The agency principal relationship is has received the following criticism when applied to the director shareholder relationship within public and private companies;

The first, being that the theory has been criticized as being *too complicated when the principal is an amorphous mass of unknown individuals to the directors of the business.*²⁶ The agency relationship is easier when both parties are easily identifiable by the other. The shareholders, are viewed as merely holding shares as property which is actually being invested in by the directors.

Secondly, the *agency theory is limited to operations of a single period and not a dynamic model.* It is not viewed as realistic in a multi- period setting. Limited liability companies are bodies with separate legal identity from its members and managers as identified in the landmark case of Salomon v Salomon²⁷. The separation of identity is one of the effects of registration of the company as outlined in the Act²⁸ as is perpetual succession.

Additionally, the *assumption made that the agent and principal are both rational utility maximizers. The 'model of man'*²⁹ and the *Resourceful, Evaluative, Maximizing Model*

²⁵ Young A, 'Frameworks in Regulating Company Directors: Rethinking the Philosophical Foundations to Enhance Accountability' 12 *Sweet & Maxwell* (2009), 67

²⁶ Professor Güler A and Professor Crowther D, *A Handbook of Corporate Governance and Social Responsibility* 1 Gower Publishing Ltd, 2012, 220

²⁷ *Salomon v A Salomon and Co Ltd* [1897] AC 22

²⁸ Section 19, Companies Act (Act No.17 of 2015)

²⁹ Jensen and Meckling, Theory of the Firm: 'Managerial Behavior, Agency Costs and Ownership Structure', 4 *Journal of financial economics*, (1967),305-360

(REMM)³⁰ acted as the underlying principles for the agency Theory.³¹ The problem lies in the fact that these reductionist assumptions of human motivation guide both organizational and managerial theory building, and serve to produce behavior in the organization that is consistent with those assumptions.³²

2.1.2 Stewardship theory³³

This theory was developed by Donald and Davis in 1991.³⁴ The main assumption it addressed was on the model man, reduction theory of man as a rational being as well as the static nature of the agency theory.

The theory proposes that managers when left on their own will act responsibly in accordance with their directorship roles and duties. It looks at directors and managers as stewards of the company and views monitoring as redundant³⁵. Regarding the board, superior corporate performance will be linked to a majority of inside directors and that the position of Chairman and CEO should be held by the same person since this provides clear leadership.³⁶

The key assumption made under this theory is that the behavior of the directors mirrors the shareholders' interests, placing primacy on the meeting of objectives by both the directors and the shareholders.³⁷

³⁰ Pastoriza D and Arino M, "When Agents Become Stewards: Introducing learning in the stewardship theory", 1st IESE Conference, Barcelona, 2008, 4, <https://papers.ssrn.com/sol3/Papers.cfm?abstract_id=1295320>

³¹ Referred to in Appendix 2

³² Pastoriza D and Arino M, "When Agents Become Stewards: Introducing learning in the stewardship theory", 1st IESE Conference, Barcelona, 2008, 4, <https://papers.ssrn.com/sol3/Papers.cfm?abstract_id=1295320> founded on Ferraro et al., 2005.

³³ Wan Y and Alhaji, 'Insight of corporate governance theories' 1.1 *Journal of Business and management*, (2012), 52-63.

³⁴ McWilliams, Abigail, Siegel D, and Patrick M, 'Corporate social responsibility: Strategic implications' 43.1 *Journal of management studies*, (2006), 1-18.

³⁵ Donaldson, Lex, and Davis J, 'Stewardship theory or agency theory: CEO governance and shareholder returns' 16 *Australian Journal of management*, (1991), 49-64.

³⁶ Gakeri J, 'Enhancing Kenya's Securities Markets through Corporate Governance: Challenges and Opportunities' 3.6 *International Journal of Humanities and Social Science*, (2013)

³⁷ Slyke, David M. 'Agents or stewards: Using theory to understand the government-nonprofit social service contracting relationship' 17.2 *Journal of Public Administration Research and Theory*, (2007), 157-187.

Critiques on the stewardship theory

The stewardship theory entails a physiological element on the part of the directors. The commitment and use of personal power as a basis of influence is subjective.³⁸ It is influenced by his/her cultural background.

Additionally, the *problem arises when there are conflicting forces between the psychological and the situational factors the director faces*. There may arise a mismatch between the management philosophy of the company which may be more inclined towards the agency theory and the psychological characteristics of the manager remains rather unexplored under current stewardship theory.

Third, the assumption made in becoming a steward has been an area of critique.³⁹ *The assumption is that becoming a steward or an agent is the result of a purely rational process.*⁴⁰ The questions that then arise are; How can an individual rationally decide whether his nature is that of a steward or an agent? and What role does motivation play in this picture?

2.1.3 The other major theories:

2.1.3.1 Stakeholder theory

This theory addresses the concept of the "principle of who or what really counts".⁴¹ Unlike the agency theory that doesn't include other stakeholders apart from the shareholder of the company, this theory incorporates the interests of other parties who have an equally important interest in the company.

This theory is seen in the section 143 duty under subsection 1(c) directors ought to ensure the need to foster the company's business relationships with suppliers, customers, creditors and

³⁸ Pastoriza D and Arino M, "When Agents Become Stewards: Introducing learning in the stewardship theory", 1st IESE Conference, Barcelona, 2008, 3,
<https://papers.ssrn.com/sol3/Papers.cfm?abstract_id=1295320>

³⁹ Refer to Appendix 3

⁴⁰ Pastoriza D and Arino M, "When Agents Become Stewards: Introducing learning in the stewardship theory", 1st IESE Conference, Barcelona, 2008, 4,
<https://papers.ssrn.com/sol3/Papers.cfm?abstract_id=1295320>

⁴¹ Freeman, Edward and McVea, 'A stakeholder approach to strategic management' 1.2 *Darden Business School Working Paper* (2001), 28

others.⁴² Additionally, in the same section the interest of the community and environment are to be factored in, which is further evidence of the stakeholder theory underlying statute.⁴³

According to this theory, benefit is maximized if the business is operated by management on behalf of all the stakeholders and the returns are in turn divided among the stakeholders in an acceptable manner to all.⁴⁴ This theory mainly features in the corporate governance structure adopted in the German and Japanese financial markets.

Critiques on the stakeholder theory

The main critique is on the manner of division of the returns. The theory stipulates that the division ought to be in a manner acceptable by all stakeholders within the realm of the company⁴⁵. However, a universal mechanism hasn't been developed or stipulated by this theory on how returns are to be divided in a way that is accepted by all stakeholders. This leaves many ways for ambiguity and accounting discrepancies.

2.1.3.2 Managerial hegemony:

In contrast to agency theory is what is sometimes called managerial hegemony theory.⁴⁶ This relates back to the thesis of Berle and Means (1932)⁴⁷ that although shareholders may legally own and control large corporations they no longer effectively control them. Control having been effectively ceded to a new professional managerial class.⁴⁸ In this theory the directors view themselves as an elite class, a club that is exclusive and lacks transparency. The criteria for appointment of directors into the elite class is based on taking into account how he or she

⁴² Section 143(1)(c), Companies Act (Act No.17 of 2015)

⁴³ Section 143(1)(c), Companies Act (Act No.17 of 2015)

⁴⁴ Professor Güler A and Professor Crowther D, *A Handbook of Corporate Governance and Social Responsibility* 1 Gower Publishing Ltd, 2012, 219

⁴⁵ Professor Güler A and Professor Crowther D, *A Handbook of Corporate Governance and Social Responsibility* 1 Gower Publishing Ltd, 2012, 219

⁴⁶ Hung H, 'A typology of the theories of the roles of governing boards' 6.2 *Corporate governance*, (1998), 101-111

⁴⁷ Berle, Adolf A and Gardiner C, Means. 'The modern corporation and private property' (1968):, 204

⁴⁸ Cornforth C, "Power relations between boards and senior managers in the governance of Public and non-profit organizations", 2nd International Conference on Corporate Governance and Direction, Henley Management College, UK, 13-15 October 1999, <<http://oro.open.ac.uk/15399/>>

may best fit into the elite and this factor often times overrides the knowledge, experience and skills that he may or may not have to offer the company.⁴⁹

This theory is closely associated with the political scene in Kenya. This theory is criticized for its lack of transparency and narrow view on the success of the company by directors. Examples are in Enron, Jeffrey Skilling,⁵⁰ his motivation was near sighted and in the end led to the crash of the century leading to the enactment of the Sarbanes-Oxley Act.⁵¹

2.1.3.3 Resource dependency⁵²:

The basic proposition of resource dependence theory is the need for environmental linkages between the firm and outside resources. In this perspective, directors serve to connect the firm with external factors by co-opting the resources needed to survive; therefore, boards of directors are an important mechanism for absorbing critical elements of environmental uncertainty into the firm.⁵³

Our current legislature uses a bit of all the above theories however the most dominant being the agency and stewardship theory.

2.2 THE LAW ON DIRECTORSHIP DUTIES AND CORPORATE GOVERNANCE.

Implementing mechanisms focus on directors to ensure that they perform their duties and obligations. This paper aims at assessing if the director can indeed dispense his statutory section 143⁵⁴ duty in a manner in tune with corporate governance principles.

THE COMPANIES ACT No. 17 of 2015

The extent to which directors are able to divide and delegate their responsibilities was seen as ambiguous hence the development of directorship duties.⁵⁵ These duties have recently been

⁴⁹ Hung H, 'A typology of the theories of the roles of governing boards' 6.2 *Corporate governance*, (1998),101-111

⁵⁰ Gibney Alex, *Enron: The Smartest Guys In The Room*,2005

⁵¹ Sarbanes-Oxley Act, *Washington DC* (2002)

⁵² Jensen and Meckling, Theory of the Firm: 'Managerial Behavior, Agency Costs and Ownership Structure', 4 *Journal of financial economics*, (1967),305-360

⁵³ Jensen and Meckling, Theory of the Firm: 'Managerial Behavior, Agency Costs and Ownership Structure', 4 *Journal of financial economics*, (1967),305-360

⁵⁴ Section 143(3), Companies Act (Act No.17 of 2015)

⁵⁵ Refer to Appendix 4, comprehensive list of director's duties

conceptualized within the 2015 Companies Act of Kenya, it replicated 2006 UK Companies Act.⁵⁶

Consequently, Section 143 of the Act as shown above expresses the directors' duty to promote the success of the company due to this pressing need for company survival and prosperity. The same section was acquired from the UK Companies Act section 172. A comparative is shown in Appendix 1 of how this section was taken verbatim despite the loopholes it has created at the point of implementation in the UK jurisdiction.

The law on directorship duties and its efficacy in the Kenyan context will be viewed through the Uchumi case study in Chapter 3.

CODE OF CORPORATE GOVERNANCE PRACTICES FOR ISSUERS OF SECURITIES TO THE PUBLIC 2015

Notably, the above Kenyan code, forms guidelines on how directors ought to behave. It suggests behavior that is in tune with corporate governance principles and in ensuring its mandate is met it has moved away from the “comply or explain” approach to “apply or explain”. This new approach is principle-based rather than rule-based, and recognizes that a satisfactory explanation for any non-compliance will be acceptable in certain circumstances.

Effective corporate governance requires a board composed of qualified and competent members capable of exercising objective and independent judgment, and focused on guiding strategy development and monitoring management. A proper understanding of the role and responsibilities of the board must be shared not only by members of the Board, but also by company executives and external stakeholders, to ensure that the Board has appropriate autonomy, authority, and accountability in exercising its functions and that it can be held accountable by stakeholders.⁵⁷

The directors of each company shall be responsible of formulating policies and guidelines in a manner in which all their management decisions are made in accordance with prudent corporate governance practices. This responsibility as set out in the code is a statutory

⁵⁶ Section 170 (4), UK Companies Act c 46 (2006), refer to appendix 1

⁵⁷ Part II, Chapter 2, Code of Corporate Governance Practices for Issuers of Securities to the Public (2015)

obligation placed on directors that mirrors how they ought to act when making decisions that ultimately are aimed at the success of the company as a whole.⁵⁸

Additionally, the code gives guidelines on the need for transparency when the company undertakes procedures of appointment, composition, size and qualifications of board members. In light of the strive for sound corporate governance in line with the set directors' duties appointment, composition, size and qualifications of directors on the board are key areas of focus.

The entire code has not been made mandatory only a few provisions are mandatory if seen to replicate the Capital Markets Regulations, 2002⁵⁹ that aim to safeguard the interests of stakeholders. These guidelines will be used in assessing the Uchumi scandal which will be discussed in further detail in Chapter 3.

2.3 THE BODY POLITIC INSTITUTION AND ITS INFLUENCE ON CORPORATE GOVERNANCE

The practice of corporate governance doesn't occur in a vacuum, alongside the law and regulatory bodies lies the body politic. Body politic means is a body of a political nature that comprises of a single group of people at the top of government and the head of state.⁶⁰ This body according to prescription of the term acts as an institution within itself. In Kenya politics plays a major role in the corporate sector. In some instances, this body may be seen to exceed its mandate and interfere instead of intervene within the self-regulatory free market.⁶¹

One of the principal instruments by which a government is held accountable is through a free and fair democratic election process⁶². This process then allows for separation of powers between arms of government and oversight by independent regulatory bodies to ensure transparency and efficiency. For corporate governance to thrive within the market, it is essential for a country to have a stable political institution and government.

⁵⁸ Part I, Section 1.1.6, Code of Corporate Governance Practices for Issuers of Securities to the Public (2015)

⁵⁹ Capital Markets (Securities)(Public Offers, Listing and Disclosures)Regulations (2002)

⁶⁰ Harvey AD , *Body politic: political metaphor and political violence*,Cambridge Scholars Publishing, 2007,54

⁶¹ Araniya, Isukul, Chizea, 'Environmental Factors Influencing Corporate Governance The Nigerian Reality' Creative Commons SAGE and Open Access,

<<http://www.uk.sagepub.com/aboutus/openaccess.htm>>, SSRN 2615564,2015, 4

⁶² Keohane, 'Accountability and abuses of power in world politics' 99.1 *American Political Science Review*, (2005),78

In relation to this study, the government makes the laws, rules, and regulations that shape, influence, and affect corporate governance practices. At the same time, it is also involved in monitoring compliance to the laws and regulations.⁶³

CORRUPTION AND GOVERNANCE OF A NATION

Corruption can be regarded as an unsustainable practice that increases running costs of government and business enterprise, it endangers and threatens fair competition and can cause large distortions to economic growth.⁶⁴Corruption can be classified into three distinctive categories:

Political corruption when politicians take bribes using their positions of power, *bureaucratic corruption* occurs when officials take bribes, and *grand corruption* meaning misuse of public power by heads of states, ministers, and top officials for private, pecuniary profit.⁶⁵

Alford Roger posited that *corruption is a broken window that signals the breakdown of community controls necessary for the maintenance of social order*⁶⁶. A government that abuses its power for private gain is a government that cannot be trusted to pursue the general welfare of its citizens.

Empirical evidence confirms that corruption negatively alters the public's perception of government and society.⁶⁷ It hampers sustainable development, which greatly impacts the nature of business operations and the level of business efficiency in a nation.⁶⁸

There is a strong relationship between corporate governance and corruption, countries with deficient corporate governance practices and low levels of compliance to these standards by

⁶³ Caddy J, 'Why citizens are central to good governance.' *Organisation for Economic Cooperation and Development. The OECD Observer*, (2001),59

⁶⁴ Araniya, Isukul, Chizea, 'Environmental Factors Influencing Corporate Governance The Nigerian Reality' Creative Commons SAGE and Open Access,2015

⁶⁵ Lund C, 'Local Politics and the Dynamics of Property in Africa' *Cambridge university Press*,(2008),10

⁶⁶ Alford,'A broken windows theory of international corruption' 73.5 *Ohio state law journal*,(2012), 1253.

⁶⁷ Alford and Roger P, 'A Broken Windows Theory of International Corruption' 572 *Ohio State Law Journal*, (2012),78, <http://scholarship.law.nd.edu/law_faculty_scholarship/572>

⁶⁸ Wu X, 'Corporate Governance and Corruption: A cross country analysis', *Governance International Journal of Policy, administration and institutions*, (2005)

firms breed corruption leading to a wide range of transparency dilemmas as witnessed in the Uchumi scandal.

In a developing country such as Kenya, corruption is considered a serious issue affecting corporate governance practices.⁶⁹ Unethical practices such as bribery and corruption have become the norm, weakening corporate governance structures in Kenya⁷⁰, this consequently creates an uncondusive environment where business fails to thrive. Furthermore, it encourages gross violation of the rule of law, business norms, through corporate and political impunity.⁷¹

⁶⁹ Adegbite, E, ' A scrutiny of corporate governance: Abridged paper', 2.1 *Journal of the Society for Corporate Governance in Nigeria*, (2010) 242-265.

⁷⁰ Ahunwan, B, 'Corporate Governance in Nigeria' 37.3 *Journal of Business Ethics*, (2002),269.

⁷¹ Araniya, Isukul, Chizea, 'Environmental Factors Influencing Corporate Governance The Nigerian Reality' Creative Commons SAGE and Open Access,2015,5

CHAPTER 3

THE RISE AND FALL OF UCHUMI SUPERMARKETS.

BRIEF INTRODUCTION

The focus of this chapter will involve an in depth analysis into the corporate scandal of Uchumi Ltd. This scandal presents a unique set of facts that would provide a practical interplay between the aforementioned theories of corporate governance, politics and directors duties when breached. Additionally, the scandal provides an opportunity to examine the implementing mechanism of the CMA in the event a director breaches his obligations to his shareholders.

THE HISTORY OF UCHUMI SUPERMARKET LTD.

Uchumi Supermarkets is a supermarket chain based in Kenya. The retail supermarkets have been in operation since 1976. It was founded by Uchumi Shareholders-Industrial Commercial & Development Corporation (ICDC), Kenya Wine Agencies Limited (KWAL) and Kenya National Trading Corporation (KNTC). These organizations were parastatals, they formed a contract with Uchumi supermarkets limited and henceforth became privy to a management contract with the Italian company; Standa SPA.

In the 2000's, Uchumi begun experiencing financial and operational hurdles. The rate of expansion became unmanageable. This was mainly attributed to the poor level of strategic planning and the weak internal control systems.⁷²

In 2005, Uchumi closed 10 of its perennially loss making branches. It was in the same year that the company managed to raise Kshs 1.2 billion in a successful rights issue, but majority shareholders reduced most of their shareholding from 52% to less than 20%.⁷³ In 2006, Uchumi was at a negative bottom line and by the end of 2008, Uchumi returned a profit of

⁷² NIC Securities, 'Uchumi Supermarkets Investor Note', 30th May 2011, http://younginvestors.co.ug/docs/report-uchumi_investor_note.pdf, accessed on 1st January 2017.

⁷³ Uchumi Supermarkets Limited, 'The History of Uchumi Supermarkets', <http://kenya.uchumicorporate.co.ke/about-us/history>, retrieved 13th August 2016.

Kshs 106 million against a loss of Kshs 257 million.⁷⁴ It was with the help of its lending bankers that the receivership was lifted and it resulted in having Uchumi Supermarkets Limited relisted on the Nairobi Securities Exchange on 31st May 2011.⁷⁵

UCHUMI AFTER 2011

After the 2011 re-listing, Uchumi tried staying afloat without sufficient resources.⁷⁶ In 2014, they did not pay dividends to their shareholders. From 2014, henceforth they operated under negative values as they tried to keep their capital afloat. It is from this year henceforth, when the case study proves to be most influential. The senior management and directors of the company, displayed impunity, disregard for their investors, shareholders and stakeholders' interests. They breached their fiduciary and common law duties towards the company. A comprehensive breakdown of the case follows at this juncture.

ANALYSIS OF THE UCHUMI CASE

FACTS AND ISSUES

Conflict of Interest

The senior management became the lead suppliers. This led to exaggeration of the cost of supplies as the drive for self-interest took over. The directors pushed their own interests above those of the company advocating for a higher buying price than selling price. Chief Executive Officer Jonathan Ciano and his chief financial officer Chadwick Okumu⁷⁷ as well as five past directors and board members were involved in the retailer's financial mismanagement. A forensic audit conducted by audit firm KPMG revealed that Mr. Ciano's wife was a supplier of fresh produce raising the conflict of interest.

Fraudulent Books of Accounts

The audit also revealed that the company misled the CMA and several of its stakeholders and investors as to the state of their financial accounts. The figures presented to the public were

⁷⁴ "Uchumi Supermarkets Investors Note", NIC securities, May 2011.

⁷⁵ "The History of Uchumi Supermarkets", <http://kenya.uchumicorporate.co.ke/about-us/history>, retrieved 13th August 2016.

⁷⁶ The numerical representation of the financial health of the firm is provided for in Appendix 6.

⁷⁷ Bernard Mwinzi, Daily Nation, 'Audit puts Ciano on the spot over Uchumi troubles', March 2016

not a fair and true representation of the company's status during the rights issue they conducted in 2014. The figures presented to the Nairobi Securities exchange and shareholders was Kshs. 262 million in loss but the true figure was established to be 1.9 billion⁷⁸. Uchumi booked in a Kshs. 3.2 billion loss in the financial year ending June 2016⁷⁹ after the company wrote off the Kshs. 1.04 billion debt that had been accumulated due to manipulation of the books. The company used a revaluation of its properties so as to conceal the losses they made in 2014.⁸⁰

Fraudulent Prospectus

The directors also failed their duties to their shareholders when they issued a fraudulent prospectus. The company included assets that they had already sold off to Rent Co. It is stated in the KPMG report as follows:

“From our view, members of the Board were aware of the transaction and the reporting accountants Ernst & Young had captured this transaction in their management letter for the audit of the year ended June 30, 2014 and dated September 18, 2014, and were therefore aware of this deal and its implications,”⁸¹

Non-conformity with prescribed rules of procedure and operations

The KPMG audit report indicated the high level of non-conformity to background and quality checks required by law for all players in the industry so as to ensure consumer protection.⁸² This led to the high level of acceptance of dubious agreements, suppliers with a

⁷⁸ KPMG Audit on Uchumi, Bernard Mwinzi, Daily Nation, ‘Audit puts Ciano on the spot over Uchumi troubles’, March 2016

⁷⁹ Otiato Guguyu, Ipsos.co.ke, 'Ex-Uchumi CEO Ciano to record police statement' Ipsos Kenya, 16th September 2016 <http://www.ipsos.co.ke/NEWBASE_EXPORTS/Unilever/160916_Business%20Daily_1,4_bd1d3.pdf> accessed 4 January 2017

⁸⁰ Otiato Guguyu, Ipsos.co.ke, 'Ex-Uchumi CEO Ciano to record police statement' Ipsos Kenya, 16th September 2016 <http://www.ipsos.co.ke/NEWBASE_EXPORTS/Unilever/160916_Business%20Daily_1,4_bd1d3.pdf> accessed 4 January 2017

⁸¹ Mwinzi B, ‘Audit puts Ciano on the spot over Uchumi troubles’, Daily Nation, March 2016, <<http://www.nation.co.ke/news/Probe-exposes-how-Uchumi-was-looted/1056-3120330-5kicq1/index.html>>, accessed 4 January 2017

⁸² Article 46, *Constitution of Kenya* (2010)

conflict of interest and substandard products. Additionally, over 45%⁸³ of the procurement staff did not meet the threshold set in the Human resource guidelines. Uchumi, therefore dealt with suppliers who had a conflict with the company and even made agreements that lacked good faith.

The board lacked oversight seeing as they didn't appear for most meetings, failed to approve multiple transactions leaving Mr. Ciano with authority that went over his capacity as CEO.⁸⁴

⁸³ Otiato G, *'Ex-Uchumi CEO Ciano to record police statement'* Ipsos Kenya, 16th September 2016, <http://www.ipsos.co.ke/NEWBASE_EXPORTS/Unilever/160916_Business%20Daily_1,4_bd1d3.pdf> accessed 4 January 2017

⁸⁴ Otiato G, *'Ex-Uchumi CEO Ciano to record police statement'* Ipsos Kenya, 16th September 2016, <http://www.ipsos.co.ke/NEWBASE_EXPORTS/Unilever/160916_Business%20Daily_1,4_bd1d3.pdf> accessed 4 January 2017

LAW

Conflict of Interest

As prescribed by the Companies Act 2015, the general duties of directors are based on common law rules and equitable principles.⁸⁵The directors duty to avoid a conflict of interest is clearly outlined in statute under Section 146 of the Companies Act 2015.⁸⁶The directors ought to ensure that they avoid a situation in which they have a direct or indirect conflict with the interest of the company.

Additionally, the exploitation of any property, information or opportunity. This duty can be infringed by the directors of public companies only in the event that the company's constitution includes a provision enabling the directors to give such an authorization and the directors comply with the requirements of the provision. A director who doesn't disclose a conflict of interest that he may have he is liable to a fine not exceeding one million shillings.⁸⁷

Fraudulent Books of Accounts and Prospectus.

Fraud is defined as willful misrepresentation of the truth with intent to deceive by one party resulting in actual or potential loss to another party or illegitimate gain to the fraudster. This includes fraudulent sale of client shares, Insider trading, market manipulation, stealing of client funds, and manipulation of client records among other offences.⁸⁸

The CMA has the mandate of ensuring investor protection. Under Section 11 of the Act⁸⁹, the authority is mandated with the duty to ensure that the markets are free from impediments so as to boost investor confidence. This is done by ensuring that the participants of the market are authenticated by meeting the set checks and balances as well as the regulatory framework.

The CMA formed a body known as the Capital Market Fraud and Investigations Unit (CMFIU). The body was formed in May 2009 through collaboration by the Kenya Police and

⁸⁵ Section 140(3), Companies Act (Act No.17 of 2015)

⁸⁶ Section 146, Companies Act (Act No.17 of 2015)

⁸⁷ Section 151(10), Companies Act (Act No.17 of 2015)

⁸⁸ Capital Markets Authority, '*CMFIA Background*'

Cma.or.ke,2013, http://www.cma.or.ke/index.php?option=com_content&view=article&id=122&Itemid=536, accessed 4 January 2017

⁸⁹ Section 11(d), Capital Markets Act (Act No. 48 of 2013)

Capital Markets Authority (CMA) with a view of consolidating the investigations of all securities related fraud cases.⁹⁰Its core function is detection, prevention and apprehension of offenders perpetrating fraud within the Securities Market. The standard of proof for sustaining successful prosecution of persons suspected of criminal offences is generally submission of proof beyond reasonable doubt by the prosecution. Penalties range from fines of up to Ksh15,000,000.00 or a jail term of up to 7 years.⁹¹

Non-conformity with prescribed rules of procedure and operations.

This could have been avoided if general rules of governance were adhered to such as transparency, accountability and oversight⁹² due to clear separation of powers among those in the board. The board lacked transparency which is prescribed under Chapter 7 of the Code of Corporate Governance. Indeed, transparency and disclosure are crucial for the market-based monitoring of companies and are central to a shareholder's ability to exercise his or her ownership rights.⁹³

⁹⁰Capital Markets Authority ,'*CMFIA Background*' Cma.or.ke, 2013, http://www.cma.or.ke/index.php?option=com_content&view=article&id=122&Itemid=536,accessed 4 January 2017

⁹¹Capital Markets Authority ,'*CMFIA Background*' Cma.or.ke, 2013, http://www.cma.or.ke/index.php?option=com_content&view=article&id=122&Itemid=536,accessed 4 January 2017

⁹²Capital Markets Authority ,'*CMFIA Background*' Cma.or.ke, 2013, http://www.cma.or.ke/index.php?option=com_content&view=article&id=122&Itemid=536,accessed 4 January 2017

⁹³ Section 7.0, Code of Corporate Governance Practices for Issuers of Securities to the Public (2015)

APPLICATION OF THE LAW

As regards the conflict of interest, the law is clear on the need for directors to avoid a conflict of interest whether direct or indirect, failure to do so attracts a fine of not less than Kshs. One million. The directors must act in good faith and thus promotes the success of the company and is for the benefit of the members as a whole.⁹⁴

They did not abide by the agency or stakeholder theory that acts as a backbone on how the directors ought to conduct themselves when attending to the affairs of the business and they didn't exercise independent judgement nor devote sufficient time to carry out their responsibilities and enhance their skills.⁹⁵

The CMA as the regulator indeed has the mandate to protect all users of the market and boost investor confidence in the market. A failure on their part to detect the fraudulent activity of Uchumi shows the level of inefficiency the authority has. There exists the CMFIU which before accepting the offer of the Uchumi rights issue in 2014 would have been used to establish the true and fair position of Uchumi. The law is clear on the fine amount or jail time of 7 years when fraud is confirmed.

DECISION MADE BY THE CMA

The CMA, after conducting investigations too action against the flowing perpetrators and imposed the following sanctions:

Against Mr. Jonathan Ciano, the regulator imposed a Sh5 million fine and is currently still seeking to recover Sh13.5 million from him as profit from illegally supplying Uchumi with goods. Additionally, he was banned from serving in any capacity for a listed firm for a time cap of 5 years.⁹⁶He was however cleared over the invoiced payments transacted by his wife when supplying the company. According to CMA, they found that he had not in fact disclosed the fact that had a conflict of interest to the other directors and was therefore culpable of misleading the board and shareholders of Uchumi's true financial position that eventually led

⁹⁴ Section 143, Companies Act (Act No.17 of 2015)

⁹⁵ Section 2.3.2, Code of Corporate Governance Practices for Issuers of Securities to the Public,2015

⁹⁶ Citizen Team, '*CMA goes after ex CEO for role in Uchumi mess*', Citizen Digital, 18th November 2016, <https://citizentv.co.ke/business/cma-goes-after-ex-ceo-ciano-for-role-in-uchumi-mess-149303/>Citizen Team, accessed on 27th November 2016

to its collapse. The Authority additionally lodged a complaint against him for the start of a disciplinary hearing by the Institute of Certified Public Accountants of Kenya (ICPAK).

The CMA also fined former Chief Financial Officer Chadwick Okumu, board directors James Murigu, Bartholomew Ragalo as well as chairperson Khadija Mire. Mr. Okumu was disqualified from holding office as a CFO, director or key officer of a public listed company and/or issuer, licensee or any approved institution of the Authority for a period of two years. He too, got a complaint lodged against him for the start of a disciplinary hearing by the Institute of Certified Public Accountants of Kenya (ICPAK).

Ms. Mire, was disqualified from holding any position in a public company, and the CMA sought to recover about Sh1.77 million⁹⁷ which was paid as board allowances between 2014 and 2015. Additionally, the CMA directed her to attend Corporate Governance Training to be eligible for appointment as a director in a listed company in future.

Moreover, the CMA held the entire board accountable for lacking oversight into the affairs of the business as is their prescribed mandate. In relation to the fraudulent rights issue that caused a tainted image of the finances of the company to potential investors Faida Investment Bank, which was the lead transaction advisor for Uchumi's rights issue, was suspended from offering transaction advisory services for a period of six months.

⁹⁷ Otiato G, '*Ex-Uchumi CEO Ciano to record police statement*', Ipsos Kenya, 16th September 2016, <http://www.ipsos.co.ke/NEWBASE_EXPORTS/Unilever/160916_Business%20Daily_1,4_bd1d3.pdf> ,accessed 4 January 2017

ANALYSIS AND DISCUSSION OF RESEARCH QUESTIONS AS PER UCHUMI CASE STUDY.

What is the availability and adequacy of the legislative and implementation framework on corporate governance in Kenya?

Corporate governance guidelines and recommendations are all outlined in the Capital Markets Act and the Code of Corporate Governance as all clearly outlined above, the issue that points to the focal point of this research is how is the statute then implemented?

In the case of Dav Ciano, the sanctions given included a fine that totaled up to Kshs.18.5million. This was based on an order to repay the amount illegally provided for in supplies and acquiring the profits illegally. Implementation is about transparency, predictability that upon breaching the law the consequences are certain since they are clearly prescribed in the law.

Fraudulent behavior according to the CMFIA warrants penalties that range from fines of up to Ksh15,000,000.00 or a jail term of up to 7 years.⁹⁸

The CMA prescribes⁹⁹ that the it may in liaison with the Nairobi Stock exchange, remand, fine, suspend, expel or discipline the subject person.

Additionally The Authority establishes under section 35A of the Act, the Capital Markets Tribunal.¹⁰⁰ Any dispute or difference which may arise between the holders, fund manager, trustee or the board of directors as the case may be, is handled by this tribunal. According to the Act, The Tribunal shall have power to award the costs of any proceedings before it and to direct that costs shall be paid in accordance with any scale prescribed for suits in the High Court or to award a specific sum as costs¹⁰¹. Additionally, the Tribunal shall regulate its own procedure.¹⁰² Despite the wide discretion the Tribunal is statutorily provided, it has failed in its mission of ensuring that white collar crime is efficiently prosecuted.

⁹⁸ Capital Markets Authority, '*CMFIA Background*' Cma.or.ke, 2013, http://www.cma.or.ke/index.php?option=com_content&view=article&id=122&Itemid=536

⁹⁹ Section 22, Capital Markets Act (Act No. 48 of 2013)

¹⁰⁰ Section 35(A), Capital Markets Act (Act No. 48 of 2013)

¹⁰¹ Section 35A(19), Capital Markets Act (Act No. 48 of 2013)

¹⁰² Section 35A(13), Capital Markets Act (Act No. 48 of 2013)

The only known case that showed the potential to act as a deterrent was that of Rebecca Mwikali Nabutola v Republic¹⁰³ This criminal case was held in the High Court where it was brought for further appeal.

Rebecca, to defraud contrary to Section 317 of the Penal Code among others.¹⁰⁴The Ethics and Anti-Corruption judge argued out that for corporate crime the only punishment that can effectively act as a deterrent is that of jail without an option of bail. This decision by Judge L. Nyambura was stern and up unit the appeal Ms. Rebecca Nabutula served a jail term of about 4 years.

This case shows that the judiciary has the capacity to implement the law in the fight against corruption, however this has been a win among many loses.

The CMA Tribunal has so far shown no progress in the fight against white collar crime and the compliance towards the upholding of codes of sound corporate governance. The Uchumi scandal was a clear indication of the inefficiencies in the way the Authority conducts its operations.

Analysis of the section 143 duty ‘The duty of a director to act in good faith in a way that will most likely promote the success of the company for the benefit of its members as a whole.’¹⁰⁵

The section 143, duty is one that if poorly monitored can indeed promote the non- conviction of directors who are culpable for white collar crimes. The duty is one recently passed in statute and was not in place at the time of the Uchumi Scandal. However, if enforced it is a loophole that may be used by the fraudulent Directors such as Ciano, to evade all culpability.

According to the history of Uchumi as provided, before Jonathan Ciano the company was financially unhealthy, they recorded great losses. Jonathan Ciano, upon taking over salvaged the company making it seem as though his level and capacity of governance was indeed promoting the success of the company as he acted in good faith to benefit the members of Uchumi as a whole.

‘*Success*’ is an ambiguous term, it may be taken to be subjective. In the UK this section is the most controversial due to its ambiguity. It has in the UK’s jurisdiction provided directors with

¹⁰³ *Rebecca Mwikali Nabutola v Republic* [2012] eKLR.

¹⁰⁴ *Rebecca Mwikali Nabutola v Republic* [2012] eKLR

¹⁰⁵ Section 143, Companies Act (Act No.17 of 2015)

a ‘get out of jail free card’¹⁰⁶ when their actions are challenged in court. The UK’s jurisdiction is one that we mirror due to their judicial progression and stability. Mirroring an already faulty law in the UK may cause even greater damage to a nation tainted with impunity and high levels of corruption.

Indeed, this success though seen as ambiguous by numerous authors, the major proponent being Andrew Keay, has been limited by the Act.

Decisions directors adopt must comply with the statutory provisions outlined in the Act. Such provisions entail the need to factor in long term consequences, employee interests, act fairly with shareholders and other members of the company and the secondary environment.¹⁰⁷ The section 143 duty¹⁰⁸ sets a further limitation on the nature of decisions that a director as agent, may take when faced with adopting transactions whose purposes isn’t directly aimed at the benefit of the shareholders. In the event that this happens, subsection (1) acts as the overriding section.¹⁰⁹ Subject to the Act, the section imposes a duty on directors in certain circumstances to consider or act in the interest of the creditors, such as in the event the company is being liquidated¹¹⁰.

CONCLUSION

The CMA as regulator needs to ensure that there is proper regulation of the market by ensuring that all market participants comply with the Capital Markets Act as well as the Code of Corporate Governance. In order to effectively prosecute perpetrators of white collar crime, the functions, authority and competence of the CMA along with the Tribunal need revisal. Their prosecutorial and investigative powers require skilled personnel to effectuate and thus mitigate corporate fraud.

¹⁰⁶ Keay A, ‘The duty to promote the success of the company: is it fit for purpose?’ *University of Leeds School of Law, Centre for Business Law and Practice Working Paper* (2010),35

¹⁰⁷ Section 143(1)(a)-(f), Companies Act (Act No.17 of 2015)

¹⁰⁸ Section 143(2), Companies Act (Act No.17 of 2015)

¹⁰⁹ Section 143(3), Companies Act (Act No.17 of 2015)

¹¹⁰ Section 204, Kenya Insolvency Act (Act No. 18 of 2015)

CHAPTER 4: FINDINGS

INTRODUCTION

The purpose of this chapter is the presentation of the data collected from the archived information, interviews and questionnaires given to the sample selected. The chapter will be organized into three parts: Presentation of the data; Explanation of the information acquired; and finally a summary of the major findings. The chapter provides the findings in relation to the study centered around implementation of corporate governance guidelines in Kenya. A set of questions were prepared for a number of people within the market who represent the regulator, the investors, or are in a position of leadership or directorship. The data collected was through interviews, questionnaires and literature review.

Presentation of data

Research Methodology

The methods of research adopted the use of archived information, interviews and questionnaires by specific groups. The underlying corporate governance theories were utilized in the study.

Sample selection

The choice of groups will be chosen according to those affected by the adherence or evasion of the principles of good governance by the managerial sect.

The sample selection will include Professor Gituro Wainaina, a former director in the CMA and currently a Director of the Social and political pillar under the Vision 2030 Delivery, second is Mr Kabage Karanja , the Group Chairman of Pacific Insurance Brokers (EA) Ltd and several other boards in the public and private sector, the third is Mr. Francis Kang'ata Kiragu, previously the Marketing and Corporate Sales Manager in Uchumi Ltd, and finally, a former head legal officer of Uchumi Supermarkets Limited.

Assignment

The people in the above sample selection were chosen on the basis of the years held within the corporate field, the amount of exposure the participants have had in relation to gross

misconduct of those in governance positions and their years of practice in law or policy making.

FINDINGS ON CORPORATE GOVERNANCE MODEL UTILIZED IN KENYA

The self-regulatory model that our markets utilize is not the most effective way of regulating the markets, indeed for such a model to work a culture of honesty ought to be engrained. *“Our nation is engrained with impunity and the only way companies can indeed comply with the set principle of corporate governance is to make it compulsory. We cannot benchmark our level of compliance with an honest economy such as the UK, and as far as adopt their model of corporate governance it cannot work in our economy.”*¹¹¹The interviewees as well as archived information presented two models of corporate governance. The Anglo-Saxon model and the German model of corporate governance.

ANGLO-SAXON MODEL

This model is characterized by the dominance in the company of independent persons and individual shareholders. The manager is responsible to the Board of Directors and shareholders, the latter being especially interested in profitable activities and received dividends.¹¹²

The Code is complied with on a voluntary basis, however the important standards for listed companies are set by the UK Corporate Governance Code, which is issued as an appendix to the Listing Rules.¹¹³ This is a development made from the previous “tick box system” of the Cadbury Code 1992.¹¹⁴ The Code successfully works within the United Kingdom capital markets due to their pro- capitalistic drive for self-regulation of the market, a proposition posited by Adam Smith centuries ago where there is minimal interference by the state.

¹¹¹ Interview with Professor Wainaina Gituro, board member of the CMA ,held on 20TH December 2017.

¹¹² Ungureanu M, 'Models and practices of corporate governance worldwide' *CES Working Papers*, (2012), 625-635

¹¹³ Alastair A, *The Financial Services and Markets Act 2000: A Guide to the New Law* , Jordan Publishing, 2000, para. 12.1.

¹¹⁴ Prof. Klaus J and Leyens P, 'Board Models in Europe -- Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France, and Italy', 1.2 *European Company and Financial Law Review*, (2004),135-168

Rationale behind the self-regulatory/voluntary principle in the Anglo-Saxon Model.

The voluntary principle has generally worked in the United Kingdom because it was based on a consensus agreed between corporations and the Authority, it is due to this mutually agreed upon consensus that firms are compelled to observe the code of corporate governance. One may attribute this to their principled culture and level of development as a nation. The rationale behind this model is because of a number of reasons: its flexibility, if mandatory companies would have minimal effects on the operations of the company,¹¹⁵ expert personnel customized to understand the market and the best way to approach efficient regulation¹¹⁶ and the agencies are smaller and more cohesive thus work in an efficient manner that minimizes information asymmetry and reduces the costs incurred in mandatory.¹¹⁷

Despite the above advantages for this model it has its shortfalls. The main weakness lies in implementation of the Code by the agencies on all the market participants to ensure the standards are kept competitive, the investors are protected and the Board of Directors protects the Shareholders and the Stakeholders and secondly, their leniency on director's who have breached their statutory duties as opposed to professionals.¹¹⁸

The Anglo-Saxon Self-Regulation Model in Kenya and its effectiveness.

Kenya being a past English protectorate implemented most of the nation's governance policies. Due to its success it was adopted in Kenya in 1999.¹¹⁹

In Kenya, the corporate governance code is formed from the private sector. It is then supervised by the Nairobi Securities Exchange and the Capital Markets Authority. The rules state that a company must issue a statement of compliance together with their annual report.¹²⁰ The effectiveness of the United Kingdom's corporate Governance model was hinged

¹¹⁵ Cheffins B, *Company Law: The Theory, Structure and Operation* Oxford Clarendon Press, 1997

¹¹⁶ Ogus A, 'Rethinking Self-Regulation', 15.1 *Oxford Journal of Legal Studies*, (1995),97-108

¹¹⁷ Ntongho R, 'Self-regulation of corporate governance in Africa: following the bandwagon?', *International Company and Commercial Law Review, Westlaw.UK, Sweet&Maxwell and its contributors*,(2009),6

¹¹⁸ Miles M and Jeffrey G, 'Exploring the practice of corporate venturing: Some common forms and their organizational implications' in Lunderstorm A and Stevenson L, *Entrepreneurship: Theory and Practice*,2006,21-41.

¹¹⁹ Ntongho Rachael, 'Self-regulation of corporate governance in Africa: following the bandwagon?', *International Company and Commercial Law Review, Westlaw.UK, Sweet&Maxwell and its contributors*,2009

¹²⁰ Financial Standard Foundation, Standard Report, 'Standard: Principles of Corporate Governance', at <http://www.estandardsforum.com>, accessed 6th January 2017

on the following reasons prior to their adoption by the CMA for the Kenyan Capital Markets.¹²¹

The first, was that the model avoided the resort to courts in the event that a market participant is non-compliant to the Code. The code is not mandatory and as such doesn't legally bind the company. The CMA would use a specially created tribunal, that would oversee the resolution of disputes within the Capital Markets and would therefore be the effective vehicle of dispute resolution.

Secondly, the model was seen as flexible in that in comparison to the German's use of statutory regulation, 'command and control'. This level of flexibility allows for ease in amending the Code when the market develops in an aspect that was unforeseeable at the drafting period, it additionally adapts to various cultures and institutional frameworks within the market.¹²²

Moreover, the Kenyan market is largely composed of small and medium sized companies(SME's). They are seen to be the most prolific sources of employment in Kenya.¹²³ With majority of the market falling under SME's policy provisions adopted by the CMA for market participants would need to be favorable to the SME sector so as to boost their operations and consequently boost the country's economy.¹²⁴

The introduction of the comply and control principle as depicted in the German model would be viewed to discourage many SME's from venturing into market and being listed in the Nairobi Securities Exchange due to the high levels of disclosure and scrutiny by the Capital Markets Authority.

Third, the model would be less costly at compliance and procedural level. The resultant effect would be an easier and shorter time frame taken to implement the code due to the consensus to only involve industry participants and the regulator. Given the high levels of corruption in

¹²¹ Ntongho R, 'Self-regulation of corporate governance in Africa: following the bandwagon?', *International Company and Commercial Law Review*, Westlaw.UK, Sweet&Maxwell and its contributors,(2009)

¹²² Sheikh S and Rees W, *Corporate Governance and Corporate Control* Cavendish Publishing, 1995, 89

¹²³ Mwiraria David, 'Kenya National Budget Speech', 2003

¹²⁴ Wanjohi Anthony, 'SME Sector in Kenya', Kenpro Papers Portal,2012, <http://www.kenpro.org/sme-sector-in-kenya/>, accessed on 7th January 2017.

Kenya, the fact that there would be lower government involvement translates to this model eventually lowering the level of corruption.¹²⁵

Despite these advantages and benefits seen to accrue from adopting the Anglo- Saxon model the level of compliance shown by market participants within the Kenyan market has been low. Through a report done by the Financial Standard Foundation, the level of compliance to principles of corporate governance was seen to be below the average standard of OECD principles. Standard compliance with the code was rated ‘*very low*’ in Kenya and Tanzania by the Financial Standard Report of 2008.¹²⁶

In 2015, the Economic Freedom Index of Kenya¹²⁷ indicated that the economic freedom to do business in Kenya was unfree due to an unfavorable assessment of compliance with corporate governance codes, the rule of law, corruption and a poor judiciary.

In the 2016 Doing Business survey, Kenya was ranked 115th among 189 countries and 17th among the 47 Sub- Saharan Africa countries for protection of minority investors in governance.¹²⁸ When drafting the new compliance approach in the 2015, Corporate Governance Code, the voluntary principle was still present showing that yet again we are relying heavily on the Anglo-Saxon model.¹²⁹ The reasons why the code isn’t working in Kenya were found to be as follows:

Weak monitoring and supervision.

In Kenya, efforts have been taken to ensure that the code is implemented in companies. An example is the Private Sector Corporate Governance Trust (PSCGT). This Trust trains shareholders on their role and significance in the corporate governance web within the market.

¹²⁵ Armstrong P., ‘*Status Report of Corporate Governance Reform in Africa*’, paper presented at the Pan African Consultation Forum on Corporate Governance, Nairobi, Kenya, 2003.

¹²⁶ Financial Standard Foundation Report, 2008

¹²⁷ The Heritage Foundation, ‘*Index of Economic Freedom, Kenya*’, 2015
<http://www.heritage.org/index/pdf/2015/countries/kenya.pdf>, accessed on 7th January 2017.

¹²⁸ World Bank, Doing Business Survey Project, 2016,
<http://www.doingbusiness.org/data/exploreeconomies/kenya>, accessed 7th January 2017

¹²⁹ Capital Markets Corporate Governance Steering Committee, ‘A corporate governance blueprint for Kenya’, 2014

“The trend is that individuals go through corporate governance training as a form of ticking the box and then thereafter acting in a manner contrary to the entire objective of the training. It is critical that the appointing authority regulates the entry point carefully. There ought to be a requisite disposition set so as to have a quality board of directors who are qualified for the position. Once you sort out your entry gate the success of the company in line with corporate governance principles will be effectuated.”¹³⁰

Weak Stakeholders and shareholders

The poorly informed shareholders and stakeholders lack the capacity to hold the directors accountable when they breach their common law and statutory duties. This is due to the fact that they lack the pre-requisite investor knowledge on the affairs of the market or their rights as stakeholders and shareholders of the company.

Consequently, the shareholders do not apply sufficient pressure on directors to perform their duties.¹³¹ In the UK and USA, the main reason for compliance is due to the fact that consumers, employees and investors are able and capable of applying pressure on director to ensure that the Code of corporate governance is complied with.¹³²

The application of such pressure is done through screening of potential companies by investors and advocacy which is the use of the shareholders’ vote within the corporate meeting to compel the firm to comply with the code.¹³³ Both are not practiced heavily in Kenya.

The high level of unemployment in Kenya.

In Kenya unemployment is a national issue that has been present for a long time. In comparison with developed countries this is not the case. The Kenyan market pushes for self-regulatory mechanisms so as to ensure that the market is easily accessible to employees. *“It*

¹³⁰ Interview with Mr. Kabage Karanja, Group Chairman of Pacific Insurance Brokers (EA) Ltd, held on 9th January 2017

¹³¹ Gordon K, ‘Rules for the Global Economy: Synergies between Voluntary and Binding approaches’, *Working Papers on International Investment*, (1999)

¹³² Graham and Woods, *Making Corporate Self-Regulation Effective in Developing Countries* Elsevier Publications, 2006,34

¹³³ Dulacha B, ‘Factors Influencing Voluntary Corporate Disclosure by Kenyan Companies’ 14.2 *Journal of Corporate Governance: An International Review*, (2006),107-125

makes it extremely difficult in such an economic climate for an employee to appropriately react to issues of corporate governance where in the event they bring non-compliance of the firm to the attention of the Authority they risk losing their jobs.”¹³⁴

Fragmentation of levels of enforcement.

The institutional framework in Kenya is fragmented. There exists multiple enforcement players as opposed to a sole independent regulator with sufficient mandate and authority to implement corporate governance principles. Corporations find themselves subject to the rules and regulations of the Central Bank of Kenya, The Capital Markets Authority and the Nairobi Securities Exchange. The Kenya institute of Directors, was also created to serve as an overall organization for oversight and implementation the code.

*“The framework that exists, is inadequate and lacks cohesiveness in the manner the various agencies and institutions ought to co-relate so as to effectively and efficiently dispense their duties. The resultant effect is that the weak level of enforcement of the Code has led to a complicated system and lack of transparency. This is evidenced by the lack of judicial precedent on Kenya on convicted persons charged with corruption and economic crime within the capital markets. The CMA tribunal has been described to be an institution that has simply ticked the compliance box.”*¹³⁵

Limited resources

In Kenya, resources are limited and as such there is need to choose a model of regulation that easily be enforced. The Anglo- Saxon model requires channels of information dissemination that are efficient so that investors are updated on the code of corporate governance easily. *“The Kenyan market though progressive needs to efficiently use the technology that is capable of properly informing the market as well as training personnel who will be able to use these machines.”*¹³⁶

An effective institutional framework must be established if the Anglo-Saxon model, to thrive. Kenya as of the moment requires to adopt a model that is in line with the resources available

¹³⁴ Riordan and Gatewood R, ‘Corporate Image: Employee Reactions and Implications for Managing Corporate Social Performance’ 401 *Journal of Business Ethics* ,(1997), 401-412

¹³⁵ Interview with Professor Wainaina Gituro , board member of the CMA ,held on 20TH December 2017.

¹³⁶ Interview with Professor Wainaina Gituro , board member of the CMA ,held on 20TH December 2017.

to ensure enforcement and proper monitoring of the capital markets. It must suit the needs and cultural undertones of the capital market.

Political interference.

An obstacle to the enhancement of corporate governance is the considerable presence of government controlled companies which are averse to good corporate governance.¹³⁷ Listed companies were still sluggish in implementing the principles of good corporate governance. The report isolates government owned corporations as major culprits. The Government of Kenya is the controlling shareholder of several listed companies and exercises overwhelming influence in the appointment and removal of directors.

“In Uchumi, the Ministry of Trade had a large shareholding, they sent a representative to sit on the board who lacked competency. The fact that the Ministry of Trade sat on the board would imply that they would be more vigilant but this was the contrary. The competency of directors should be set in stone. There should be a minimum number of training hours on corporate governance made mandatory to ensure good conduct and that the untouchables also face the consequences of the law.”¹³⁸

GERMAN MODEL

In Germany, history shows that there was a reluctance towards the exercise of powers on a non- statutory basis. Their laws are backed with sanction in the event of non –compliance.¹³⁹ Compliance under in Section 161 of the German Stock Corporation Act¹⁴⁰ indicates that the Code of Corporate Governance is binding German company law has traditionally relied upon statutory regulation, in which the two-tier board model is firmly rooted¹³.

There are three unique elements of the German model that distinguish it from the Anglo-Saxon model. First, the German model prescribes two boards with separate members. The

¹³⁷ Paul Wafula & Mwaura Kimani, 'Institutions fail Good Governance test at Awards', BUSINESS DAILY, Nov. 16, 2010,25

¹³⁸ Interview with Mr. Kang'ata Kiragu, past Marketing and Corporate Sales Manager in Uchumi Limited, held on 9th January 2017

¹³⁹ Prof. Klaus J and Leyens P, 'Board Models in Europe -- Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France, and Italy', 1.2 *European Company and Financial Law Review*, (2004),9

¹⁴⁰ Section 161, Stock Corporation Act of Germany, 1965)

management board consists of executives; and the supervisory board is composed of the employees' representative and the shareholders representatives.

The management and supervisory boards of listed companies have to declare compliance with the Code every year as per section 161 of the German Companies Act,¹⁴¹ compliance is mandatory.¹⁴² This publication is done alongside the annual financial statements to the register of companies.¹⁴³

Currently, the shareholders and stakeholders within this model have easy access to information and the State ensures that the process for complaints due to non-compliance with the German Code of Corporate Governance is clearly outlined. The German command and control model is effective in imposing the standards of good corporate governance to all market participants with immediacy. The benefits of this model are as follows:

The penalties of non-compliance are strongly passed from the government to investors and directors without any room for ambiguity. Civil and criminal sanctions are utilized when a company is not compliant with the Code, lowering corruption.¹⁴⁴ Secondly, this model creates uniformity and certainty. Finally, it compels corporations to maximize wealth in a responsible and principled manner that enables morality, ethics and corporate governance standards to be upheld.

ANALYSIS OF MODELS WITHIN THE KENYAN CAPITAL MARKET.

The Anglo-Saxon Model in comparison with the German model both exhibit some benefits and some weaknesses. Failure to comply with statutory rules calls for civil and or criminal sanctions within the German model which may increase deterrence in Kenya. In recent past, nation states utilize hard law to protect fundamental areas of the market to prevent or mitigate

¹⁴¹ Rosen DV, 'Corporate Governance in Germany', 15.1 *Journal of Financial Regulation & Compliance*, (2007), 79-105

¹⁴² Section 161, Stock Corporation Act of Germany (1965)

¹⁴³ Corporate Governance Kodex (2002) English version: <<http://www.corporate-governance-code.de>>.

¹⁴⁴ Baldwin and Cave, 'Understanding Regulation', *Oxford University Press*, (1999)

the risks in letting the industry regulate itself. *“The financial crisis of 1998 in the USA, was a clear example of what can happen if we leave the markets devoid of the government.”*¹⁴⁵

Additionally, Germany uses law to ensure that the capital markets are protected especially stakeholders. The nation applies mandatory co- determination law to ensure that employees have a means to participate in the decision-making within corporations that are made in line with the policies on welfare. This is what we lack in Kenya, *“employees seek job security above everything. The point when an employee will raise an issue on corporate governance effectuates his or her immediate dismissal.”*¹⁴⁶

The command and control may be seen to be too rigid and in the event of development and amendment the procedure and costs involved would be high. However, an enforced self-regulation model entails market participants creating a corporate governance code for themselves which would ensure high commitment, fewer costs to the government and is practical to the company since it is made by the directors along with shareholders and stakeholders.

Enforcement is a key factor needed in the model adopted within the Kenyan market. Thus far, enforcement is seen as the core of any effective regulatory system. As seen in the Kenyan market, voluntary self-regulation has not worked, coercive force is needed to ensure implementation takes place because without any incentive the participants will not comply with the set corporate governance guidelines.¹⁴⁷

The model adopted for the Kenyan market ought to have a rule and principle based aspect. It must combine both the statutory and non-statutory so as to be effective. Efficacy is measured by the level of compliance and at the moment for corporate governance principles to thrive within the Kenyan market there is a need to sanction non-compliance.

¹⁴⁵ Interview with Mr. Kabage Karanja, Group Chairman of Pacific Insurance Brokers (EA) Ltd, held on 9th January 2017

¹⁴⁶ Interview with Mr. Kang’ata Kiragu, past Marketing and Corporate Sales Manager in Uchumi Limited, held on 9th January 2017

¹⁴⁷ Ayres and Braithwaite, ‘Responsive Regulation; Transcending the Deregulation debate’, *Oxford University Press on demand*, (1994),143

CONCLUSION

The models of corporate governance were developed based on the culture, resources, history and technological advancement of these jurisdictions. Our code and governance structure must be based on our national, economic and social environment so as to meet the needs of the Kenyan market customized for their market.

CHAPTER 5: CONCLUSIONS AND RECOMMENDATIONS

Indeed, the current corporate governance implementing mechanisms in Kenya are inadequate, leading to insufficient accountability by directors when fulfilling their duty of promoting the success of the company as a whole.

The Companies Act is ineffectual in relation to the mandate of director's duties and it is based on the 'shareholder' in line with the Anglo-Saxon model as opposed to the German 'stakeholder' model of corporate governance. The fact that compliance with the Guidelines is voluntary was intended to encourage compliance, but listed companies have not been taken them as part of their corporate culture.

The body politic in Kenya has a great impact on the nomination and dispensation of duties by a board. This institution has had a large part to play on the lack of transparency, disruption of the corporate governance framework and mechanisms by issuers of shares to the public and the CMA.

According to the Uchumi case the CMA as the core regulator of the Markets has shown inadequacy and inefficiency in a number of areas.

In the realm of drafting the Act, mirroring the 2015 Kenyan Companies Act to the UK Companies Act and the adoption of the Anglo-Saxon model without customizing any of them to fit our markets doesn't promote sound corporate governance.¹⁴⁸

Regulatory choices depend on the economic objectives of the state and its institutions. Self-regulation is the first option, and when it fails, as it has in Kenya, enforced self-regulation can be introduced and then thereafter command and control can be imposed.¹⁴⁹ *"We should make the code mandatory, because unfortunately as Kenyans that is the only kind of regulation that shows efficacy. Indeed politics and directorship is very intertwined in Kenya."*¹⁵⁰

¹⁴⁸ Ungureanu M, 'Models and practices of corporate governance worldwide' *CES Working Papers*, (2012) < http://www.ceswp.uaic.ro/articles/CESWP2012_IV3a_UNG.pdf >, accessed on 5th January 2017

¹⁴⁹ Ntongho R, 'Self-regulation of corporate governance in Africa: following the bandwagon?', *International Company and Commercial Law Review*, Westlaw.UK, Sweet&Maxwell and its contributors,(2009)

¹⁵⁰ Interview, Legal Consultant, Uchumi Supermarkets Limited.

This paper thus recommends making the CMA functionally independent from the state so as to ensure that they efficiently implement the director's duties. They should vet the directors after nomination but before presentation to the shareholders for election into the board. Additionally, a system that profiles directors that provides their competency level according to their role and levels of integrity should be envisioned. It will publicize any suspensions of directors from serving on any boards as easily accessed public information. This system will also bar an individual from serving more than 3 boards at the same time to ensure proper and concentrated dispensation of directors' duties.

There is need for a cohesive framework in the event that a director breaches his directorship duties. In order to effectively prosecute perpetrators of white collar crime, the functionality and competence of the CMA along with the Tribunal need revisal. As author, I recommend increasing the investigative and prosecutorial powers of the CMA and its tribunal through skilled personnel who have undergone specialized capacity building. This recommendation should however take place, after 3 years of devolved functionality from the government. This is upon revisal with established growth markers of devolved functionality and corporate governance practice.

As regards the ambiguity of the term success in section 143, the general interpretation of the duty by directors was that it encapsulates the perpetual successive nature of the company. All decisions made should be for the success of the company, with the fact that the company must remain sustainable. When making these decisions, directors ought to take a mental flight and ensure that they do not disrupt the fundamentals of the company.

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APPENDICES.

APPENDIX 1.

KENYA COMPANIES ACT 2015 SECTION 143.

This section is summarily coined as the Section143 duty of director to promote the success of the company. It mirrors the above section in the UK Companies Act as evidenced below;

<u>UK COMPANIES ACT SECTION 172</u> <u>Duty to promote the success of the company</u>	<u>KENYA COMPANIES ACT 2015</u> <u>SECTION 143</u>
<p>(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—</p>	<p>(1) A director of a company shall act in the way in which the director considers, in good faith, would promote the success of the company for the benefit of its members as a whole, and in so doing the director shall have regard to —</p>
<p>(a) the likely consequences of any decision in the long term,</p>	<p>(a) the long term consequences of any decision of the directors;</p>
<p>(b) the interests of the company’s employees,</p>	<p>(b) the interests of the employees of the company;</p>
<p>(c) the need to foster the company’s business relationships with suppliers, customers and others,</p>	<p>(c) the need to. foster the company's business relationships with suppliers, customers and others;</p>
<p>(d) the impact of the company’s operations on the</p>	<p>(d) the impact of the operations of the company on the</p>

community and the environment,	community and the environment; the desirability of the company
. (e) the desirability of the company maintaining a reputation for high standards of business conduct, and	. (e)to maintain a reputation for high standards of business conduct; and
. (f) the need to act fairly as between members of the company.	(f) the need to act fairly as between the directors and the members of the company.
. (2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.	(2) If, or to the extent that, the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.
. 3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company	(3) The duty imposed by this section has effect subject to any law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.

The table above shows; the statute was taken on without any adjustment. Section 143 has maintained all the sections, even those which the UK found to be weak in promoting corporate governance.

APPENDIX 2

Criticism on the agency relationship

Figure 1: Comparison of the REMM and Economic Model of Man

The criticism made on the agency relationship is the *assumption made that the agent and principal are both rational utility maximizers. The ‘model of man’¹⁵¹ and the Resourceful,*

Human Assumptions	
REMM	Economic Man
Bounded Rational	Rational
Maximizer based on thorough evaluation	Maximizer
Self-Interested	Self-Interested
Actions driven by Incentives	Motivated by incentives
Opportunistic if beneficial	Opportunistic with guile
Will substitute goods if beneficial (not driven exclusively by extrinsic rewards)	Focus on extrinsic rewards
Altruistic if beneficial	Not other-regarding
Resourceful – innovative when facing constraints and opportunities	(Resourceful) ^a

Evaluative, Maximizing Model (REMM)¹⁵² acted as the underlying principles for the Agency Theory. These underpinnings primarily were of the notion that a human being is rational, self-interested, and opportunistic^{153,a}

calculating individual who seeks to attain rewards and avoid punishments, especially financial ones.¹⁵⁴The company is conceived as a nexus of contracts, and it is assumed that contracts can motivate, reward and supervise agents’ efforts¹⁵⁵. These models were in line with the economic model of man in the corporate scene. The comparison is as shown below¹⁵⁶

¹⁵¹Jensen and Meckling, Theory of the Firm: ‘Managerial Behavior, Agency Costs and Ownership Structure’, 4 *Journal of financial economics*, (1967),305-360

¹⁵² Pastoriza D and Arino M, “When Agents Become Stewards: Introducing learning in the stewardship theory”, 1st IESE Conference, Barcelona, 2008, 4, <https://papers.ssrn.com/sol3/Papers.cfm?abstract_id=1295320>

¹⁵³ Pastoriza D and Arino M, “When Agents Become Stewards: Introducing learning in the stewardship theory”, 1st IESE Conference, Barcelona, 2008, 4, <https://papers.ssrn.com/sol3/Papers.cfm?abstract_id=1295320> founded on Eisenhardt, 1989

¹⁵⁴ Pastoriza D and Arino M, “When Agents Become Stewards: Introducing learning in the stewardship theory”, 1st IESE Conference, Barcelona, 2008, 4, <https://papers.ssrn.com/sol3/Papers.cfm?abstract_id=1295320> founded on Donaldson and Davis, 1991

¹⁵⁵ Pastoriza D and Arino M, “When Agents Become Stewards: Introducing learning in the stewardship theory”, 1st IESE Conference, Barcelona, 2008, 4, <https://papers.ssrn.com/sol3/Papers.cfm?abstract_id=1295320> founded on Hoskisson et al., 1999

¹⁵⁶ Smith T, ‘Agency Theory and Its Consequences; A study of the unintended effect of Agency Theory on Risk and Morality’, Unpublished LLM Thesis, Copenhagen Business School, 2011, 15

APPENDIX 3

Diagrammatical representation that attempts to take the reader through the decision making process made by the director in choosing which model to take on.

		Principal's Choice	
		Agent	Steward
Manager's Choice	Agent	Minimize Potential Costs Mutual Agency Relationship 1	Agent Acts Opportunistically Principal Is Angry Principal Is Betrayed 2
	Steward	3 Principal Acts Opportunistically Manager Is Frustrated Manager Is Betrayed	4 Maximize Potential Performance Mutual Stewardship Relationship

Figure 2: Principal- Manager choice model.¹⁵⁷

The above Principal-Manager choice model, reflects two individuals choosing to become either a steward or agent. The criticism made on this analysis of decision is that it assumes the decision is made at a single point, it is static. Contrarily, dynamic relationships that are long term and require a large amount of trust and reciprocity from the principal and manager are not characterized by the

agency model which leaves either party betrayed when the other acts in an opportunistic nature. What has been advocated for with this model is the need for a deeper understanding between the dynamic interaction between agents and stewards as both parties oscillate between the two models as the long term dynamic relationship unfolds.¹⁵⁸ It has been argued that virtuousness complements rationality by controlling the spontaneous impulse to pursue pure extrinsic results, as opposed to transcendent results. This theory can then be posited as the 'soft' law in corporate governance, but can equally be seen as acting as the spirit behind statute primarily directorship duties.

¹⁵⁷ Pastoriza D and Arino M, "When Agents Become Stewards: Introducing learning in the stewardship theory", 1st IESE Conference, Barcelona, 2008, 7, <https://papers.ssrn.com/sol3/Papers.cfm?abstract_id=1295320> see also Davis Schoorman and Donaldson 1997
¹⁵⁸ Pastoriza D and Arino M, "When Agents Become Stewards: Introducing learning in the stewardship theory", 1st IESE Conference, Barcelona, 2008, 7, <https://papers.ssrn.com/sol3/Papers.cfm?abstract_id=1295320>; see also Davis Schoorman and Donaldson 1997

APPENDIX 4:

THE COMPANIES ACT No. 17 of 2015

Division 3. The duties run from Section 140 to Section 150.

The duties are as follows¹⁵⁹:

Section 140: Scope and nature of general duties

Section 141: Director's right to protest against removal.

Section 142: Duty of director to act within powers.

Section 143: Duty of director to promote the success of the company.

Section 144: Duty of director to exercise independent judgment.

Section 145: Duty of director to exercise reasonable care, skill and diligence.

Section 146: Duty of director to avoid conflicts of interest.

Section 147: Duty not to accept benefits from third parties.

Section 148: Civil consequences of breach of general duties.

Section 149: Cases within more than one of the general duties.

Section 150: Consent, approval or authorization by members.

¹⁵⁹ Section 140-150, Companies Act (Act No.17 of 2015)

APPENDIX 5

Uchumi's Timeframe before 2011

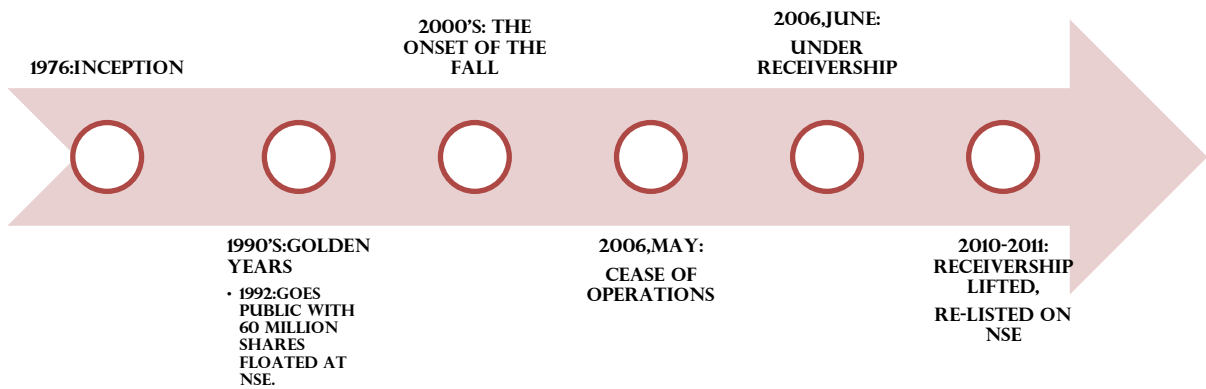
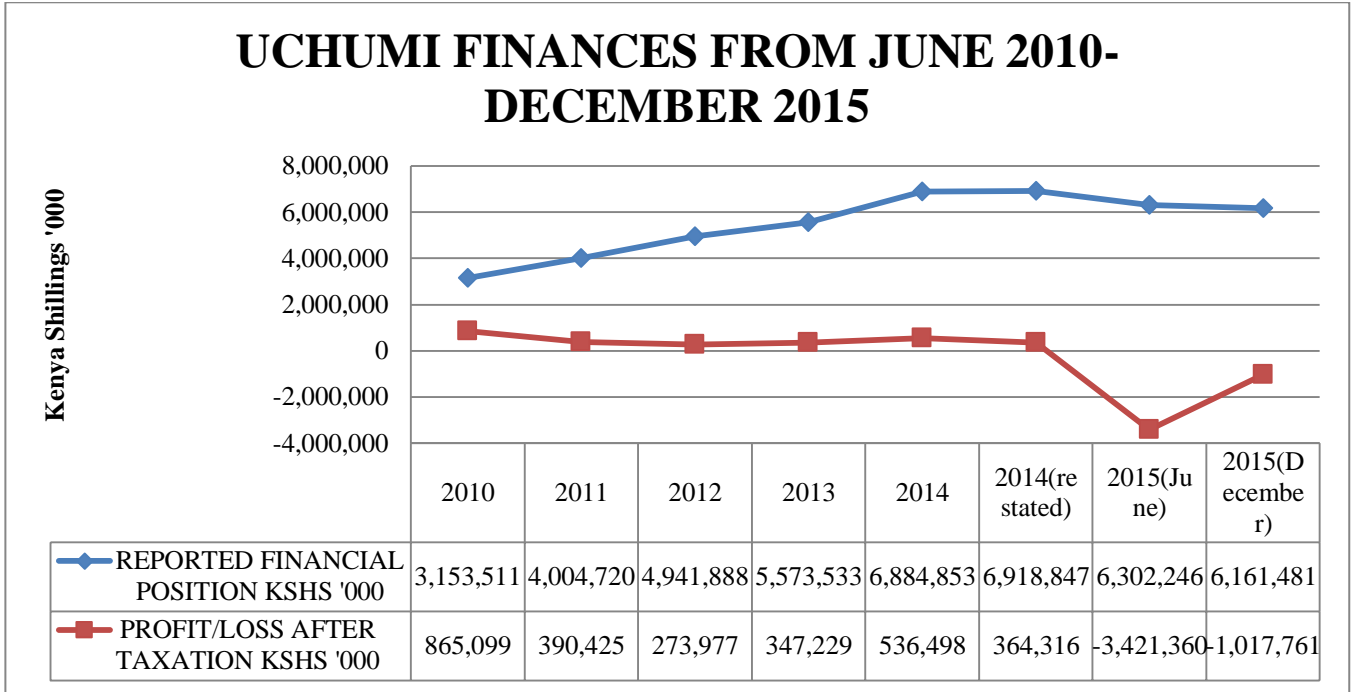


Figure 3: Uchumi's History.

APPENDIX 6

Uchumi Finances from June 2010-December 2015 as per the NSE.



APPENDIX 7.

The following are the interview questions that were asked in performance of Chapter 4 of the study. The interviewees either signed consent forms or verbally agreed to have their words quoted directly, with the exception of interviewee 7.4 below who only agreed to be quoted when orally defending my paper.

Sample of nature of questions

Questions

1. First off, which corporate governance theory have you encountered as widely practiced in the Boards you have served?
2. Code of Corporate Governance Practices for Issuers of Securities to the Public 2015, opted to defer from the ‘comply or explain’ approach to the ‘apply or explain’ approach.
 - a. How does this principle based approach change the operations of board of directors in strive towards sound corporate governance?
 - b. What would be the effect of making this code mandatory?
3. What would be the effect on boards and directors if the functions of the CMA were to be broadened and devolved from the Treasury?
4. In your years of experience, what is the role played by politics within the Board of Directors?
5. In terms of policy making and practice, through the Judiciary and CMA Tribunal , what should be done to eradicate white collar crime conducted by directors and therefore mitigate the number of corporate scandals?
6. Do you think the CMA is an effective regulator of industry?
7. Companies Act 2015 Section 143; ‘Duty of the director to Promote the success of the company’ How is this duty interpreted by Directors?

ABOUT INTERVIEWEES

7.1 Interview with Mr. Kabage Karanja

9th January, 2017

**The Insurance Centre,
Rose Ave, Off Dennis Pritt Rd.**

Mr. Kabage has held several positions of leadership as a director of several boards such as the Group Chairman of Pacific Insurance Brokers (EA) Ltd, First Reinsurance Brokers Ltd (FirstRe), Chairman - Association of Insurance Brokers of Kenya (AIBK), Secretary of Insurance Institute of Kenya (IIK), Chairman of the Communication Commission of Kenya, Chairmanship capacities of three key private sectors; Federation of Kenya Employers (FKE), Kenya Private Sector Alliance (KEPSA) and Kenya Business Council (KBC).

He has served as Commissioner with Energy Regulatory Commission (ERC) which is responsible for Electricity, Petroleum and Renewable energy and has been a member of the Kenya Nuclear Electricity Board.

7.2 Interview with Mr. Francis Kang'ata Kiragu

9TH January, 2017

Strathmore Law School

Mr. Francis Kangata has had vast experience as the Marketing and Corporate Sales Manager in Uchumi Ltd. He was responsible for specialty partners as well as fresh produce and bakery units which he also managed during his tenure as Branch Operations Manager. He has significant experience in branch operations having worked as Branch Manager at Sarit Centre in Westlands, and Langata Hyper.

7.3 Interview with Professor Wainaina Gituro

20th December 2016

**Parklands Sports Club,
Nairobi, Kenya.**

Director of the Social and Political Pillars under the Vision 2030 Delivery Secretariat, board member of Capital Market Authority and board committee member at Management University of Africa.

7.4 Interview with past lead legal consultant in Uchumi Supermarkets.

Tuesday 10th January 2017 at 10:30 am

The interviewee was the principal legal counsel in charge of all board and shareholder matters and in charge of Public Relation and Corporate Social Responsibility.