THE LAW GOVERNING DIRECTORS IN KENYA: A COMPARATIVE REVIEW.

A thesis submitted to The University of Manchester for the degree of
Doctor of Philosophy
in the Faculty of Humanities

2012

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SCHOOL OF LAW

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KENYA

The Corporate Governance Guidelines in the Capital Markets Act 2002, Cap. 485A

Acronyms

AG –Attorney General
Board – Board of directors
CA – Companies Act
CC – Combined Code
CCCC - Citizens Coalition for Constitutional Change
CCG – Centre for Corporate Governance
CCK- Communications Commission of Kenya
CIC -Capital Issue Committee
CMA – Capital Market Authority
CMA Guidelines – Capital Markets Act 2002 Corporate Governance Guidelines
ESV – Enlightened Shareholder Value
EU – European Union
FRC – Financial Reporting Council
ICGN - International Corporate Governance Network
IMF – International Monetary Fund
ISI - Import Substituting Industrialization
MA – Model Articles
MCC – Market for Corporate Control
MP – Member of Parliament
NAK -National Alliance Party of Kenya
NCCK – National Christian Council of Kenya
NCEC - National Convention Executive Council
NDP – National Democratic Party
NED – Non-executive director
NSE – Nairobi Stock Exchange
OECD - Organisation for Economic Co-operation and Development
Plc – Public listed company
PNU –Party of National Unity
SID – Senior Independent Director
SME – Small and medium-sized enterprise
UK – United Kingdom
US – United States

Abstract

Name of University: **The University of Manchester**

Candidate's Name : **Musikali, Lois Mwende**

Degree Title : **Doctor of Philosophy**

Date : **2012**

This thesis seeks to understand why despite adopting England's corporate framework, poor corporate governance remains one of the main challenges facing Kenya today. In so doing it carries out a comparative review of Kenya's framework primarily comparing it to that of England, with the aim of making suggestions on how Kenya's legal framework for governing directors can be adapted to reflect local conditions and ideologies so as to improve accountability in Plcs in Kenya.

It starts off by examining the legal transplants debate and the proposition that a weak legal system may be the main explanation for poor corporate governance in Kenya as claimed by the 'law matters' thesis. This thesis challenges the proposition of the 'law matters' thesis and argues that other path-dependency factors matter: particularly culture through ethnic diversity. As such, this thesis argues that for a transplant to take matters such as whether it is institutionally compatible and culturally acceptable need to be taken into consideration.

The contribution of this thesis is that it provides a description of Kenyan culture and an illumination of how this culture affects the effective function of corporate law. In this regard it finds that ethnicity, particularly through kinship plays a key role in the efficacy of the Anglo-American model of corporate governance when it is transplanted to the Kenyan context.

This thesis states the law in England and Kenya as it was on 27th January 2012.

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Acknowledgement

As it is not possible to list everyone who has contributed to this thesis in one way or another, I will list a number of people to whom I am highly indebted.

I would like to thank my supervisor Prof. Andrew McGee for his support without which this thesis would not have come to fruition. I am greatly indebted to Mr. Philip Lawton for his feedback which greatly improved this thesis. I would also like to thank Prof. John Birds for his comments.

I am highly indebted to my parents Joseph Musikali Mutemi and Rachel Nzuna Mutemi, for their support of my education. For this, I remain eternally grateful.

Above all, I thank God who has remained true and faithful in my life.

Dedication

To my parents:

Joseph Musikali Mutemi & Rachel Nzuna Mutemi

To my siblings:

Paul Mutemi, Priscilla Mawia, Elizabeth Mueni & Emmanuel Kioko

Chapter 1: Introduction to thesis

This chapter introduces the subject matter of this thesis by providing a background to this study. It also defines the research question that is the subject of this thesis, the methodology, scope and structure of this thesis.

1.1 Background of the study

Kenya is a common law jurisdiction, which has to a large extent adopted England's corporate laws and practices of corporate governance.[1] Kenya's companies' legislation, the Companies Act 1948[2], was adopted almost in entirety from England's Companies Act 1948. Similarly, Kenya's corporate governance code, the Sample Code for Corporate Governance 2002[3] - assimilated into law through the Capital Markets Act 2002[4] and hereafter, the CMA Guidelines - is based to a large extent on the model recommended in the Cadbury Report 1992. Therefore, both Kenya's Companies Act and the CMA Guidelines are legal transplants. For this reason, this thesis will be based on the transplants debate.

The reason for basing this thesis on the legal transplants debate is that despite adopting a similar regulatory framework to that of England in order to modernise Kenya's corporate law and improve the governance of corporations, poor governance of corporations remains one of the main challenges facing corporate governance in Kenya today.[5]Kenya's corporate framework, though modern on paper, does not seem to be meeting the expectations at the time of transplanting such as efficiency and accountability. This is evidenced by the fact

[1] Although Kenya was a British colony, the laws that the British exported to Kenya were mainly English laws. See s.3 Judicature Act, Cap.8 of the Laws of Kenya. All Kenyan laws and reported cases can be accessed at www.kenyalaw.org.

[2] Kenya's Companies Act is sometimes referred to as the Companies Act 1962. This mix up in dating, with some sources citing 1948 as the date of the Act while others cite 1962 is because the official print out of the Act was dated 1962. In practice, these dates do not make much of a difference as the copies of the Companies Act that are dated 1948 and 1962 are the same in entirety.

[3] The Corporate Governance Guidelines incorporated in the Capital Markets Act 2002 were first introduced as Principles of Good Corporate Governance in a 1999 publication by the Private Sector Trust, now the Centre for Corporate Governance. The author refers to the 2002 Guidelines as they are the ones by which directors of companies listing in the Nairobi Stock Exchange (NSE) are legally bound by virtue of the fact that they form part of the Capital Markets Act 2002.

[4] Chapter 486A, the Laws of Kenya.

[5] See generally Mensah, S. (2003), 'Corporate Governance in Africa: The Role of Capital Market Regulation', Paper presented at the 2nd Pan-African Consultative Forum on Corporate Governance, Nairobi, Kenya.

that whilst misappropriation of funds by company directors[6] and corruption leading to corporate collapses are less common in England, such occurrences are still commonplace in Kenya.[7] Since Kenya's independence, a large number of major corporations have collapsed as a result of poor governance. The 1980s were marked by the collapse of 33 banks.[8]Similarly, the 1990s were characterised by the mass looting and collapse of major state corporations such as the *Kenya Tea Development Authority (KTDA)*, *The Kenya Coffee Growers Association (KCGA)* and the *Kenya Co-operative Creameries (KCC)* to name a few.[9] Following the mismanagement of state corporations, the Kenya government decided to privatise a number of state corporations, amongst them Kenya Airways and Kengen. In 2006, *Uchumi*, a company listing on the stock exchange came to near collapse due to poor corporate governance strategies amongst them irrational expansion and a lack of risk management strategies.[10]

Following the privatisation of a number of state companies, corporate governance issues in Kenya's public listed companies (Plcs) have mainly centred on mistrust between the majority shareholders – usually a controlling family or institutional investor – and the minority shareholders, usually the local public. A case in point is *AccessKenya*. Since AccessKenya's listing on the NSE in 2008 shareholders have complained that decision-making at AccessKenya has remained in the grips of the Somen family - the controlling shareholders - to the exclusion of independent directors, despite the firm going public. The family has since been forced to dilute the Somen's family influence on the Board to reduce friction between shareholders and management. [11]

Corporate governance weaknesses and a general culture of impunity have been blamed for the collapse of four stock market intermediaries[12] since 2006 -*Ngenye*

[6] The terms 'director' and 'manager' are used interchangeably in this thesis as US literature uses the term management rather than director, see for instance Scott, E. K. (1983), 'Corporation Law and the American Institute Corporate Governance Project', Stanford Law Review, 35.
[7] On the Kenyan situation, see generally Republic of Kenya (2005), Sessional Paper on Privatisation of State Corporations and Investments.
[8] Barako, D.C., Hancock, P. and Izan, H. Y. (2006), 'Factors Influencing Voluntary Disclosure by Kenyan Companies', Corporate Governance: An International Review, Vol 12, 2, 107-125.
[9] See Himbara, D. (1994), Kenyan Capitalists, the State and Development, Boulder & London, preface.
[10] See generally Eshiwani, A. (2006) 'Director Liability in the Wake of Uchumi (Collapse)', Institute of Directors (Kenya), July 14, 2006
[11] Mwanza, K., Somen leaves AccessKenya board after 10 years in chair, Business Daily, July 9th 2010.
[12] Okoth, J. and Anyanzwa, J., 'Unresolved Regulatory matters keep NSE investors guessing', The Standard, 19th March 2009.

Kariuki and Company Ltd., Discount Securities Ltd., Nyaga Stockbrokers and Francis Thuo and Partners Ltd - resulting in a loss of over Kshs. 2.7 Billion (US $ 33.7 million).[13] Amongst the reasons cited for the collapse of Ngenye Kariuki and Company Ltd., is weak internal control.[14]Discount Securities Ltd., was described as experiencing '*corporate governance challenges*.'[15] In Nyaga Stockbrokers, a manager was accused of stealing Kshs.6.6 million and fraudulent accounting.[16]Although these matters are under investigation, the CMA has been reluctant to release forensic audit reports carried out on these intermediaries post-insolvency stating in one case that, '*any public comments at this stage may undermine the process (reform) which is underway*'.[17]This kind of behaviour is reflective of a culture of *secrecy* and *paternalism* which has undermined the achievement of good corporate governance and accountability in Kenya's corporations.

The collapse of four intermediaries in quick succession is also a sign of institutional and regulatory failure[18]occasioned by a culture of impunity that is also evident in the courts which have failed to hold anyone accountable for mismanagement of company funds even following the privatisation of corporations. The most recent instance of this is the acquittal of the former directors of Uchumi on the basis on a legal technicality where the Prosecutor wrongly applied the law and lost focus of the main thrust of the corporate governance issue thereby losing the case on behalf of shareholders.[19] This lack of accountability has resulted in a general loss of investor confidence in the NSE.

Therefore transplanting the corporate governance concepts contained in the CMA Guidelines seems not to have solved Kenya's corporate governance problem as the level of impunity in the management of corporations has hardly changed.

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[13]This is the total loss estimated for three of the intermediaries. Business Daily, 29th May 2009

[14] Anyanzwa, J. (2010), 'CMA Takes over Another Troubled Stock Broker', The Standard, February 6th 2010

[15] Press Statement by the Capital Markets Authority and the Nairobi Stock Exchange, 'The State of the Kenya Capital Markets and the Restructuring of Discount Securities Limited', (13th October 2008) available at http://www.cma.or.ke/index.php?option=com_content&task=blogcategory&id=24&Itemid=100&limit=5&limitstart=35.

[16] Thuku, W., 'State to Prosecute Former Brokerage Manager', The Standard, 31st March 2010.

[17] Press Statement by Capital Markets Authority, 'Nyaga Stockbrokers Forensic Audit Report' available at http://www.cma.or.ke/index.php?option=com_content&task=view&id=142&Itemid=100.

[18]Editor, 'CMA must move quickly to restore confidence' Business Daily, 10th February 2010.

[19]See Omondi, M., Uchumi faces strict checks for return to stock market, Business Daily, 30th May 2011.

This calls for an examination of the theory underlying legal transplants – whether effective transplants are possible and whether transplants are a sensible means of legal reform and the extent to which culture plays a role in the efficacy of transplants.

1.2 The legal transplants debate & its relevance to the Kenyan context

The term legal transplant was coined in the 1970's by Alan Watson to indicate the moving of a rule or a system of law from one country to another.[20] Watson has been described as, '*the guru of transplants'* [21] as well as '*the most prominent contributor to the transplants literature*.'[22] Watson perceives transplantation as the most fertile source of legal development and asserts that legal transplants are as old as the law is[23] and most law has its elements or its entirety emanating from a borrowed source.[24] According to Watson, transplanting law is easy as legal rules are equally at home in many places and states whatever their historical origins may have been. Watson contends that the '*the two most startling, and sometimes most obvious, characteristics of legal rules are the apparent ease with which they can be transplanted from one system or society to another, and their capacity for long life.*'[25]Other proponents of legal transplants include Hernando De Soto, who in his book 'The Other Path', states that, '*…The legal system may be the main explanation in the difference in development that exists between industrialized countries and those that are not industrialized.*'[26] According to De Soto, '*Development is possible only if efficient legal institutions are available to all citizens*'[27] as '*The law is the most useful and deliberate instrument of change available to people.*'[28]

[20] See generally, A. Watson, Legal Transplants: An Approach to Comparative Law, Edinburgh, 1974.
[21] Xanthaki, H. (2008), 'Legal Transplants in Legislation: Defusing the Trap', International and Comparative Law Quarterly, Vol. 57, p.660.
[22] Kanda, H. and Milhaupt, C.J. (2003) 'Re-examining Legal Transplants: The Director's Fiduciary Duty in Japanese Corporate Law.' (Draft of March 24, 2003).
[23] Watson, A. (1974), 'Legal Transplants: An Approach to Comparative Law, Scottish Academic Press, Edinburgh.
[24] Watson, A. (1996), 'Aspects of Reception of Law', The American Journal of Comparative Law, 335, 336.
[25] Watson, A. (1978), 'Comparative Law and Legal Change', Cambridge Law Journal, 37, p. 313.
[26]De Soto, H. (1989), 'The Other Path: The Invisible Revolution in the Third World', p.185.
[27]De Soto, H. (1989), p.186.
[28]De Soto, H. (1989), p.187.

Levy, however, points out that not all parts of a legal system are equally amenable to reception of a transplant. A transplant of business law is easier to transplant than one of family law as the law of personal property – most notably that of commercial goods and consequently most of the law of contracts is,'… *more loosely connected with a people's past and therefore more easily copied*.. .' [29]According to Levy, areas which are controlled by economic interests rather than national customs or sentiments, have at all times offered the readiest seed ground for a reception.[30]

Whilst business can be said to be more loosely connected with a people's past, than say family law, it is not solely controlled by economic interest as Levy argues. National customs or sentiments affect the efficacy of transplanted business law particularly in developing countries with a collective culture such as Kenya. Business in Kenya can hardly be detached from the traditions of society particularly the '*relationship*' culture. Factors such as tribalism and kinship continue to affect how business is carried out in Kenya even following the transplantation of the CA 1948 and the CMA Guidelines 2002. This reality is in line with research which shows that '*old unities based on kinship, custom and belief*' persisted in the traditional environments in which Soviet law was intended to reshape.[31]More recent recognition is given to the role that kinship continues to play in the business environment of collective societies in Ruskola's work on China. Ruskola makes the point that contract is the 'norm' of traditional corporate law in Anglo-American systems whereas in collectivist/kinship based systems it is often kinship that is the basic norm of business associations.[32]This suggests that affective ties do exist in business communities in some contexts. According to Friedman even in the Anglo-American context (which is individualist and governed by the contract norm):

> 'Continuing relationships are vital to business communities – these ties may not be 'affective' in the same sense as family ties; but they are not the cold, hands-off relationships of classic economic theory. There are also mixed communities: the family-based business behavior of the

[29] Levy, E. (1950), 'The Reception of Highly Developed Legal Systems by People's of Different Cultures', Washington Law Review, Vol. 25, p.244.
[30] Levy, E. (1950), p.244.
[31] Massell, G. J. (1968), 'Law as an Instrument of Revolutionary Change in a Traditional Milieu: The Case of Soviet Central Asia', Law and Society Review, Vol 2, pp. 179-228.
[32] See generally, Ruskola, T. (2000), 'Conceptualizing Corporations and Kinship: Comparative Law and Development Theory in a Chinese Perspective', Stanford Law Review, Vol. 52, No. 6, pp. 1599-1729.

> overseas Chinese, which are both affective and instrumental, or at least can be so defined.'[33]

The existence of affective ties that are the result of kinship, custom and belief is likely to affect the efficacy of transplanted law from one jurisdiction to another particularly where there is a difference in culture between the home state and the host state -in this case England and Kenya respectively. Whilst England has an individualistic culture, Kenya has a collective culture.[34] Laws transplanted from England are unlikely to reflect and accommodate the affective ties that continue to play a huge role in collective cultures such as Kenya. This has led to these laws being largely ignored, evidenced in the fact that unlike England's CA 1948 and its corporate governance code which has been reviewed a significant number of times to keep up with the pace of changes in society, Kenya's CA and CMA Guidelines have not been reviewed since inception despite there being need for such reform to improve corporate governance and in particular accountability in Plcs.

Although business-based law is supposed to be easily amenable to transplanting as it is not based on customs or sentiments according to Levy, a successful transplant of business law may not be possible. Cotterell points out that despite the ease with which business law is supposed to be easy to transplant:

> '.. economic interests that inspire legal change are often the interests of business or elite communities. .. There seems to be no reason to assume that such communities will always welcome reform, for example of commercial or contract law. There may well be strong interests in the modernization and in the facilitation of economic relations that the new law might bring. But there may also be resistance to new law that upsets practices on which people, for example operating business have come to rely as serving their collective interests.'[35]

In the case of Kenya, the elite have stood in the way of company law reform partly because the corporate framework as is, already serves their interests as majority

[33] Friedman, L. (2001), 'Some Comments on Cotterrell and Legal Transplants', in Nelken, D. and Feest, J. (2001), Adapting Legal Cultures, Hart Publishing, p.96

[34] Hofstede et al (2005), Culture and Organizations: Software of the Mind, The McGraw Hill Companies, Ch.pp.77-78

[35] Cotterrell, R. (2001), 'Is there a Logic of Legal Transplants?' in Nelken, D. and Feest, J. (2001), Adapting Legal Cultures, Hart Publishing, p.82.

shareholders in Plcs.[36] Ownership in existing Plcs at independence was acquired by the privileged elite hence Kenya's concentrated ownership structure.[37]

Consequently, law reform promoting transparency, accountability and the recognition of other interests such as those of stakeholders has not been welcomed. The earliest attempt at reform is Goyder's 1951 paper which put forward various proposals for the reform Kenya's company law so that it reflects a stakeholder approach recognising amongst other matters the company's responsibilities to workers, the community and the consumers which the existing company law does not take into account.[38]Goyder's recommendations were not adopted. Similarly, following independence in 1963, there have been at least three efforts to review the CA; the first is that of a 1999 Taskforce that was appointed to review Kenya's outdated corporate laws. A report (the King'arui Report) was produced but never implemented.[39] This failure by the Attorney General to implement recommendations is cited by the Kenya Law Reform Commission as being one of the challenges facing law review in Kenya.[40] The second post-independence attempt at reviewing Kenya's corporate law was that of Mwaura who, in his 2003 doctoral thesis, reviewed Kenya's CA as it applied to all companies and made suggestions for reform. [41] Although parts of Mwaura's thesis have been published, they have not been published in media that is widely accessible to Kenya's drafters thereby reducing their likelihood for consideration in any proposed review of company law. The third attempt is the World Bank sponsored 2007 effort in which a foreign researcher has come up with a drafts Bill which is very similar in content to England's CA 2006. This draft Bill is yet to be tabled in Parliament five years on, confirming the fact that company law review is not a political priority in Kenya despite the public funding that has gone into previous reviews. This confirms Cotterell's argument that there is no reason to assume that

[36] Majority of Kenyans do not also engage with company law beyond incorporation of companies and therefore its deficiencies are not that apparent to them. The reason for this may be the lack of a litigious culture in which disputes in small and medium enterprises, which represent 99% of companies in Kenya, are mostly resolved out of court.

[37] See generally, NCCK (1968), Who Controls Industry in Kenya? Report of a Working Party, East African Publishing House.

[38] Goyder, G. (1951), 'The Future of Private Enterprise: a Study in Responsibility', cited in NCCK (1968), p.240.

[39] Republic of Kenya (1999), Report of the Task Force Appointed to Review the Law Relating to Companies, Investments, Partnerships and Insolvency.

[40] See the section on Challenges on the Kenya Law Reform Commission website: http://www.klrc.go.ke/

[41] Mwaura, J. K. (2003), The Kenyan Regulation of Directors: an Analytical Study (doctoral thesis, University of Wolverhampton).

elite communities who should have an interest in reform will always welcome such reforms.[42]

The question that then follows is why Kenya did not until recently replace its Attorney General given the reason that he has stood in the way of reforms; the answer to that is that he is a member of the elite and had the support of the elite.[43] Until the recent passing of the new constitution, it was nearly impossible to remove members of the elite from government posts even where they stood in the way of reform.[44]This was compounded by the fact that until recently there was no significant middle class to provide meaningful pressure to remove such officials from office. In addition, the middle class are only recently investing in Plcs and appreciating the need for reform to improve accountability in Plcs following recent scandals associated with companies listing on the Nairobi Stock Exchange (NSE). Even with the current growth and awareness of the middle class, especially after the passing of Kenya's new constitution, the removal of retrogressive politicians and government officials remains a challenge. It remains a common occurrence for public officials accused of fraud to insist on remaining in office despite protests from the general public.[45] Kenya is therefore suffering from regulatory capture generally, including in the area of corporate law.

Such regulatory capture in the area of corporate law is acknowledged in Bebchuk and Roe's research which points out that the presence or absence of a controlling shareholder affects substantially the way in which, and the ends towards which, a corporation will be governed.[46]Currently, corporations in Kenya are being run for personal rather than national gain despite Kenya's development policy at independence.[47] This has entrenched the concentrated ownership structure which characterised the newly independent Kenya. This inference is supported by the

[42] Cotterrell, R. (2001), 'Is there a Logic of Legal Transplants?' in Nelken, D. and Feest, J. (2001), Adapting Legal Cultures, Hart Publishing, p.82.
[43] See Daily Nation (2011), Kibaki Nominates New Attorney General, 23rd August 2011. Even following replacement, Kenya's former AG is still standing in the way of investigations and legal enforcement. See Mung'ahu, A. (2011), Wako Cannot be Found to Testify in Anglo-Leasing Case, Court Told, 2nd November 2011. In this instance Wako refused to attend court on the guise of being outside the country when that was not the case according to the Daily Nation.
[44] The Constitution of Kenya (2010) published by the National Council for Law Reporting. The Constitution can be found at the following link: http://www.kenyalaw.org/Downloads/The%20Constitution%20of%20Kenya.pdf
[45] See Cheserek, E., and Munyeki, J. (2011), Ongeri declares he won't resign, The Standard, 28/06/2011.
[46] Bebchuk, L. A. and Roe, M. J. (1999), 'A Theory of Path Dependence in Corporate Ownership and Governance', Stanford Law Review, p.133.
[47] To be discussed in further detail in Ch.2.

argument that in corporate systems that enable controllers to extract large private benefits of control, *'rent protection'* considerations might lead to concentrated ownership.[48]In addition, concentrated ownership might persist because players that enjoy rents under them might have both the incentive and power to impede changes in ownership structure[49]that could possibly result from law reform. Consequently, existing corporate structures might well have persistence power due to internal rent-seeking, even if they cease to be efficient.[50]

The legal transplant debates hinges on the extent to which one deems transplants to be *possible*. Legrand, the key promoter of the skeptic view argues that rules cannot travel because their meaning is culture specific. Accordingly, legal transplants are impossible.[51]Teubner states that even though European nations are very similar culturally, politically and in developmental status, legal transplants can still be problematic.[52]Kingsley, commenting on Teubner's findings, states that the logical extension of Teubner's analysis is that more substantial difficulties are likely to result when laws are transplanted from developed nations to developing nations whose political, cultural, developmental and economic differences are starkly different.[53] Other skeptics point out that the law can be changed, but failures will inevitably result from problems in the design and implementation of legal reform programmes. In addition, there are significant obstacles and problems because laws are deeply determined or embedded in a set of political, cultural and societal institutions.

If one perceives the success of a transplant as depending on the borrowed law being shown to have the effects intended, which were the reason for it[54] then Kenya's entire political and legal system can be said to be a failed transplant and the reason for its failure being that rules cannot travel as their meaning is culture

[48] Bebchuk, L. A. and Roe, M. J. (1999),p.138.
[49] See generally, Bebchuk, L. A. and Roe, M. J. (1999), p.153.
[50] Bebchuk, L. A. and Roe, M. J. (1999), p.130.
[51] Legrand, P. (1997), 'The Impossibility of Legal Transplants' Maastricht Journal of European and Comparative Law, 4, 111.
[52] See generally,Teubner, G. (1998), 'Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Divergences', Modern Law Review, 61, p.24.
[53] Kingsley, J. J., 'Legal Transplantation: Is This What the Doctor Ordered and are the Blood Types Compatible? The Application of Interdisciplinary Research to Law Reform in the Developing World – A Case Study of Corporate Governance in Indonesia', Arizona Journal of International & Comparative Law, Vol. 21, No. 2, p.514.
[54]Cotterrell, R. (2001), 'Is there a Logic of Legal Transplants?' in Nelken, D. and Feest, J. (2001), Adapting Legal Cultures, Hart Publishing, p.79.

specific.[55] A key example in the legal arena of a failed transplant from Britain's political legacy in Kenya is Kenya's first constitution.[56] Kenya's first constitution, based on the British constitutional, social and political system, was expected to work with perfect success as it did in England but it failed. The colonialists, at independence:

> '… unaware either of the historical circumstances which have helped produce the present British constitutional, social and political system, or of the many other complex differences between the society in Britain and in developing countries… erroneously thought that a constitutional system which worked with perfect success in England will thrive with an equal measure of success in an independent Commonwealth country.'[57]

Kenya had only made slight changes[58] to the constitution up until its overhaul and the redrafting of a new constitution based on Kenyan values and norms in 2010.[59] In the context of corporate law, despite adopting England's CA and a corporate governance code modeled on the Cadbury code, corporate governance problems in particular looting within companies and the lack of accountability in companies have continued to persist. England's corporate framework has therefore not succeeded in Kenya if it is to be evaluated on its ability to achieve the intended effects such as accountability.

This trend where transplants are adopted without considering their suitability to local conditions is highlighted in McQueen's work on company law in the colonies. In his 1995 paper, '*Company Law as Imperialism*,' McQueen takes note of the internationalisation of the limited liability corporate form as a result of colonialism and questions whether the introduction of company law to colonial possessions was a positive contribution to those nations' development (as it is often claimed) or an impediment to those countries' independent development (and thus an instance of imperialism). Company law often, if not invariably, ran against local economic interests and displaced local forms of business organisation which were eminently suited to local conditions though it was ill suited to local conditions. Local needs were generally dismissed as irrelevant while close adherence to the English model of corporate law was generally presented as part of the civilizing mission of the

[55] See Legrand, P. (1997),p.111
[56] This former constitution was found in the Kenya Independence Order in Council in 1963.
[57] Oluyede, P. A. (1973), Administrative law in East Africa, Kenya Literature Bureau, p.1
[58] Usually a few words here and there to achieve political aims. The form remained the same.
[59] The Constitution of Kenya (2010).

imperial power.[60] The success of such laws was not generally as a result of their superior knowledge claims, but rather was tied to unequal relations of power between the coloniser and the colonised.[61] McQueen points out that comprehending the processes by which local understandings were subsumed in the past and the long-term effects of that sub-sumption is crucial to a fuller understanding of the ongoing process of globalisation today.[62]The next chapter will therefore give a detailed historical analysis of the processes of introduction and subsequent operation of this transplanted imperial companies legislation in Kenya.

1.3 Research question

The question that is the subject of this thesis is:

> 'How can Kenya's legal framework for governing directors be adapted to reflect local conditions and ideologies so as to improve accountability in Plcs in Kenya?'

The general lack of accountability in Kenya's corporate governance makes Kenya an interesting case-study not only because misappropriation of corporate funds is widespread, but also, despite having one of the most advanced legal frameworks, securing accountability in Plcs has remained a challenge.

1.4 Research objectives and methodology

Based on the above research question, this study focuses on director's duties and corporate governance mechanisms in England in comparison to such mechanisms applicable in Kenya. Therefore, the key legislation that is going to be considered is the Companies Act of the respective countries (England's CA 2006 and Kenya's Companies Act 1948) as they stipulate the conduct that is required of directors and the respective corporate governance codes (England's Combined Code 2010 and Kenya's CMA Guidelines 2002) as they govern the relationship between the key players in the company; that is, the executive directors, the non-executive directors (NEDs) and the shareholders of the company. The aim of this study is to compare – taking into account differences in socio-economic context- how

[60] McQueen, R. (1995), 'Company Law as Imperialism,' Australian Journal of Corporate Law, Vol. 5, pp.188-189.
[61] Mc Queen, R. (2008), 'The Flowers of Progress: Corporation Law in the Colonies', Griffith Law Review, Vol 17, No. 1, pp.385-386.
[62] Mc Queen, R. (2008), p.385.

accountability is secured in legislation and corporate governance guidelines in England and Kenya with a view of drawing lessons for Kenya and making recommendations on how Kenya's law and corporate governance guidelines can be adapted to achieve accountability in Kenya's corporate governance.

With the aim of achieving these objectives, this study adopts a comparative analysis of the UK's corporate framework in comparison to Kenya corporate framework as contained within their respective Companies Act and corporate governance codes. A comparative approach is necessary as it allows a detailed examination of the various formal and informal rules governing directors in these jurisdictions enabling weaknesses and strengths to be highlighted accordingly. In particular, comparative method enables one to 'see' the law of their own country. As Lepaulle states:

> 'To see things in their true light, we must see them from a certain distance, as strangers, which is impossible when we study any phenomena of our own country. That is why comparative law should be one of the necessary elements in the training of all those who are to shape the law for societies... '[63]

The author undertakes to make a comparative study of frameworks governing directors in England and Kenya as examination of the duties expected of directors gives important insights into the law, and particularly aids Kenya in scrutinising its laws and guidelines on directors' behaviour. Additionally, Kenya can also learn from England in this area which may help to improve or reform Kenya's corporate law and practice on corporate governance. In this regard, Hill points out that one of the main aims of comparative law is to facilitate legislative reform64 and it is to assist this aim that comparative methodology is applied in this thesis. Zweitgert and Kortz argue that comparative law not only seeks to criticise existing rules; it also seeks to indicate the best ways to enhance the effectiveness of existing rules and facilitates the formulation of new rules.65 The position of Kenya needs to be compared with that of England as Kenya's corporate framework has generally been adopted from the UK and it seems likely that future development in Kenya's corporate law will be influenced by developments in UK corporate law and corporate governance.

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[63] Lepaulle, P. (1922), 'The Function of Comparative Law: with a Critique of Sociological Jurisprudence', Havard Law Review, 35, p.858

[64] Hill, J. (1999), 'Comparative Law, Law Reform and Legal Theory,' Oxford Journal of Legal Studies, 9, p.102.

[65] See Zweigert, K. and Kotz, H. (1998), An Introduction to Comparative Law, OUP, p.34

Drury and Xuereb state that a comparative analysis that goes beyond mere descriptive analysis is necessary if we are to discover how different systems solve a particular problem and why a certain solution is appropriate for one system but not another. The underlying concepts, policy considerations and assumptions of each system need to be addressed before the real nature and relative importance of key matters in each system can be properly understood.66 For this reason, this thesis gives a historical account of the social-political organisation of Kenyan society as well as a description of Kenya's development plans and policies as Kenya's corporate governance problem, its cause, effect and solution is best understood and analysed in this context. Zweitgert and Korz contend that, 'the basic methodological principal of comparative law is that of functionality.' Different legal systems can therefore only be compared if they solve the same factual problem, satisfying the requirement in adequate legal regulations.67 This factual problem for the purpose of this thesis is how to ensure that directors act in the interests of the company as a whole in the Kenyan context.

This thesis will rely on primary resources such as corporate statutes, case law and listing rules. As best practice and the principles of corporate governance are relatively new in Kenya, the literature on legal aspects of corporate governance is relatively modest. Therefore to facilitate the comparative study of this thesis, secondary sources on corporate governance such as company annual reports, academic journals and newspaper articles will be used to give a picture of the Kenyan context in particular concerns about poor corporate governance in Kenya's companies.

1.5 Motivation for this study

The choice to compare a developed and developing country in the common law jurisdiction category is motivated by the 'law matters' thesis.[68] La Porta et al, the leading proponents of the 'law matters' thesis argue that legal origin determines a country's corporate governance. According to La Porta et al's 1997 study, countries with common law systems have dispersed ownership systems and

[66] See, Drury, R. and Xuereb, P. (1991), European Company Law: A Comparative Approach, Dartmouth.
[67] Zweigert, K. and Kotz, H. (1998), p.5
[68] See generally, Roe, M. J. (2005), Corporate Governance: Political and Legal Perspectives, Edward Elgar Publishing Ltd.

strong shareholder protection.[69] Whilst, La Porta et al's findings are true for England which is characterised by dispersed ownership and strong shareholder protection, they are falsified when applied to Kenya. Nevertheless, Kenya reformed its corporate governance by adopting an Anglo-Saxon based corporate governance code that promises to increase shareholder protection and lead to financial development through dispersed ownership. Ten years on, these corporate governance reforms have not resulted in dispersed ownership or high levels of shareholder protection in Kenya. The ownership structure of Plcs in Kenya remains concentrated and shareholder protection remains weak thereby contradicting La Porta's et al's hypothesis.

Cheffins criticises the assumption of the La Porta et al's 'law matters' thesis that diffuse share ownership offers inherent economic advantages[70] as it results in the policy prescription that the rights of outside investors should be promoted.[71] He refers to this assumption as 'Darwinian.' The Darwinian version of the 'law matters' thesis presumes that countries where blockholders dominate suffer financial underdevelopment. Law reform is prescribed as a cure, with the anticipated result being better overall performance.[72] However, Cheffins finds three weaknesses in the Darwinian view: first, there is evidence that countries where blockholders dominate, such as Germany and Japan, can achieve financial development. Secondly, enhancing minority shareholder rights might impede the formation of and survival of beneficial control blocks where companies with blockholders have an edge, for instance in countries where close relations with stakeholders or reliance on informal networks are ingredients of corporate success.[73]Thirdly, the policy resulting from the law matters thesis – that the rights of outside shareholders should be protected to encourage dispersed ownership - is based on the unrealistic assumption that all firms within a country will encounter a level playing field in their dealings with the state. Where 'crony capitalism' exists blockholders, being aware of the implications of legal reform will use their political connections to lobby against such changes. Consequently, Cheffins argues that even if law reform occurs in the books, it will fail to

[69] La Porta, R., et al (1997), 'Legal Determinants of Finance', The Journal of Finance, Volume 11 (3), pp.1131-1150.
[70] Cheffins, B. R. (2002), 'Corporate Law and Ownership Structure: a Darwinian Link?', University of New South Wales Law Journal, 25 (2), p.346.
[71] Cheffins, B. R. (2002), p.376
[72] Cheffins, B. R. (2002), p.372
[73] Cheffins, B. R. (2002), p.375

manifest in practice thereby inhibiting dispersed share ownership.[74] Therefore, 'surface' legal reforms that create protection for investors 'on the books' are unlikely to make a difference in the quest to attain dispersed ownership if supporting institutions are weak. Even with institutions in place, Cheffins contends that the Berle-Means corporation (where ownership is dispersed) will only result if it offers intrinsic economic advantages that will drive it to the forefront in a market economy: not automatically as a result of law reform as the 'law matters' thesis suggests.[75]

La Porta's 'law matters' thesis suggests that ownership concentration could be the reason for Kenya's financial underdevelopment, the solution to which is legal reform. However, it is questionable whether legal reform by itself can achieve the dispersed share ownership that is associated with development in an environment such as Kenya where 'crony capitalism' is rife and relationships with stakeholders and informal networks play a significant role in determining a company's success. Other institutions such as politics may be influencing concentrated ownership and low shareholder protection in Kenya and as such the result of legal reform may be minimal without addressing these other factors.

An alternative explanation for the determinants of corporate governance is Roe's 'politics matters' thesis. Roe argues that La Porta et al's focus on legal families is oversold. According to Roe, before a nation can produce, it must achieve social peace. If conflict is expected, investors search for the organisational form that minimises the chances and costs of conflicts. As the way to achieve and maintain social peace varies, that variety explains a bit why corporate governance structures vary around the world.[76] Roe points out that in corporatist polities, owners and stakeholders have protected themselves by being concentrated enough to be national political players, because that's where the economic pie is divided up.[77] Therefore examining labour and political institutions can better explain why some nations have deep separation and strong stock markets while others do not.[78] Roe's analysis suggests that law alone is not the only

[74] Cheffins, B. R. (2002), pp.374-375
[75] Cheffins, B. R. (2002), pp.353-354
[76] Roe, M. J. (2005), Corporate Governance: Political and Legal Perspectives, Edward Elgar Publishing Ltd p.1
[77] Roe, M. J. (2005),p.280.
[78] Roe, M. J. (2005),p.281.

determinant of corporate governance. Kenya's concentrated corporate governance system and low levels of shareholder protection could be the result of its politics and in particular the treatment of labour concerns.

Rajan and Zingales offer an alternative explanation for ownership structure and shareholder protection levels to the 'law matters and 'politics matters' thesis. Their research casts doubt on La Porta et al's argument on the superiority of common law in financial development by showing that financial markets in countries with a civil law system were not less developed than those in countries with a common law system in 1913 and in 1929 but only after WWII. Rajan and Zingales argue that when government has a will, civil law countries have a greater ability to translate governmental policy into law because laws emanate from the centre rather than evolving through judicial decisions. Private interests therefore have a greater chance of seeing their agenda enacted in a civil law country.[79] On this basis they advance an 'interest group' theory of financial development. Under the 'interest group' theory, incumbents in the financial sector and industry can be hostile to arm's length markets as arm's length markets do not respect the value of incumbency and instead can give birth to competition. The incentives and the ability of incumbents to oppose development is muted when a country's borders are open to both trade and capital flows thereby allowing development to flourish. The decision to open trade and capital flows is partly political[80] and therefore government action is needed for financial development.[81] According to their findings, countries that regulate entry more tend also to be less financially developed.[82] Therefore, Kenya's financial underdevelopment may be explained by the extent to which incumbents in the financial sector and industry have been open to arms lengths markets and Kenya's economic policy on whether to open up its borders to trade and capital flows. A related finding by Rajan and Zingales is that a country's cultural heritage plays the strongest role when the country is shielded from foreign competition and private interests can reign unhindered.[83] As Kenya has

[79] Rajan, R. G. and Zingales, L. (2003), 'The Great Reversals: the Politics of Financial Development in the Twentieth Century', Journal of Financial Economics, 69,p.42.
[80] Rajan, R. G. and Zingales, L. (2003),p.7
[81] Rajan, R. G. and Zingales, L. (2003),p.18
[82] Rajan, R. G. and Zingales, L. (2003),p.20
[83] Rajan, R. G. and Zingales, L. (2003),p.43

until recently been a closed economy, culture may play a significant role in explaining its corporate governance.

There is a considerable body of literature casting doubt on these theories. Amongst the critics of the 'law matters' thesis are those who criticise La Porta et al's methodology for instance Braendle who disagrees with the significance of law on the validity of the index used to determine the findings of La Porta et al 1997 and Coffee who disputes La Porta's 1997 index on the grounds of accuracy as opposed to the underlying argument that law has a role in corporate governance.[84] Additionally, there is also a class of critics that dispute La Porta's findings in general in particular the importance of legal origin as a determinant of corporate governance. Mahoney, for example, states that the principal drawback of La Porta et al's analysis is the lack of a theoretical reason to expect legal origin to be especially relevant to investor protection.[85] Mahoney argues that it is difficult to make out a strong case for the superiority of the rules produced by common law or civil law as each performs well on the most important measures, providing for enforcement of property and contract rights and requiring compensation for certain wrongful (tortuous) acts.[86] According to Mahoney, the economic significance of the distinction between the common law and civil law derives principally from their distinct ideological and constitutional content, not their substantive rules. The common law is historically connected to strong protection of property rights against state action, whereas the civil law is connected to a strong and less constrained central government. Consequently, in common law countries the judge is an independent policy maker occupying a high-status office, whereas in civil law countries, the judge is a relatively low status civil servant without independent authority to create legal rules. This difference fragments power more in a common law system than in a civil law system.[87]Fragmentation limits the ability of government actors to grant, and therefore of interest groups to obtain, rents because it is more difficult to coordinate the decisions and actions of multiple government actors. This suggests that Kenya's government structure could affect its corporate governance. From

[84] See Braendle, U. C. (2006), 'Shareholder Protection in the USA and Germany - On the Fallacy of LLSV', German Law Journal, 7(3), p. 266 and Coffee, J. C. (2001), 'Do Norms Matter? A Cross-Country Evaluation', University of Pennsylvania Law Review, 149(6), pp. 2154 – 2155.
[85] Mahoney, P. G. (2001), 'The Common Law and Economic Growth: Hayek Might Be Right', Journal of Legal Studies, Vol. 30, p.504.
[86] Mahoney, P. G. (2001), p.506
[87] Mahoney, P. G. (2001),p.507

Mahoney's analysis, by having a common law system, it can be hypothesised that Kenya strongly protects property rights and is a democratic and decentralised state. These statements have not always been true for Kenya. Property rights are yet to be strongly protected despite having a common law system and real democratic space and decentralisation is yet to be achieved. This thesis will explore the extent these factors explain why Kenya contradicts the hypothesis of the 'law matters' thesis. Kenya's ideology and constitutional content will be examined.

The arguments of the foregoing schools of thought make Kenya an interesting case study. Taking these theories into account – the 'law matters' thesis, the 'politics matters' thesis and the 'interest group' theory- this thesis seeks to find an explanation for why despite adopting England's corporate framework, Kenya has failed to achieve high shareholder protection and dispersed ownership. The aim is to assist in making suggestions, if need be, for adapting Kenya's corporate law to make it more effective and suited to its socio-economic context. As it is generally accepted that the law plays a key role in corporate governance[88] and critics of the 'law matters' thesis dispute its importance on the basis of the degree that the law actually plays in determining corporate governance, this research will still proceed with the aim of improving the existing corporate law as law does play a role – even if that role is minimal. Roe highlights the importance of a good quality corporate law for developing countries when he states that, 'many poor nations have decrepit corporate law institutions and in these countries it is possible that weak corporate law is holding them back.'[89]For that reason the quality of a country's companies' legislation and corporate governance framework cannot be ignored, if that country's aim is to achieve economic development.

1.6 Structure of this study

This thesis will be structured as follows: Chapter 1 is a general introductory chapter which introduces the subject matter of this study and presents the

[88] See La Porta, R., et al (2006), 'What Works in Securities Laws?', Journal of Finance, 61(1), p. 27; La Porta, R., et al (1997), 'Legal Determinants of External Finance', Journal of Finance., LII (3), p.1149 and Shleifer, A., & Vishny, R. (1997), 'A Survey of Corporate Governance', Journal of Finance, 52(2), p. 774.
[89] Roe, M. J. (2005),p.293.

research question that is addressed in this thesis. The scope and aims of this study, the methodology that is used in this thesis and the structure of this thesis are also discussed. Chapter 2 describes Kenya's socio-economic and political context. The aim of chapter two is to give a detailed historical analysis of the processes of introduction and subsequent operation of Kenya's transplanted imperial companies' legislation. Chapter 3 positions Kenya within the corporate governance debate. It introduces the concept of corporate governance and considers the impact of globalisation on Kenya's corporate governance. Additionally, it suggests a policy to guide the review of Kenya's corporate framework and the comparative study of this thesis. Chapter 4 reviews Kenya's corporate governance mainly drawing on England's experience to make suggestions for reforming Kenya's corporate framework to a reasonable standard, but it also considers the experience of other common-law countries such as Australia and outside the common-law world, South Africa whose corporate law is common-law based but whose jurisdiction is a mixture of civil and common law. Chapter 5 is the conclusion chapter of this thesis. This chapter draws the matters discussed in this thesis to a close and highlights the contribution of this thesis. In addition it notes the methodology problems and limitations of this thesis and points out directions for future research.

1.7 Conclusion

This chapter introduced the subject matter of this thesis as being the regulation of directors in Plcs in Kenya. It began by stating that Kenya's corporate framework is an Anglo-Saxon-based legal transplant which has failed to be efficient in securing accountability in Kenya's public listed corporations. A difference in national customs and sentiments, particularly the contract and kinship norm, has affected the efficacy of the transplanted corporate framework resulting in the framework being largely ignored after incorporation. The elite has not welcomed reforms – particularly stakeholder-based reforms- as the law as it is favours its economic interests, therefore the law has remained the same since inception. The concentrated ownership structure of Plcs has also persisted for the same reason. A culture of secrecy and paternalism, coupled with impunity and incompetence has resulted in a general institutional and regulatory failure resulting in regulatory capture. As institutional and cultural compatibility is important for a transplant to take, Kenya's corporate framework would have

fared better had its merits and impact on the pre-existing African legal culture been considered. Consideration of Kenya's culture, including its legal culture is necessary in informing recommendations to guide shareholder engagement and improve accountability in companies.

The scope, structure of this thesis and methodological issues were also dealt with. The research question was defined as follows:

> 'How can Kenya's legal framework for governing directors be adapted to reflect local conditions and ideologies so as to improve accountability in Plcs in Kenya?'

The following chapter will provide a detailed historical account of Kenya's socio-economic and political context prior to the transplantation of England's corporate framework. The aim will be to trace the path-dependent development of Kenya's formal and informal institutions and assess the extent to which Kenya was prepared for the reception of England's corporate framework. A historical account will assist in identifying the local conditions and ideologies which influence accountability that should be taken into account in adapting the transplanted framework to Kenya's socio-economic context in order to improve efficiency and accountability in Kenya's corporations.

Chapter 2: Kenya's Social, Economic & Political Organisation: 19th Century to present

The previous chapter stated that Kenya's corporate framework is an Anglo-Saxon based legal transplant which has failed to take due to a difference in the social-economic and political context of England and Kenya particularly in the business norm: while England has a contract culture, Kenya has a kinship culture. This chapter gives a historical account of the Kenyan context in line with McQueen's research which highlights the need for a comprehensive historical examination of the factors surrounding the introduction and subsequent operation of company law legislation in contexts other than England.[90]

McQueen argues that the rigid adherence to metropolitan models must be understood in the context of forces compelling introduction of the legislation in the first place: such as whether the introduction of companies' legislation was occasioned by local or imperial needs and if it was occasioned by imperial needs, the extent to which legislation designed for English economic conditions was suited to the requirements of the colonies. Where there was a mismatch between local requirements and legislative structures, what were the long-term effects of such a mismatch and how receptive were local businesses to the new organisational structures made available by the limited liability legislation.[91] This chapter takes these issues into account in describing the context into which company law was introduced to give a suitable account of the Kenyan context that will be useful in making an assessment of the institutional and cultural compatibility of England's company law and the Kenyan context in latter chapters.

[90] McQueen, R. (1995), 'Company Law as Imperialism,' Australian Journal of Corporate Law, Vol. 5, p.188.
[91] McQueen, R. (1995), p.193.

2.1 Pre-colonial Kenya

Kenya, officially the Republic of Kenya, is one of Africa's 54 countries located in East Africa on the equator. With its capital in Nairobi, Kenya's current population is estimated at 39.8 million[92] representing people of different cultures; local tribes as well as people of other ethnicities mainly Asians and Europeans. The identity of Kenya as a nation, legally, politically, economically and also in terms of corporate governance are all hallmarks of its British colonial past.

Present-day Kenya consists of over 40 tribes which can be classified into three main groups representing the different families of languages spoken by these tribes: '*Bantu, Nilotic and Cushitic speech communities.*'[93]The Bantu, as of 1800 were the most numerous group consisting among others the *Meru, Kikuyu* and *Akamba* in the heartland of Kenya; the *Gusii, Luhya* in Western Kenya; and the *Taita, Mijikenda* and *Swahili* along the Kenyan Coast.[94] The second largest linguistic cluster comprised of the Nilotes, that is, the *Maasai, Luo,* and *Kalenjin* amongst others whilst the smallest group the Kenya Cushitic speech community was made up of the *Gabbra, Borana,* and *Somali* amongst others. These tribal groups still remain to a great extent region-based and in the same proportions in terms of size.[95] There are other tribes that speak dialects of the Bantu, Nilotic and Cushitic groups for example, the *Boni*, the *Okiek*, the *Dorobo* who were historically hunting and gathering groups.[96]

2.1.1 Social organisation in pre-colonial Kenya

[92] See http://www.worldbank.org/ .
[93] Ochieng, W. R. (1992), 'Kenya's Internal and International Trade in the Nineteenth Century' in, Ochieng, W. R. and Maxon, R. M. (1992), An Economic History of Kenya, p.35.
[94] Ochieng, W. R. (1992), p.35.
[95] Their sizes are also directly proportional to their political influence, an aspect which will be discussed in further detail later in this thesis.
[96] Ochieng, W. R. (1992), p.35.

Across the speech communities generally the family was the basic social unit of organisation.[97]Amongst the Agikuyu (Bantu) the lowest social unit was the family, which consisted of a man, his wife/wives, their children, grandchildren and great-grandchildren. The clan, which consisted of several families descending from one common ancestor, was the next level of social organisation. The clan had a mutual social responsibility in matters affecting its members and clan members participated in common activities such as initiations and marriages. They also helped each other pay fines and avenge insults. The Agikuyu had a system of age or status grades, which covered an individual's life from birth to old age. The Agikuyu were also organised into age-sets, *riika*, which were formed by boys and girls who were initiated at the same time. During initiation, the secrets of the tribe were taught.[98] This pattern of organisation was generally the same in other Bantu communities with suttle differences such as joining the clan through means other than decent. The Akamba for example practiced adoption with their kinship system being open to members of other communities[99] to the extent that some clans had their ancestry outside the Kamba community. All clans were patrilineal and therefore the children belonged to the father's clan. The Luo, however had some differences in their system of social organisation. Amongst these differences is the lack of age-sets and age-grades in their system of social organisation.[100]

2.1.2 Economic organisation in pre-colonial Kenya

The Bantus, including the Agikuyu and Akamba, practiced agriculture as the mainstay of their economies whilst the Nilotes, including the Luo, practiced a mixed economy in which livestock rearing had the pride of place.[101] Another group of people that was present in Kenya before colonialism was the East African Indians.[102] These Indian merchants, based on the coast of East Africa,

[97] See Kenya Literature Bureau (2003), Secondary History and Government Form 1 Students' Book, Ch.5. A detailed description of the social organisation of the more than 40 tribes of Kenya is not possible given the scope and aims of this chapter, however the few tribes picked – Agikuyu, Akamba and Luo (key players in Kenya's politics today) - give a general picture of social organisation in the different speech communities in the pre-colonial times.
[98] Kiio, M., Manji, J. and Munyao, L. (2003), Explore History and Government, Form 1, Longman Kenya, pp.57-58.
[99] Kiio, M., Manji, J. and Munyao, L. (2003),p.64
[100] See generally Kiio, M., Manji, J. and Munyao, L. (2003), ch.5.
[101] Ochieng, W. R. (1992), p.36.
[102] Himbara, D. (1994), Kenyan Capitalists, the State and Development, Boulder & London, p.7.

served the transit route between Europe and the Far East for centuries. After the 1840s they linked and controlled hinterland trade.[103]The Indian community in Kenya remains small. Over the centuries, agriculture and pastoralism were established and developed in Kenya as the major modes of production.[104] The Bantu produced a sufficient amount of commodities for subsistence and exchange with other groups when there was a shortfall. Livestock served as a regional currency: an accepted medium of exchange in most transactions, a standard of value, and a means of accumulation and exchange.[105] The basic unit of production and consumption was the household or extended family, which did not function in isolation and cooperation was essential for the performance of agricultural and pastoral tasks.[106] Such cooperation was normally accomplished and regularised through kinship ties, particularly through '*traditional self-help groups*.'[107] Alongside the traditional economies, various handicraft industries existed in the 19th century Kenya most of which involved some degree of labour specialisation but they did not involve payment in the capitalist sense. Barter trade was the traditional form of exchange.[108]The colonial conquest brought dramatic changes to this pattern.

2.2 Colonial Kenya

Kenya became a British protectorate in 1895.[109]The declaration of a protectorate over much of what is now Kenya marked the beginning of official British rule in Kenya, a rule that was to endure until 1963.[110]The British acquired control of Kenya through a favourite Victorian colonial device, the chartered company – in this case, the Imperial British East Africa Company (IBEAC) – and the declaration of the protectorate signified the demise of the Company as an instrument of acquisition and administration.[111]

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[103] Himbara, D. (1994), p.25.
[104] Ochieng, W. R. (1992), p.36.
[105] See generally Ochieng, W. R. (1992), pp.36-37.
[106] Maxon, R. M, (1992), 'The Establishment of the Colonial Economy', in Ochieng, W. R. and Maxon, R. M. (1992), An Economic History of Kenya, p.63.
[107] Maxon, R. M, (1992), p.63.
[108] Maxon, R. M, (1992), p.64.
[109] Ogonda, R.T. (1992), 'The Colonial Industrial Policies and the Process of Industrialization in Kenya', in Ochieng, W. R. and Maxon, R. M. (1992), An Economic History of Kenya, p.160.
[110] Ghai, Y. P. and McAuslan, J. P. W. B. (1970), Public Law and Political Change in Kenya: A Study of the Legal Framework of Government from Colonial Times to the Present, Oxford University Press, p.3.
[111] Ghai, Y. P. and McAuslan, J. P. W. B. (1970), p.3.

With colonialism, came the introduction of additional people groups to Kenya; mainly Europeans. During this time, the East African Indians were coastal merchants, as well as new workers from India, worked as wage workers and administrative cadres associated with the building of the Kenya-Uganda Railway. The colonial state had to turn to India for a labour force precisely because local productive relations were such that there was no 'free' labour to be had and the need for wages, not to speak of a disciplined labour force, still had to be created.[112]European settlement began in earnest after the passing of the Crown Lands Ordinance of 1902 which declared that all land belonged to the British Empire.[113]European farmers were encouraged to settle in the country to grow cash crops to help finance the expenditures of the country[114]marking the transition from the traditionally mixed economy to an agricultural-based economy. The Crown Ordinance of 1902 provided that settler farmers would lease land for 99 years. Each settler was to be given 160 acres free of charge as an inducement to farm. This led to an influx of settlers between 1908 and 1914.[115]

This European settlement had been conceptualised by European travelers, missionaries and imperialists who regarded uninhabited lands as *'no man's land'* and therefore free for settlement and exploitation by European settler-farmers.[116] It is true that some parts of Kenya were uninhabited [117]as there were not many people in pre-colonial Kenya. The population of Kenya by 1800 is estimated at not exceeding 2.5 million people.[118]In some cases areas had been evacuated when calamities such as droughts, famines or pestilence struck. However, there was no such thing as *'no man's land.'*[119] The coming of the Europeans to Kenya had led to the displacement of some communities from their land, particularly the *Kikuyu*, resulting in significant changes in the landscape.

[112] Himbara, D. (1994), pp.7,33.
[113] Kenyanchui, S. S. S. (1992), 'European Settler Agriculture', in Ochieng, W. R. and Maxon, R. M. (1992), An Economic History of Kenya, p.114.
[114] Ogonda, R.T. (1992), p.160.
[115] Kenyanchui, S. S. S. (1992), p.114.
[116] Kenyanchui, S. S. S. (1992), p.111.
[117] Kenyanchui, S. S. S. (1992), p.111.
[118] Ochieng, W. R. (1992), p.35.
[119] Kenyanchui, S. S. S. (1992), p.112.

Amongst these changes were the change in the people's identity from 'nations' to nation, the move from African customary law to rule of law, the transformation from communal ownership to the introduction of property rights, the move from the co-operative to the adoption of the company as a business form and the introduction of a monetary economy.

2.2.1 From 'nations' to 'nation': the birth of the Kenyan state

Before colonialism, the area now occupied by Kenya was inhabited by diverse nations -tribes- who lacked formal state organisation.[120] Governmental authority, if it existed at all, was highly diffuse and the centre for sovereignty was grossly blurred.[121] Most tribes were headed by a Chief and governed through a Council of Elders.

The *Agikuyu* were politically decentralised. The smallest unit was the family, headed by the father. Several families made up a clan (the basic political unit) that occupied a local territorial unit usually along a ridge. The clan was ruled by council of elders, *Kiama*, whose Chairman, *Muramati*, was highly respected for his wisdom. He was a unifying factor and possessed great leadership qualities. The main functions of the council included solving land and inheritance disputes, settling civil and criminal cases, and presiding over religious functions. A council of senior elders, *Kiama Kia Ndundu*, was selected from a number of councils and served as a court of appeal.[122]

Amongst the *Akamba* related families formed a clan council, *Mbai*, which dealt with land disputes, property ownership and compensation for wrongs done to members of other clans. Non-related families within the same village, *utui*, also organised themselves into a council, *nzama*, which presided over civil and criminal cases. The council also controlled planting and harvesting and even regulated the size of livestock herds in proportion to available pasture. Several

[120] Orwa, K. (1990), 'Diplomacy and International Relations', in Ochieng, W. R. (1990), Themes in Kenyan History, Heinmann Kenya, p.219.
[121] Orwa, K. (1990), p.219.
[122] Kenya Literature Bureau (2003), Secondary History and Government Form1, p.52

villages formed a larger political unit, *Kivalo*, which had power to declare war or sue for peace, preside over religious functions, solve inter-village disputes and organise large-scale ceremonies. All adult males up-until their mid thirties were involved in leadership at one level or another usually belonging to various warrior grades. After this, they graduated into elder grades. Junior elders, *anake*, were married but still with uncircumcised children.[123] They also served as senior warriors whose main duties included defending the community. Medium elders, *nthele*, were those whose children had joined the ranks of junior elders. They helped in administration by listening to simple cases and passing judgment. Full elders, *atumia ma kivalo*, were ranked as first elders, *atumia ma kisuka*, second elders, *atumia ma nzama* and third elders, *atumia ma ithembo* according to age. They were greatly respected for their wisdom and leadership communities and they presided over religious functions like communal prayers and ceremonies.[124]

The *Luo* were divided into thirteen sub-tribes, *oganda*, each occupying an autonomous political and territorial unit, *gweng*. Below this was the village council, *jodongo*, and the clan council, *doho*. The political and territorial unit was ruled by a council of elders, *buch piny*, made up of heads of clan councils, prominent diviners, healers, rainmakers and military commanders. The council of elders was headed by a chief, *ruoth*. It dealt with important matters such as murder, cattle theft, boundary disputes, warfare and calamities and carried out ritual ceremonies and declared war or negotiated peace with adversaries. The council could also admit strangers into the community or expel undesirable individuals.[125]

The state of Kenya, as we know it today, is a colonial creation which entered in the arena of international relations only in 1963[126] when Kenya became an independent and sovereign state.[127] Kenya would never have existed but for the European powers' scramble for colonies in Africa in the latter part of the 19th

[123] Circumcision was a rite of passage into adulthood in African tradition.
[124] Kenya Literature Bureau (2003), p.55.
[125] Kenya Literature Bureau (2003), p.59.
[126] The Kenya Independence Act, 1963 provides that on and after 12th December 1963, Her Majesty's Government in the UK would no longer have responsibility for the Government of Kenya or any part thereof.
[127] Orwa, K. (1990), p.219.

century, following which territorial boundaries were carved out across natural divisions particularly tribe and geography into countries with peoples lacking any common culture, indigenous language or religion.[128]Amongst these countries was Kenya. Kenya's statehood is therefore a colonial legacy.[129]

2.2.2 From African customary law to 'rule of law'

Each of Kenya's 40 tribes had its own culture, traditions as well as its rules/law. Jackson, in one of the early texts on Kenyan law, '*The Law of Kenya*'[130], states that:

> 'It must not be thought that there was no law in Kenya before the adoption of English law. There were rules applicable to different ethnic groups in Kenya and these rules formed what is described as **African customary law**. Customary law includes, for example, the following matters – land held under customary tenure, marriage, divorce, dowry, maintenance, matters affecting status, succession, claims in contract and tort. The documentation of customary law is improving, but **the rules of customary law are not common to all ethnic groups**.'[131]

As seen in the previous section, in addition to having different rules/ laws, each tribe had a system of dispute resolution in place akin to that of the courts: usually, the Council of Elders.

When English settlers first came to Kenya, they brought with them the rules of English law as they existed at that time. In 1921 the applicability of English law, including, *'the substance of the common law, the doctrines of equity and the statutes of general application in force in England on the 12th day of August, 1897,'* was confirmed by the Kenya Colony Order in Council.[132] In general, customary courts were prohibited from administering the received law or local

[128] Gower, L. C. B. (1967), Independent Africa: The Challenge to the Legal Profession, Harvard University Press, Cambridge, Massachussetts, p.4.
[129] Gower, L. C. B. (1967), p.4.
[130] Jackson, T. (1988), The Law of Kenya, Kenya Literature Bureau, 3rd Edition.
[131] Jackson, T. (1988), p.21.
[132] Jackson, T. (1988), p.8. The Order in Council, a form of delegated legislation, was one of the instruments by which the Privy Council in the United Kingdom legally controlled the British colonies. Even if a colony had a local legislature, Orders in Council prevailed over local statutes.

legislation but British courts could administer customary law when it was applicable to a dispute before them. The received law was administered by British-type courts – operating, moreover, with all the paraphernalia of English tradition, including wigs and gowns, totally unsuited to tropical conditions- presided over by judges drawn from the Colonial Legal Service, and operating under a procedure based on that prevailing in English courts but with the substitution, generally of assessors or a judge alone for the jury.[133]Before independence the customary courts had therefore been integrated to a greater or lesser degree into a common court system, and, efforts were being made to ensure that all judges received some sort of training. This legal legacy was one of extreme complication, fraught with problems of internal conflicts between diverse customary laws and between customary laws and received law. English law was applied without consideration of its suitability to local conditions and this was the position that prevailed up to independence.[134] Therefore, the rule of law as we know it – that is the presence of a bill of rights and constitution, the introduction of statutes and common law, adjudication of disputes by independent courts - is a British legacy.

2.2.3 From communal ownership to the introduction of property rights.

Ownership in the African traditional society, including Kenya, was generally communal. Land was owned communally by the Clan and individuals had no title to the land. Their concern was only with occupational rights[135]also referred to as 'use' rights. In pre-colonial times, land had little or no importance and land ownership disputes did not exist. As much land was cultivated as was required to live on, and the rest was left idle. The individual was unable to dispose authoritatively the land he cultivated. He may have used it at his will and even sold it for a certain time, but always on the implicit condition that within a reasonable time he may pay back the price and have his land returned. In the event that a man died during alienation of a piece of his land, the Clan had a right to recover it regardless of the willingness of the new owner. Therefore the

[133] Gower, L. B. (1967), pp.28-29.
[134] Gower, L. B. (1967), p.29.
[135] Okoth-Ogendo, H. W. O. (1991), Tenants of the Crown: Evolution of Agrarian Law and Institutions in Kenya, ACTS Press, p.10.

absolute ownership of the land resided exclusively in the Clan as a joint body, the individuals who exploited it being simply custodians by communal consent.[136]

Amongst the few Kenyan communities that recognised private ownership was the *Agikuyu*.[137] It was the *aim of everyone* amongst the Agikuyu *to possess* a number of cattle as cows were the currency of the land, with which all affairs were settled from marriage contracts to the most complicated juridical cases. Cattle ownership was vested in the family rather than in the individual; the head of the family would dispose of it at will.[138] Even amongst the Agikuyu personal ownership was interpreted very broadly, so that various articles, whilst the property of a person, may easily be turned into communal use.[139]

Colonialism resulted in alienation and acquisition of land as a prelude to the establishment of the colonial state; imposition of English property law and the celebration of title in the alienated areas; and the introduction of tenure reforms in the African areas and native reserves.[140] Since Africans owned land in terms of occupational rights the colonialists assumed that unoccupied land was ownerless and therefore it reverted to the territorial sovereignty- the Crown.[141] This was the general assumption except in Kikuyu country where the Kikuyu were compensated for their alienated land.[142] This can be attributed to their previous familiarity with the concept of private ownership.

2.2.4 From the 'co-operative' to the 'company'

The colonial conquest of Kenya after 1895 not only established alien political domination, but it also created conditions conducive to the penetration of

[136] Wambugu, H., Ngarariga, J. M., Kariuki, P. M. (2006), The Agikuyu: their customs, traditions & folklore, Wisdom Graphics, p.29.
[137] Wambugu,H. et al (2006),p.28.
[138] Wambugu,H. et al (2006),p.28.
[139] Wambugu,H. et al (2006),p.29.
[140] See generally Okoth-Ogendo, H. W. O. (1991).
[141] Okoth-Ogendo, H. W. O. (1991), p.11.
[142] Okoth-Ogendo, H. W. O. (1991), p.11.

capitalism[143] which would materialise after the Second World War (WWII). A particular change was the introduction of the concept of the company through the CA 1948. The business corporation in the Anglo-American sense, where a corporation had its own personhood and therefore could act on its own behalf and be sued was a radically new transplant in the Kenyan context with no equivalent in Kenyan tradition. The nearest entity to the corporation in pre-colonial Kenya was the '*traditional self-help group*' which is commonly known today as the *chama*. The *chama* is popular amongst women as a means of saving and raising much needed capital to undertake projects that require a substantial amount of income in relation to the income of one individual. Kanogo and Maxon describe the early forms of this phenomenon while discussing the evolution of co-operatives in Kenya as follows:

> 'The evolution of the modern co-operatives was closely related to the colonial economy. Yet **the concept of co-operation was not a colonial invention**. Rather self-help and co-operative principles were firmly ingrained in all pre-colonial Kenya societies. Members of **kinship or neighbourhood groups** joined forces to perform certain tasks together and in rotation from one member to another depending on their needs. Amongst the Kikuyu there existed the *Ngwatia*, and the Kamba had the *Mwethiya*. Similarly, among the Luo there was *Kwath* and *Saga, Kokweti* for the Kalenjin, *Obotwari* and *Obarisia* among the Gusii to cite a few examples. These traditional co-operative groups built houses, broke the land, planted, herded and hunted. They pooled resources together and shared the proceeds of that labour, and this produced **a spirit of sharing and unity**. People joined these groups even if they did not immediately need the services provided. In this characteristic, traditional self-help groups differ from the modern-day co-operatives which operate only for the benefit of members; people do not join them unless they require their services.'[144]

The difference between today's Anglo-American corporation and the traditional *chama* is the underlying norm; whilst today's corporation is based on contract as the norm, the traditional *chama* was based purely on kinship. Therefore while the Anglo-American corporation was based on shareholder value, the traditional chama embraced a form of stakeholder/communal value that was not profit-based. Today's *chama* is based on a common-endeavour usually dependent on proximity and therefore its basis is more on the spirit of neighbourhood rather

[143] Maxon, R. M, (1992), 'The Establishment of the Colonial Economy', in Ochieng, W. R. and Maxon, R. M. (1992), An Economic History of Kenya, p.63.
[144] Kanogo, T. and Maxon, R. M., 'Corporatives', in Ochieng, W. R. and Maxon, R. M. (1992), An Economic History of Kenya, p.372.

than kinship. For instance, people, usually women, working in the same organisation or attending the same social group may come together and form a *chama* to meet their respective needs irrespective of their ethnic or tribal affiliations.

This difference in the underlying norm between the traditional clan-based corporation and the transplanted modern day corporation has been noted in Ruskola's work on the role of kinship in corporations in China. Ruskola makes the point that contract is the 'norm' of traditional corporate law in Anglo-American systems whereas in collectivist/kinship based systems it is often kinship that is the basic norm of business associations.[145]According to Ruskola, before the introduction of European law, the Chinese operated 'clan corporations' or relatively large commercial enterprises organised in the guise of the family, a tradition which continues to inform the understanding and operation of business in contemporary China[146] with much success. Familism/kinship has had less of a positive effect on Kenya's corporate landscape in comparison to China.

In particular is the fact that large commercial enterprises based on clan organisation have failed to materialise/come into being in the Kenyan society as is the case in China. The reason for this may be that the Kenyan African community has not developed the 'discipline' necessary to sustain corporations. Commenting on co-operatives as one of the best vehicles for development in Kenya's Development Plan for the years 1964-1970, the Sessional Paper gave recognition to this discipline factor:

> 'Co-operatives have direct roots in African tradition but their extensive use in the monetary sector of the economy will involve **greater discipline and training** that has hitherto been necessary. Those who share in the tasks of the co-operative or who use its services share also in its benefits as the co-operative belongs to them.'[147]

[145] See generally, Ruskola, T. (2000), pp. 1599-1729
[146] Ruskola, T. (2000), p.1602.
[147] Sessional Paper No.10 on African Socialism and its Application to Planning in Kenya, para 46, p.15

Although the foregoing quote refers to co-operatives, it can be applied to the Kenyan perception of the corporation. Greater training and discipline is required to change the Kenyan perception of the modern corporation as a body that is there to take care of its employees, its success not being paramount. This perception that is rooted on a *dependency* culture has been transferred from the clan where members expected the head of the clan to take care of their welfare. The clan head therefore owed them a duty of care to be diligent in protecting their welfare whereas the members of the clan owed the clan a duty of loyalty. The result of this is evident in society's expectation of an individual who gains employment in a company. The general expectation is that because a member of the clan has secured employment in a particular organisation, they will canvass for the employment of their unemployed relatives in that company. The consequence of this is negative familism/kinship – where the success of the company ceases to be the objective of the company and is replaced by the success of the clan. This ends up in negative consequences for corporate governance such as wrong board compositions based on '*know who*' rather than '*know how.'* Consequently, whilst family businesses form the heart beat of enterprise in Kenya and cut across all industries and regions of Kenya,[148] the companies that have a lifespan of more than three generations tend to be Asian/European owned – not African. Although family-based Kenyan firms such as the Chandaria Group are doing well economically, having become multinationals, the owners of these firms are of Indian origin suggesting that although familism/kinship is in play in these firms, it is Asian kinship rather than African kinship that is in play. Whilst kinship/familism seems to work for Asian firms making them progressive, it seems to have a retrogressive effect in African corporate governance. Ruskola draws an analogy between the Chinese clan corporation and the Anglo-American corporation noting amongst their similarities the pursuit of profit.[149] Kenya's self-help groups /*chamas* differ from the clan corporation in that their aim is more to save than to make profit.

2.2.5 From a 'barter' economy to a 'monetary/market' economy

Another change that created conditions conducive to the penetration of capitalism was the introduction of currency as a form of exchange in lieu of

[148] See Bindra, S., Family firms are not great until they evolve, Business Daily, March 20th 2009.
[149] Ruskola, T. (2000), p.1605.

barter trade. As the building of the Kenya-Uganda Railway progressed inwards, the former coastal merchants and new Indian traders followed it expanding their trade in imported consumer goods inwards thereby resulting in the introduction and spread of the use of money, namely Indian *rupees*.[150]The *rupee* became the currency of commerce at the turn of the century, hence the British made the Indian silver *rupee* the standard coin in British territories in East Africa.[151]

From the outset of British rule, a European class was established in Kenya and with the development of a market economy, other forms of production became subject to the needs of capital.[152]By the early 1920s, the number of Europeans in Kenya had reached 20,000 compared to the African inhabitants who were about 3 million. These settlers exercised a degree of influence that was out of proportion to their numbers with the resident section of estate capital being the dominant political force within the administration.[153]By 1920 when Kenya became a Crown colony, settler farmers constituted a group whose interests were bound up with internal accumulation. Swainson points out that the difference between a settler farmer like Lord Delamere and a large British plantation company was that the ownership and control of the latter lay outside the local formation. Following this phase of 'primitive accumulation of capital' with the settlers intending to control the means of production and exchange in Kenya, a dual policy of African and European agricultural production was passed by the metropolitan government in 1922. This policy asserted the doctrine of 'native paramountcy', but was fraught with contradictions. It encouraged dual forms of agricultural production, peasant-households and estates which competed directly with each other for labour. Another contradiction was that one of the key functions of the Kenyan administration from the early period of European settlement was to ensure a labour supply to the estates. By means of taxation and forced labour before 1925, Africans were forced to either sell their labour to European farmers or to cultivate cash crops for the market.[154] The settlers were determined to force Africans into the labour market:

[150] Himbara, D. (1994), p.25.
[151] Himbara, D. (1994), p.34.
[152]Swainson, N. (1980), The Development of Corporate Capitalism in Kenya 1918-1977, Heinemann, p.5.
[153] Estate capital included the larger settler farmers and foreign estate companies.
[154] Swainson, N. (1980),pp.6-7.

> '… the government has an obligation to see that the fit African adult male does in fact enter the labour market in sufficient numbers to build up the country's strength.'[155]

Forcing Africans to work on settler firms at this point was a paradox as the state heavily relied on revenue from African-grown cash crops which as of 1913 furnished three quarters of the country's export earnings. This created political and economic problems for the colonial administration as it was difficult to perpetuate the myth of racial supremacy in the face of statistics on African agriculture as African agriculture was meant to complement not to compete with European agriculture. Eventually, the settlers were content to accept the fact that Africans dominated, at least statistically, cash crop production, as long as they controlled the distribution of agricultural commodities. This resulted in the development of an African farming class which the Europeans could not tolerate as it presented a threat to their political monopoly.[156]

The period before 1945 was therefore characterised by the dominance of the agricultural and mercantile sector. Manufacturing was relatively absent and the little manufacturing there was, was controlled by foreign firms. Foreign investment in the manufacturing sector was confined to estate production of exported commodities such as sisal, tea, coffee and wattle. Much of the food processing industry was controlled by the settlers. Asians and Africans were effectively excluded from participating in the manufacturing sector. Large-scale trading was therefore dominated by foreign-owned firms while petty trading was generally controlled by Asians and a new emergent African bourgeoisie.[157]

Before WII the European minority in Kenya effectively resisted any pressure from the indigenous people for devolution of power.[158]During this period, the British policy on industrialisation was against the development of manufacturing industries in the colonies. The British policy towards the colonies was to use

[155]Huxley, E. (1975), The Settlers of Kenya, Greenwood, Connecticut, p.47.
[156] Swainson, N. (1980),p.7
[157] Kaplinsky, R. (1978), Readings on the Multinational Corporation in Kenya, OUP, Nairobi, p.6.
[158] Swainson, N. (1980),p.8.

them as a basis for the extraction and/or production of foodstuffs, especially raw materials for British industries.[159]Kenya in particular was colonised to provide raw materials for industrial Britain while affording a captive market for Britain's manufactured goods.[160]Thus, colonial territories were considered markets for industrial goods, and the development of manufacturing industries in the colonies represented a threat to British products in the home market.[161] This policy was however soon to change.

By 1940, the British policy towards colonial industrialisation had changed in favour of investment in manufacturing. WWII was the main stimulus behind this change of policy because during the war, the Europeans living in Kenya and East Africa were unable to obtain goods they had earlier imported by sea from Britain. Consequently, it became necessary that some local manufacturing should be started to alleviate shortages and to strengthen the country's economy. Therefore during the war the manufacturing industry in the country was strongly encouraged and supported by colonial authorities in both London and Nairobi. This policy continued after the war for three reasons: First, the war had led to the rise of gigantic international firms such as Unilever which had enough financial resources to set up subsidiary firms in the overseas territories. Secondly, the levels of wages in Britain were at least 400% higher than in East Africa. Therefore, firms such as Unilever wanted to take advantage of the cheaper East African labour. Thirdly, the Labour Party came to power in Britain in 1945 and due to its socialist leanings, it was anxious to encourage growth of new industries in Britain's colonies.[162]In response to this state of affairs, various government bodies were created in Kenya to foster industrial development. The earliest of this was the East African Industrial Research & Development Board (EAIRDB) established in 1941 to assist in the establishment of industries. In 1942, the EAIRDB was reconstituted and renamed the East African Industrial Council (EAIC).[163] The EAIC was responsible for the development of manufacturing industries throughout East Africa. During 1942-1945 the East African Industrial

[159] Ogonda, R.T. (1992), 'The Colonial Industrial Policies and the Process of Industrialization in Kenya', in Ochieng, W. R. and Maxon, R. M. (1992), An Economic History of Kenya,p.160.
[160] Maxon, R. M, (1992), 'The Establishment of the Colonial Economy', in Ochieng, W. R. and Maxon, R. M. (1992), An Economic History of Kenya, p.63.
[161]Ogonda, R.T. (1992), p.160.
[162] Ogonda, R.T. (1992), p.164.
[163] Ogonda, R.T. (1992), p.164.

Management Board (EAIMB) had started several industries in Kenya. At the end of the war, the Board on behalf of the Kenya government arranged with the Unilever Group to form a company to take over the business and equipment of the Board. The new company was named East African Industries Limited.[164]

During the post-war period, 1945-1963, the forms of ownership and control of capital began to undergo a long-term shift in favour of international capital, which was accompanied by a relative decline in settler production in the colony.[165] A number of foreign industries were given considerable monopoly positions in certain industrial sectors in addition to the freedom to remit back home all or part of their profit earnings.[166] Asian industrial capital went into manufacturing.[167] By then only a few Asian families had managed to accumulate capital from wholesale and import trade and were able to venture into large-scale manufacturing. The dominant feature of postwar Kenya was the massive investment of financial agencies in African cash-crop agriculture which was effected by extending loan capital and providing link-ups with technical expertise for agricultural and industrial projects which were not initially attractive to private capital. This policy was implemented through the *Swynnerton Plan of 1954* which was aimed at developing indigenous agriculture for the world market. This plan broke the competitive opposition which existed between estate and household commodity and integrated the two under the aegis of international capital. Multinational firms were closely linked with government plans to develop cash crops such as pyrethrum and tea, which were dominated by Mitchell Cotts and Brooke Bond respectively. These changes in the Kenya's structure of production necessitated the destruction of racial boundaries surrounding production. Domestic savings had increased in the colony after 1945 and capitalist relations were extended. Larger numbers of Africans entered the labour market in both agriculture and industrial production, working in the factories and estates and in peasant cash crop production.[168]

[164] Ogonda, R.T. (1992), p.165.
[165] Swainson, N. (1980),p.9.
[166] Ogonda, R.T. (1992), p.165.
[167] Ogonda, R.T. (1992), p.168.
[168] Swainson, N. (1980),p.10.

The post-war period was transient in terms of political dominance. It became increasingly hard to arbitrate between contending class forces of settler, indigenous and foreign elements. Policies favouring the development of African agriculture required a break in settler monopolies over production and distribution in Kenya. These policies were intended to encourage an African middle class which would hopefully stabilise the political scene and pre-empt a more radical nationalism. A degree of African participation was allowed in agricultural boards, although this attempt to incorporate African nationalism within a political system dominated by whites was doomed to failure. During this period many of the larger farmers and European businessmen had realised that their political future lay in a compromise with African nationalism but the bulk of smaller settlers had everything to lose from an African nationalist settlement. Settler capital was in relative decline after the war and settler enterprises were being rapidly absorbed by Asian and foreign firms. The 1950s were marked by the rise of the *Mau Mau* rebellion which the settlers were unable to quell without British military intervention. Following this revolt, plans for immediate political representation for Africans were brought to the top of the agenda. This marked the beginning of the end of the settler aspiration for self-government in Kenya. The settlers finally conceded nationalist settlement in the 1960s and that was the final blow to their supremacy – at least politically. This transitional period was to give way to the hegemony of the indigenous bourgeoisie in the 1960s. [169]However, prior to examining this, it is fitting to examine company formation in colonial Kenya.

2.2.6 Company formation in colonial Kenya

In the sections on company formation, this chapter draws heavily on the works of Swainson and a few other authors as that is all the information there is on company formation and ownership structure in Kenya in peer-reviewed work.[170]

[169] Swainson, N. (1980), p.11.

[170] There is limited information on company formation in Kenya partly due to the lack of a research culture resulting from a deliberate decision during the Moi presidential era (1978-2002) not to fund universities for fear of a growth in enlightenment that would challenge Moi's authoritarian regime. In addition, the general impunity culture, mismanagement and outdated infrastructure of government institutions such as the Office of the Registrar of Companies, which keeps records on company

This general lack of data due to weak institutions is one of the limitations of this thesis. The author however tries to make the most of the little information available in analysing Kenya's corporate governance system.

2.2.6.1 Company formation in Kenya: 1907-1922

Business formations between the years 1907-1922 and land were largely controlled by the settlers. Although small in number, settlers controlled state policy which was invariably bent towards supporting their own accumulation. Swainson points out that the most striking feature of company formation during this time was the instability of such investments and the interlocking nature of ownership. The average life-span of the first 35 public companies to form was only 9 years, with 5 of them surviving for less than a year. The ownership structure of these companies was also concentrated among a small number of individuals. Lord Delamere, one of the most prominent settler barons, for example owned a share in the capital of three of these early companies: Unga Ltd., Nyama Ltd., and the Times of East Africa (the latter being an important organ in settler politics). Nyama Ltd. was a cattle ranch whilst Unga Ltd was a grain milling concern. Delamere's position as part of the large farming group and prominent politician was reflected in his business formations.[171]

Captain E.S. Grogan, another settler politician principally involved in timber and property had shareholdings in 6 out of these 35 companies. Most of these companies were owned jointly with members of his family, notably his wife and brother. They included Kilindini Harbour and Wharf Company (Kilindini), Upper Nairobi Township and Estate Company, Masailand Trust Corporation, Ndimu, Miti and Kenani Fibrelands. Kilindini became amongst the earliest examples of the interaction between politics and corporate governance in Kenya. Kilindini had been set up in 1906 by Grogan, his wife and another settler, W. Hunter, with the Grogan family having the controlling interest. Grogan had been unofficially granted 50 acres of land abutting on Kilindini Harbour in Mombasa where he had constructed a small timber wharf equipped with gear for uploading cargo from

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formation, means that such information is not readily available/accessible. See Kenya Hansard (2004), National Assembly: Official Report, Wednesday 12th May 2004, pp.1080 -1096.

[171] Swainson, N. (1980), p.48

ships. The settler group began to resent the fact that an essential service was controlled by an individual rather than the state resulting in strong pressure on the administration from elements of the settler group to purchase the wharf. Finally, after four years of negotiation, Grogan agreed to sell the wharf and 50 acres of adjoining land to the government for £350,000 in 1925. The wharf had been valued at £37,000 in 1920 and the 50 acres had been leased to Grogan at nominal rent. Despite paying an exorbitant price for the wharf and the land, the government was not able to use it for some years as it had been privately leased by Grogan to another wharfage company. Six months later, the wharf began to show signs of collapse. Swainson points out that this kind of speculation only succeeded if an individual had close connections with the bureaucracy. Both Grogan and Delamere were prominent on a number of committees and boards responsible for policy-making in the colony.[172]

Hunter, a company secretary and Grogan's brother-in-law, had shareholdings in 9 of the 35 companies several of which overlapped with Grogan. These firms, including the Upper Nairobi Township Company, were mainly in the areas of property and farming. Similarly, W. Fletcher, a law clerk in Nairobi, had shares in 11/35 companies. His firms were in land, property and farming, the only exception being the Nairobi Motor Transport Company. Fletcher was also involved in Delamere's company, Nyama Ltd. His firms also overlapped with Grogan. The joint subscribers to the Masailand Trust Corporation, for instance, were Grogan, Allsopp and Fletcher. The Mackinnon Brothers owned two firms in this group which were concerned with land development: the Nairobi Prospecting and Acquiring Syndicate (1907) and Mackinnon Bros Ltd (1911) both of which were established in the import/export trade.[173]

The combination of ownership and control was a common feature of these early firms. These companies were short-term based and as such directed towards concerns that produce capital quickly. 25/35 of these early companies were involved in land, property development and agriculture with the remainder in trading or small-scale servicing such as printing, repair work and newspapers.

[172] Swainson, N. (1980), p.49
[173] Swainson, N. (1980), pp.49-50

These early companies were mainly speculative and extractive. Corruption, rapid buying and selling made for an unstable pattern of early company formation. During this initial period, there was little investment in manufacturing, which required larger amounts of capital. The only company that was formed in this sector was the Mombasa Electric Light and Power Company formed in 1908 to generate electricity in Mombasa, the first town in East Africa to have electric light. This company was notable in other respects as it was unusually a partnership between Asian and European shareholders: Messrs Esmailjee Jivanjee & Company held a 70% stake in the company and a local town councillor, Udall held the remaining 30%. This company was incorporated as a public company in 1924 under the name East African Power & Lighting. On listing, the company recruited foreign technical expertise in the form of Power Securities Corporation and Balfour Beatty, who acted as the company's management and technical consultants until 1970.[174]

Though all the first 35 public companies to form in Kenya are now extinct, several have been reconstituted in a different form. These include, East African Power & Lighting, Unga Ltd and The Times of East Africa. The small presence of Asian capital in public companies during this period (with the exception of Mombasa Electric Light Company and Indian Trading Association[175]) is not surprising as their operations were not yet large enough to form public firms.[176]

In sum, the features that characterised the early formation of companies in the Kenya Colony included general instability, limited range of enterprises often speculative in nature and interlocking personnel both in terms of management and shareholding.[177]

2.2.6.2 Company formation in Kenya: 1922-1945

This period was characterised by a greater degree of stability, an increase in the number of companies as well as the size and activities of both local and foreign firms. During this period, fewer companies were struck off. Most companies failed in 1930 during the Great Depression. Racial categories were used under

[174] Swainson, N. (1980), p.50
[175] Registered in 1904 but went into liquidation in 1910.
[176] Swainson, N. (1980), pp.50-51
[177] Swainson, N. (1980), p.51

the colonial classification system reflecting the prevailing ideology of European supremacy. European firms predominated in the area of agriculture which was exclusively a settler preserve. The next area in which Europeans dominated was property and real estate. Few European firms were involved in manufacturing as settlers processed their commodities collectively through state-sponsored bodies such as Kenya Farmers Association, Kenya Co-operative Creameries and the Kenya Planters Union. These co-operative marketing organisations were the best way of ensuring the survival of the settler economy. However, in public companies Europeans took quite a substantial interest in the processing of primary products.[178]

Regulations in land holdings in the most productive areas which applied to 'non-Europeans' ensured that Asian participation in the agricultural sector was minimal.[179] The Crown Lands Ordinance (1905) which empowered the governor to veto land transactions between races. Lord Elgin noted that, 'as a matter of administrative convenience, grants of land in the upland areas should not be made to Indians.'[180] Asian capital was therefore channelled into trade and services such as whole-sale and retail trade. Asian partnerships formed an overwhelming proportion of firms registered under the Business Partnership Act. In 1949, they constituted 90% of these businesses though by 1955 this proportion had dropped to 75% with African firms closing the gap. The Business Partnership Act enabled two partners to participate in business which was not protected by limited liability, which meant that any debts incurred by the business would therefore fall personally on the partners. The larger public companies, dominated by Europeans, enjoyed the benefits of limited liability.[181]

During the period of 1922-1945, there were fewer public companies in Kenya than there were private (a trend which has remained to-date). Asians dominated in private companies sector (59%) whilst European and foreign firms dominated in public companies sector (with a combined ownership of 91%) due to the higher

[178] Swainson, N. (1980), pp.51, 53.
[179] Swainson, N. (1980), p.54
[180] Swainson, N. (1980), p.54
[181] Swainson, N. (1980), p.54

levels of capital that were required to form a public company. European firms in the public sector were dominant in the areas of agriculture and agricultural processing. Other companies registered in Kenya during this period were 'foreign branch' companies such as Standard & National and Grindlays. A large proportion of these firms invested in mining. In 1937 alone 9 new foreign firms were registered in response to the 'Kakamega Gold Rush' which was a speculative venture. An interesting feature of these 'foreign branches' registered under s.206 of the Companies Act is that they are exempt from filing any financial or shareholding details. However, they cannot not raise capital inside Kenya. Local mining firms such as Nyanza Goldfields (1933) and the Kenya Mining Investment Ltd (1933) were also registered during this period but shortly collapsed under a mountain of debt.[182]

In sum, company formation in Kenya between the years 1922 – 1945 was characterised by an increase in the numbers and size of enterprises. Racial barriers characterised company formation. Due to racial barriers that surrounded production and distribution, European and foreign firms were largely predominant in these areas whilst Asian capital was confined to trade. By 1939, Asian merchant capital dominated the sphere of retail trade, while settler and foreign firms remained largely within the area of plantations and import/export trade.[183] The Kenyan administration before 1945 was strongly influenced by the large estate farmers, who exercised a political monopoly over the means of representation and the producer boards.[184]

[182] Swainson, N. (1980), p.57
[183] Swainson, N. (1980), p.57
[184] Swainson, N. (1980), p.93

Table 1: Companies on the Register and Those Struck off

Date	Cos on the Register	Cos Struck off	Struck off as % of Total
1927	289	19	6.6
1930	399	37	9.3
1933	472	30	6.4
1936	593	29	5.0
1939	641	25	4.0
1942	679	18	2.6
1945	811	16	2.0

Source: Annual reports of the Registrar General[185]

[185] Table obtained from Swainson, N. (1980), p.51.

Table 2: Sample of Private Companies Registered between 1922 and 1945 by Enterprise and Ownership

	European	Foreign	Asian	Total No.	Total %
1. Agricultural Production and Ancillary Services	8	3	5	16	19
2. Food and Beverages, Manuf., of Chemicals, Clothes and Textiles	1	1	5	7	8
3. General Engineering and Mining	1	-	-	1	1
4.Transport	-	2	2	4	5
5. Investment and Finance	1	-	2	3	4
6. Real Estate, Property, Building and Construction	6	1	6	13	15
7. Import/Export	1	2	12	15	18
8. Wholesale/Retail (incl. Catering and Printing)	1	7	18	26	30
Total Companies	19	16	50	85	100

Source: Private companies sample, 1922-1945, one-third list sample.[186]

[186] Table taken from Swainson, N. (1980), p.52

Table 3: Sample of Public Companies 1922-1945

	European	Foreign	Asian	Total No.
1. Agricultural Production and Ancillary Services	3	1	-	4
2. Food and Beverages, Manuf., of Chemicals, Clothes and Textiles	3	2	-	5
3. General Engineering and Mining	2	3	-	5
4.Transport	-	1	-	1
5. Investment and Finance	-	-	1	1
6. Real Estate, Property, Building and Construction	2	-	-	2
7. Import/Export	1	-	-	1
8. Wholesale/Retail (incl. Catering and Printing)	2	1	-	3
Total Companies	13	8	1	22

Source: Public companies sample, one-quarter sample, both conducted 1974-5, Registrar General of Companies[187]

[187] Table taken from Swainson, N. (1980), p.52

Table 4: Constitution of Samples, Private and Public Companies 1922-1945[188]

Racial Group (private companies)	No. of companies (private companies)	%	Racial Group (public companies)	No. of companies (public companies)	%
Asian	50	59	Asian	2	9
Foreign	14	16	Foreign	9	41
European	21	25	European	11	50
Total	85	100	Total	22	100

[188] These racial groups are derived from the nationality of the majority (50%) of the firm's share capital. Before 1945 there were very few 'inter-racial' partnerships, so this method is quite an accurate assessment of ownership. Table taken from Swainson, N. (1980), p.56

2.2.6.3 Company formation in Kenya: 1946 -1963

After WII the inherent weakness of settler capital in terms of management limitations and size of enterprises became obvious. The family mode of operation of Asian enterprises rendered them more competitive than settler enterprises. Between the years 1945-1950 a large number of local settler firms were absorbed either by Asian firms or by foreign firms.[189]

Although joint stock companies were formed for the first time in Kenya in the 1900s, the first African companies were not formed until after WII. The formation of joint stock companies by Africans during the colonial period had been restricted particularly by limitations placed on borrowing between Africans and non-Africans under the Credit to Natives Ordinance of 1906 and 1926. Although it became easier to obtain credit after, this ordinance was not repealed until 1960. In 1946, 24 private African joint-stock companies were formed for the first time, the majority of which traded in primary commodities. Examples of these firms were Ukamba Fuel and Charcoal Supply Company, the African Growers and Produce Company, the Luo Thrift and Trading Company and the Kenya Fuel and Bark Company.[190] These companies were formed between the years 1946 and 1948 by the African petty bourgeoisie, mainly traders, farmers or teachers. The Luo Thrift and Trading Company and the Kenya Fuel and Bark Company were started in Western and Central Kenya by Oginga Odinga (from the Luo tribe) and Johnstone Muigai (from the Kikuyu tribe) respectively who were activist leaders of the nationalist movement.[191] (Oginga Odinga would go on to become an influential politician and leader of the opposition movement of the 1990s. His son, Raila Odinga would take over his party's leadership after his death and is the Prime Minister of Kenya today. Johnstone Muigai would later change his name to Jomo Kenyatta and become Kenya's first President until 1978. His son, Uhuru Kenyatta is the Deputy Prime Minister of Kenya today. Both Raila and Uhuru are tipped to run for presidency in the 2012 elections.)

[189] Swainson, N. (1980), pp.54-55
[190] Swainson, N. (1980), p.194
[191] Swainson, N. (1980), p.194.

Table 5: Changing Ownership of Eight Private Firms

Year Reg.	Business	Date	Transfer From	Transfer To
1. 1922	Drapers	1945	J. Stephens	M. Desai & Sons
2. 1924	Cotton ginning	1945	G. Small	Kassim et al.
3. 1928	Merchants and Jewellers	1943	Lewison	Patels
4. 1928	Property	1930	Keith	Singh et al.
5. 1930	Printing	1945	Balabanoff	Kashavji et al.
6. 1933	Dairymen	1955	J. K. Watson	Patels
7. 1941	Catering	1945	L. Holden	K. S. Jamal
8. 1945	Merchants	1950	Morgan	Patel et al.

Source: Private companies sample, 1922-45.[192]

[192] Table taken from Swainson, N. (1980), p.55

Following the state of emergency in 1953, as a result of the Mau Mau revolt against the settlers that was concentrated in the Central Province (the Kikuyu region), as most of the new joint stock companies were formed by the Kikuyu, the expansion of African enterprises in the mid-1950s was drastically curtailed. Between the years 1953-1954 the African companies dropped to zero and only picked up again after 1958.[193] By 1961 the number of Asian firms registered for the first time exceeded the 'European' group with 134 and 105 companies respectively.

[193] Swainson, N. (1980), p.194

Table 6: Number of Private Companies Forming in Kenya between 1946-1963

Year	European (%)	Asian (%)	African (%)	Mixed (%)	Total No.
1946	44	40	15	1	162
1947	44	43	11	1	205
1948	60	30	6	3	239
1949	61	33	3	3	233
1950	66	28	1	5	221
1951	62	33	2	3	248
1952	65	30	2	4	244
1953	69	29	2	-	189
1954	64	33	-	3	243
1955	70	28	-	6	351
1956	63	54	1	3	324
1957	67	29	1	3	341
1958	57	37	1	5	231
1959	50	43	2	5	270
1960	50	42	4	4	300
1961	39	49	7	5	271
1962	38	50	8	4	233
1963	45	42	5	8	360

Source: Annual Returns of the Registrar General, summary of yearly statistics.[194]

[194] Data taken from Swainson, N. (1980), p.195

2.3 Post-colonial Kenya: Ethnic-based politics and the betrayal of good governance

The political structures of pre-colonial and colonial Kenya were to play a major role in independent Kenya. Prior to the creation of the Kenyan state, most communities in Kenya were politically decentralised.[195] The salient features of decentralised political systems were that they tended not to have properly differentiated political institutions resulting in fused political functions. They also tended to be small territorially and leadership was largely based on lineage. Democracy did exist in pre-colonial Kenya's communities however, this democracy was largely collectivist and organic in nature rather than individualist. Being collectivist, it put greater premium on communal rights and privileges at the expense of individual rights and as such issues such as gender discrimination thrived. The general lack of differentiation in role and function undermined the modern democratic principle of separation of powers.[196]

The phenomenon of undifferentiated political power structures that dominated pre-colonial Kenya had been further reinforced during colonialism as the British ruled Kenya through indirect rule, thereby maintaining the prevailing communal structures.[197] The basis of the colonial rule in Kenya had been the extraction of resources from the territory and the colonialists had used authoritarianism to instil and maintain their rule. According to Maloba:

> 'Politically, colonialism was a dictatorship. It was imposed by violence and maintained by violence. Ruling with utter indifference to the opinions of the governed – the Africans-colonialism perfected a reign of terror by silencing its opponents through detention, exile, even outright extermination… Colonial administrators were appointed and not elected. They owed their allegiance to foreign centres of power, represented in the colonies by governors. **They were not accountable to Africans for their actions nor did they pretend to be constrained in their actions by local opinions**.'[198]

The colonial administration had not allowed the participation of Africans in the running of the government and political representation had remained the exclusive right of the few

[195] Matanga, F. (2003), 'Kenya: A Chequered Path to Democracy', East African Journal of Human Rights, Vol. 1(1), p.32.
[196] Matanga, F. (2003), p.32.
[197] Indirect rule was a system of government where much of the day-to-day government of localities was left in the hands of traditional rulers, who in principle gained prestige and stability albeit at the cost of a loss of autonomy, thus allowing a limited number of European colonial administrators to effectively oversee the government of large numbers of people spread over extensive areas. Crowder, M. (1964), 'Indirect Rule: French and British Style', Africa: Journal of the International African Institute, Vol. 34 (3), pp. 197-205.
[198] Maloba, W. (1989), 'Nationalism and Democratisation, 1947-1963', in Ochieng', R. W., A Modern History of Kenya, 1895-1980, Nairobi, Evans Brothers Ltd, p.173.

white settlers. Institutions of political society and autonomous civil associations among Africans were actively discouraged and those that existed were subordinated to settler interests.[199] The governance model of the colonial state was the anti-thesis of democratic thought and practice, that would become a major legacy in the post-colonial period. In particular, the wholesome carrying over of some of the colonial state's political institutions and processes would prove to be a major obstacle in the establishment of a democracy in post-colonial Kenya.[200]

As the experience of Kenyan Africans under colonialism had made them distrust government authority, Kenya's nationalists settled for a very elaborate and liberal constitution in the Lancaster House Conference talks prior to being granted independence. This constitution oversaw the transition from an autocratically governed colonial territory to an independent country, and a constitutional multi-party democracy.[201]The independent constitution, meant to rock the authoritarian foundations of the colonial state, was elaborate to a fault. It provided for decentralisation and devolution of power and operationally distributed power between the three arms of government in order to provide checks and balances. In terms of location, it distributed power between the central and federal governments and power was further dispersed within the federal governments by the establishment of county councils, urban councils, and municipals, to facilitate citizen participation in governance at local level. The constitution also protected fundamental human rights by providing for a comprehensive Bill of Rights and entrenched a market economy by, among other things making elaborate provisions for the protection of property rights. Above all, the independent constitution expressly recognised the supremacy of the people by providing for a referendum in the event of a stalemate in Parliament regarding a constitutional amendment.[202]

[199] Masime, K. and Kibara, G. (2003), 'Regime Transitions and the Institutionalization of Democracy in Kenya: The December 2002 Elections and Beyond', East African Journal of Human Rights & Democracy, Vol. 1(1), pp.15-16.
[200] Matanga, F. (2003), p.33.
[201] Masime, K. and Kibara, G. (2003), pp.15-16.
[202] Masime, K. and Kibara, G. (2003),p.16.

At the time of attainment of Kenya's independence in 1963, there were 775 industrial undertakings in Kenya.[203] Of the total nominal capital registered between 1946 and 1963, 68% was European, 21% was Asian, 11% combined Asian and European and less than 1% African.[204] This ownership structure was to change in the 1960s following the leaving of the settlers after a million acres of land was transferred from European-owned farms to Africans in 1962.[205] Thus, after independence, industrial structure was characterised by Asians and Africans who had acquired land from the colonial economic, social and political system the necessary capital and technological skills. Asian manufacturers dominated most industries – the clothing industry, furniture making, printing, soap fabrication, metal working and engineering industries. By the 1960s, a high degree of concentration in Kenyan industries had emerged and the largest proportion of Asian manufacturing was in the hands of a few industrial giants.[206]

2.3.1 The growth of an Asian bourgeoisie after Independence

One of the industrial giants emerging in the 1950s, by taking over existing companies was the Chandaria family which took over Kenya Aluminium Works in 1954 and set up steel-rolling mills, the Kaluworks in 1963. The Chandaria's bought a 50% share in the East African Match Factory in 1960 and later increased it to 75% with the Khimasia family holding the remaining 25%. The Chandaria's industrial empire expended further in the 1960s by takeover, and entered into ventures served by large and complex marketing networks.[207]Another Asian conglomerate was the Khimasia family whose business enterprise moved after WWII from trading into import substitution industrial concerns. In 1958, they established a factory to manufacture fruit squashes, mineral waters, jams and jellies, which were marketed by existing business organisations. Much of their ventures into industrial manufacturing took place in the post independence years.[208]Probably the largest industrial complex in East Africa during the post independence years was that of Madhuvani. Originally based in Uganda, the Madhuvani's industrial products found their way into Kenya

[203] Ogonda, R.T. (1992), 'The Colonial Industrial Policies and the Process of Industrialization in Kenya', in Ochieng, W. R. and Maxon, R. M. (1992), An Economic History of Kenya, p.168.
[204] Ogonda, R.T. (1992), p.168.
[205] White, N. J. (2000), 'The Business and the Politics of Decolonization: The British Experience in the Twentieth Century', The Economic History Review, New Series, Vol.53. No.3, p.551.
[206] Ogonda, R.T. (1992), p.168.
[207] Ogonda, R.T. (1992), p.168.
[208] Ogonda, R.T. (1992), p.168.

from 1955 onwards through their subsidiary Muljibhai Madhuvani Limited, with trading bases in Nairobi, Mombasa and Kisumu. The Madhuvani's moved into Kenya during the 1960s to preserve their markets for industrial products and expanded their industrial undertaking by taking over from existing firms.[209]

2.3.2 The absence of an African entrepreneurship class at independence

African entrepreneurship played an insignificant role in the manufacturing sector during the colonial period partly due to lack of capital and entrepreneurship skills. The African majority were left in subsistence agriculture, unskilled work positions and in the lowly paid areas of trade and craft production.[210]The few Africans involved in manufacturing were usually involved in the informal manufacturing or *'Jua Kali'* industries in major towns in Kenya running their own small businesses in industries such as blacksmiths, carpenters and tailors and some had acquired professional training as artisans in Asian shops, the railway workshops and technical schools.[211]

2.3.3 The Kenyatta Era: 1963 - 1978

Following independence, Kenyatta – a Kikuyu – was elected the president of Kenya. The Kenyatta era was characterised by the beginning of indigenous authoritarian rule, the start of ethnic-based politics, the centralisation of politics and the economy through the introduction of African socialism and parastatals[212] as its supporting institutions[213] and the start of ethnic based-economic policies.[214]

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[209] Ogonda, R.T. (1992), p.168.
[210] Ogonda, R.T. (1992), p.168.
[211] Ogonda, R.T. (1992), pp.169-170.
[212] Parastatals are statutory authorized corporate entities which earn their revenue from the sale of goods and services in which the government holds a majority of shares. State Corporations Act (1986), Cap.446,s.2.
[213] It is arguable though that the concept of the parastatals was already in existence during colonial times although during colonialism it was used for the promotion of settler interests. Swainson points out that settlers processed their commodities collectively through state-sponsored bodies (parastals) such as Kenya Farmers Association, Kenya Co-operative Creameries and the Kenya Planters Union. These co-operative marketing organisations were the best way of ensuring the survival of the settler economy. See, Swainson, N. (1980), pp.51-53.
[214] In the colonial era there had been forms of ethnic-based policies resulting from a clash between settler administration interests and the Metropolitan government (Britain) interests. From 1922 the Metropolitan policy intended that a dual policy of African and European agricultural production should prevail in Kenya. The settlers opposed this Metropolitan political direction. Britain was not unduly concerned as long as the colony balanced its

When Kenyatta came into power in 1963, it soon became clear that the Kenyatta government was not keen on consolidating the democratic gains by operationalising the institutional provisions of the constitution and further democratising the highly authoritarian colonial state apparatus. Constitutional amendments that were a great departure from the letter and the spirit of the constitution were made: the constitution was amended to amass all the powers on the presidency, sub-ordinate other democratic institutions and abrogate the Bill of Rights. The first amendment of the constitution abolished the office of the Prime Minister and created an office of an Executive President who became the Head of State, Head of Government and Commander in Chief of the Armed Forces. This created a pseudo-presidential system by giving more powers to the presidency at the expense of Parliament thereby entrenching an authoritarian rule.[215]

Kenyatta was able to do this because democratic organisations and procedures at independence were grossly under-developed. Kenyatta also needed to do this as he had no control over his party, which had won the independence elections, as it was a loose amalgamation of ethnically homogenous political associations hence his preference for 'over-developed' state bureaucracy as a governance tool.[216] State control as a means of capital accumulation enabled Kenyatta to easily co-opt opposition politicians and radical civil society groups including the University of Nairobi Student Union (SONU). The only opposition party KADU was convinced in the name of unity among other machinations to dissolve in 1964. Politics of federalism were replaced with a tightly controlled centralised state. One party-politics were lauded for their capacity to bring about national unity as opposed to national disintegration along party and ethnic lines though Kenyatta's real motive was to centralise power and muzzle all forms of challenge to his reign. Another party, Kenya People's Union (KPU), was formed by Kenya's left leaning politicians who accused the Government of serving neo-colonial interests. KPU was frustrated in its operations using state machinery such as the police and the provincial administration and banned in 1969.[217]In the absence of an institutionalised party system for aggregating and

budgets and the supply of primary products was forthcoming. Swainson, N. (1980), The Development of Corporate Capitalism in Kenya 1918-1977, Heinemann, p.7.

[215] Masime, K. and Kibara, G. (2003), 'Regime Transitions and the Institutionalization of Democracy in Kenya: The December 2002 Elections and Beyond', East African Journal of Human Rights & Democracy, Vol. 1(1), pp.16-17.

[216] Hyden, G. (1995), 'Party, State and Civil Society: Control versus Openess', in Barkan, J. D. (1995), Beyond Capitalism v Socialism in Kenya and Tanzania, East African Educational Publishers, Nairobi, p.90.

[217] Matanga, F. (2003), 'Kenya: A Chequered Path to Democracy', East African Journal of Human Rights, Vol. 1(1), p.34.

articulating societal interests and channelling them to the legislature, ethnic associations became the basis of organising politics and state patronage became the basis of popular support.

Kenyatta's presidency also resulted in a transition from a market-based economy based on laissez faire principals to an economy in which the laissez faire principals had to co-exist with African socialism. The introduction of African socialism was based on the traditional notion of kinship in which everything was communally owned and was to be used for the benefit of the community. This principle was carried forth into the first development plan after independence – the Sessional Paper on African Socialism - which stated that the nation's productive assets must be used in the interests of the society and its members:

> '..land and other production assets, no matter who owned or managed them, were expected to be **used**, and used for the general welfare.'[218]

On the apparent conflict between communal ownership and the need to develop a monetary economy the Paper stated that:

> 'The need to develop and invest requires credit and a credit economy rests heavily on a system of land titles and their registration. The ownership of land must, and therefore be made more definite and explicit if land consolidation and development are to be fully successful. It does not follow, however, that society will give up its stake in how resources are used. Indeed, it is a fundamental characteristic of African Socialism that society has a **duty to plan, guide and control** the uses of all productive resources.'[219]

Domestic accumulation of capital was to be encouraged and exploited through the mechanism of State enterprise, joint ventures, private companies and co-operatives.[220] Although the Paper stated that private sector was intended to play an important role in industry and commerce,[221] some basic industries regarded as fundamental to industrial development would have government participation. As a guide to the private investor, the Kenya's first development plan was weak as no indication was given of priorities in industrial development or any clear distinction between private and state industries.[222] It was clearly stakeholder-based showing little interest in promoting shareholder interests. In

[218] Government Printer (1965), African Socialism and Its Application to Planning in Kenya p.7, para. 20.
[219] Government Printer (1965), p.8, para. 22.
[220] Ghai, Y. (1965), 'Kenya's Socialism', Transition, No. 20, p.22
[221] Government Printer (1965), p.12, para. 33
[222] Ghai, Y. (1965), p.23

particular it stated as its intention the elimination of foreign economic domination[223]following which the policy of Africanisation was introduced. To secure his presidency under the guise of Africanisation Kenyatta generously awarded a narrow elite (mostly his Kikuyu tribesmen) appointments in civil service positions and parastatals in order to gain a support base.[224]

2.3.3.1 The establishment of the Kikuyu hegemony

The period between 1963–1969 has been described as a period of accumulation of presidential powers and the establishment of the Kikuyu hegemony, that is, the domination of political affairs by the Kikuyu from the Kiambu region and the corresponding marginalization of other ethnic groups.[225] At independence, the prominent Kikuyu Chiefs and Elders of the time became the elite of independent Kenya. The accumulation of wealth by these former chiefs was dubious as most of it came from their expropriation of land that was supposed to be returned to those who were displaced during colonialism.[226] It is this acquisition of land after independence that marked the start of Kikuyu domination in Kenya; at least economically. The Africanisation policy further enhanced the Kikuyu's accumulation as the ownership of companies and industries was transferred to Kenyatta's inner Kiambu subgroup and almost all the important national executive posts (attorney general, finance, commerce and industry) and state corporations (Central Bank, Kenya Commercial Bank, Industrial and Commercial Development Corporation) passed into Kikuyu hands.[227] With the establishment of new parastatals:

> 'there was a tendency for the president to staff top posts predominantly with people of Kikuyu origin… The more Kenyatta came under attack because of the favours he was seen to be granting to his **clansmen**, the more the Agikuyu bourgeoisie as a whole, whipping up popular support within Kikuyuland, banded together in defence of his presidency.'[228]

[223] Ghai, Y. (1965), p.22
[224] Masime, K. and Kibara, G. (2003),p.16; Barkan, J. D. (2004), 'Kenya After Moi', Foreign Affairs 83 (1), p.88
[225] Himbara, D. (1994), p.26.
[226]Throup, D. W (1985) *The Origins of the Mau Mau,* 84 Afr. Aff. 408 (1985)
[227] Himbara, D. (1994), p.26.
[228] Nyong'o, A. (1989), 'State and Society in Kenya: The Disintegration of the Nationalist Coalition and the Rise of Presidential Authoritarianism 1963-1978', African Affairs, Vol. 88, Issue 351, p.241.

Kinship is therefore the means by which the Kikuyu attained a dominant position in Kenya's economy. The aim of the 'Africanisation' policy had been to foster an African capitalist class in commerce and industry. This program temporarily resulted in a retreat by the domestic Indian commercial capitalists from the simpler forms of commerce and retail trading. The Indians went into more complex economic sectors not directly subject to Africanisation such as finance, construction and manufacturing. However, this Africanisation policies failed as the new owners lacked experience in running the industries and therefore could not maintain their goodwill from the state. Soon the Africanised aspects of trade were largely reclaimed by the Indian commercial bourgeoisie and the Africanisation program rendered the economy more reliant on Indian capitalists than before.[229]Kinship had once again played a role in the failure of the Africanisation policy.

In order to survive in the prevailing business environment, Indians had become 'businessmen – politicians'. As the Asians were a minority group and few in number in relation to the smallest African group – the Cushites – and dominators of the Kenyan business sector they could not count on numbers to secure the protection of their business interests in Kenya. Therefore, the Indian community became *'businessmen-politicians'*, indirectly influencing the politics and retaining control of the business environment of Kenya:

> 'Since independence Asians have been on the periphery of Kenya's political system except as **sponsors for certain politicians as their power brokers within the system.** Such brokerage, however involves bypassing established rules and getting decisions made as favours and not as official procedures. Hence African businessmen, who cannot do this and who are undercut by their fellow Asians or by MNCs, cannot get their business going.'[230]

Therefore although the Indian community in Kenya remains small and for that reason politically isolated[231]at least visually, far from their size and political isolation rendering them weak, it has exerted on them considerable pressure to survive in the new environment

[229] Himbara, D. (1994), Kenyan Capitalists, the State and Development, Boulder & London, p.36.
[230] Nyong'o, A. P. (1988), 'The Possibilities and Historical Limitations of Import-Substitution Industrialization in Kenya', in Industrialization in Kenya: In Search of a Strategy by Coughlin, P. and Ikiara, G. K. (eds.) East African Educational Publishers, Nairobi.
[231] Himbara, D. (1994), p.30.

by dominating the Kenya's business sector[232]and indirectly influencing the politics of present-day Kenya. The recent implication of Asian businessmen in high level corruption scandals such as *Goldenberg*[233] and *Anglo-leasing* and has lent support to this view.

2.3.3.2 The consolidation of the Kikuyu hegemony

Between the years 1970-1977 the Kikuyu governing elite further consolidated its control of the state.[234]An illustration of the groups political domination is the rise of the Gikuyu, Embu, Meru Association (GEMA), an ethnic investment company and political agency for the Kikuyu and associated ethnic groups. GEMA was to become powerful to the point of almost supplanting the national party, the Kenya African National Union (KANU). The membership of GEMA was characterised by members of parliament (MPs), top civil servants and top executives. In particular, the leading personalities in GEMA were the *Who's Who* of the heads of state corporations, national ministries and Kikuyu MPs. GEMA was therefore a vehicle for ensuring the domination of national affairs by the Kikuyu ethnic group.[235]GEMA became the leading force calling for an amendment of the constitution to bar the incumbent Vice President, Daniel arap Moi, a *Kalenjin* from the *Nilotic* speech community, from automatically succeeding the president. This same period also witnessed the collapse of East African Community as its various institutions - which had previously played crucial roles in national development as they were based in Kenya - collapsed after almost two decades of mismanagement and indifference.[236]

However, despite the erosion of democracy under its first president, Kenya prospered. Coffee and tea production expanded, a thriving tourist industry was established, and development was spurred by prudent macro-economic policies, extensive investments in infrastructure and the expansion of education. The economy grew at a rate of 5 to 8 % in all but two years of Kenyatta's presidency.[237] The reason for this was that although Kenyatta's

[232] See Himbara, D. (1994), p.30.
[233] On the Goldenberg scandal see, Munguti, R., Pattni may Walk Free in Attorney General Deal, Daily Nation, 15th January 2011.
[234] Himbara, D. (1994), p.27.
[235] Himbara, D. (1994), p.27
[236] Himbara, D. (1994), p.27
[237] Barkan, J. D. (2004), 'Kenya After Moi', Foreign Affairs 83 (1),p.88.

rule was authoritarian, it was relatively benign. Although he repressed opposition parties into extinction, Kenyatta allowed a measure of electoral competitiveness within the single party as long as it did not pose a direct challenge to his authority. Civil society was also allowed to flourish under similar terms. The relative socio-economic advancement of his community enabled him to appoint even on an ethnic preferential basis a fairly competent and professional civil service. The civil service and the judiciary were also allowed reasonable autonomy under the Kenyatta regime.[238]

2.3.3.3 Company formation in Kenya: 1963 -1973

The data available on company ownership during the Kenyatta era was collected by Swainson, covering the period between the years 1945-1973. It shows that African firms gradually increased following independence and by 1972, 310 African firms exceeded for the first time the 248 formed by the Asian community. By 1973 African firms constituted nearly 50% of all private firms forming in that year. Including the mixed group of companies, it can be said that from 1973 onwards companies owned by Kenyans formed the largest proportion (about 60%) of all new companies forming in Kenya.[239]

Table 7: Number of Private Companies Forming in Kenya between 1963 and 1973

Year	European (%)	Asian (%)	African (%)	Mixed (%)	Total No.
1963	45	42	5	8	360
1964	35	34	19	11	427
1965	28	34	25	12	427
1966	30	36	19	15	458
1967	26	35	23	16	516
1968	20	30	33	16	561
1969	14	38	28	20	806
1970	13	37	30	20	866

[238] Masime, K. and Kibara, G. (2003), 'Regime Transitions and the Institutionalization of Democracy in Kenya: The December 2002 Elections and Beyond', East African Journal of Human Rights & Democracy, Vol. 1(1), p.16.
[239] Swainson, N. (1980), The Development of Corporate Capitalism in Kenya 1918-1977, Heinemann, pp.195-196

1971	15	39	33	13	984
1972	17	30	37	16	825
1973	15	24	46	15	885

Source: Annual Returns of the Registrar General, summary of yearly statistics.[240]

[240] Data taken from Swainson, N. (1980), p.195

Racial categories in the classification of companies were maintained after 1963 but this time reflecting the ideology of Africanisation.[241] Similar to the colonial period, instability and interlocking directorships continued to characterise Kenyan company formation post-independence.[242] Indigenous capitalism did not operate independently of African capital resulting in an interlinkage between foreign and domestic capital.[243] In the 1968 'top fifty' director list, developed by the National Christian Council of Kenya (NCCK) most of the directors held positions exclusively in foreign firms; only very few owned shares in the companies in which they were directors. Additionally, the number of African directors was small as shown in the tables that follow. However, a 1974 study indicates a changing pattern in management and an expansion of firms actually owned by African directors. This information is sourced from a 1974-1975 sample of private and public companies in the Registrars General's Department selected by Swainson and the NCCK directorships study in 'Who Controls Industry in Kenya?' (1968).[244]

According to the table, the largest proportion of directors (36/50) in 1974 were Kenyan citizens as compared to the position in 1968 when 82% of directors were British. This change has been attributed to compelling of European and Asian residents by the Kenyanisation Immigration Department to become citizens if they wanted to continue either as salaried personnel or as businessmen. An example is Jack Block, owner of a large hotel chain who changed his citizenship from British to Kenyan between 1967 and 1974. The chairmen of both Lonrho and Mackenzie Dalgety were both Kenyans by 1974 representing a strategic alliance between foreign firms and prominent members of the indigenous bourgeoisie. [245]

There was a typical pattern of indigenous managers using the foreign firm to acquire their own capital for investment. This group of Kenyan managers often tried to buy into the same firm after a short period as managing director or chairman. An example is the case of Mackenzie Dalgety which was one of the largest foreign-owned firms in Kenya with investments in import/export trade. In 1975 this firm had 60% of its equity purchased by a

[241] Swainson, N. (1980), p.53
[242] Swainson, N. (1980), p.48
[243] Swainson, N. (1980), p.200
[244] Tables taken from Swainson, N. (1980), p.201
[245] Swainson, N. (1980), p.202

local firm, Mawamu Holdings, which was jointly owned by the chairman Mackenzie Dalgety and the chairman of Lonrho East Africa. In 1976, the managing director of a major foreign firm bought a controlling interest in the same foreign subsidiary. By 1974 there was an overlap of permanent managerial positions and development of private holdings a practice that was not discouraged by foreign firms as they could gain a more secure alliance if their manager is also a businessman in his own right. However, this process led to conflicts with some foreign firms being against it. In 1968, only one of the five Kenyan directors (an assistant minister and an MP), owned shares in one of the firms in which he also held a directorship. By 1974, only 2/17 Africans did not list any shareholding in companies.[246] The top fifty Kenyan directors are themselves strongly linked through ownership of enterprises reflecting a common class background irrespective of race. For instance, a former minister is linked through two companies with a large group of firms owned by a Nairobi doctor. These firms are in the areas of drugs manufacture and distribution, transportation and tourism. In 1976 a prominent Kenyan industrialist (31st on the top fifty list) was in partnership in three companies (two in manufacturing, one in contracting) with another government minister. There is another set of interconnections in four firms, three investment companies and one flower-exporting concern.

In sum, by 1974 there is not a high degree of separation between the owning and the managing classes who are often interlinked.[247]

[246] Swainson, N. (1980), p.203
[247] Swainson, N. (1980), p.204

Table 8: The Nationalities of Kenya's Top Fifty Directors (by number of directorships)

	African/Citizen	European/Citizen	British
1967	5	4	41 = 50
1974	18[248]	18	13 = 49

Table 9: The Professions of Kenya's Top Fifty Directors (by number of directorships)

	Civil Servants and Politicians	Professions	Foreign Companies[249]
1967	7	6 accountants 2 advocates	CDC 2 Lonrho 3 M. Dalgety 1 James Finlay 1
1974	13	2 accountants 7 advocates 1 medical doctor	CDC 2 Lonrho 4 James Finlay 2 M. Dalgety 2 United Transport Co. 1

[248] Including two citizen Asians.
[249] From the full fifty directors, the remainder were full-time owners or managers of local firms

2.3.4 The Moi Era: 1978-2002

Following the death of Kenyatta in 1978, Moi – a non-kikuyu (from the Kalenjin tribe) – became the president of Kenya. This marked the beginning of the end in dismantling the Kikuyu hegemony.[250] Although Moi had come into power promising to re-entrench democratic principles, revamp democratic institutions and declare war against corruption which was threatening to become a way of life and followed it up with actions such as the unbanning of SONU and the release of political detainees promising to do away with detention without trial, these benign acts were to be short-lived. As expected, the first task of the Moi government was to disband all 'tribal' organisations, a move primarily directed at GEMA under the guise of seeking national unity. Various changes were made in the political and economic realm leaving few senior members of GEMA – essentially Kikuyu politician-businessmen - in place. An instance of these changes was the removal of the then Chief Justice - a Kikuyu- after being accused of conducting himself, '*in a manner prejudicial to the security of the state, the position of the head of state, the image of the president and the constitutionally established government of the Republic of Kenya.'*[251]

2.3.4.1 The establishment of a Kalenjin bourgeoisie

In the process of constructing his regime Moi sought to redress the ills of Africanisation which had resulted in the dominance of the Kikuyu in the public service through tribal balancing, that is, bringing in individuals from non-Kikuyu tribes into the civil service and parastatals. However, Moi's tribal balancing quickly degenerated into the concentration of power in the hands of a narrow elite from his own tribe – the Kalenjin -[252] and the process of establishing patronage networks encouraged corruption in the form of irregular imports, contracts and illicit allocation and sale of public land.[253] Again, there was little respect for property rights, amongst other rights, under Moi's regime. Almost all heads of state corporations and national ministries were systematically replaced by the Kalenjin. For the first time in post-colonial history, the Kikuyu were excluded from all key national posts – the presidency, vice presidency, finance and defence which were now in the hands of the Kalenjin or their 'small tribe' associates. During this time, a number of constitutional

[250] Himbara, D. (1994), p.27
[251] Himbara, D. (1994), p.28
[252] Barkan, J. D. (2004), 'Kenya After Moi', Foreign Affairs 83 (1), p.88.
[253] Masime, K. and Kibara, G. (2003), 'Regime Transitions and the Institutionalization of Democracy in Kenya: The December 2002 Elections and Beyond', East African Journal of Human Rights & Democracy, Vol. 1(1), p.17.

amendments aimed at the Kikuyu elite virtually consolidated presidential powers by removing them from the hands of the state, a lesson well learned from the Kenyatta regime.[254]

In 1979 politicians expelled from Moi's party KANU, including Oginga Odinga, threatened to form the Kenya Nationalist Socialist Alliance.[255]This triggered a failed coup attempt in 1982.[256]Moi further eroded the vestiges of democratic institutions (professionalism in the civil service, fairly competitive elections, and the independent judicial and legal sectors) that had survived Kenyatta's regime and turned into a vile dictator on perceived threat to his rule. In addition to banning all ethnic associations that existed during the Kenyatta regime as he was paranoid about 'big tribes', Moi amended the constitution to make Kenya a *de jure* one party state.[257] His party (KANU through the KANU Parliamentary Group) took over policy making co-opted trade unions and agricultural co-operatives. Other civil society organisations were banned. Members of Moi's party were required to take life memberships and a party disciplinary committee was formed. Those on whom it passed a guilty verdict – in particular those who dared criticise his policies[258] - were for all practical purposes excluded from the spoils of the system. MPs could lose their seats if it recommended expulsion and Moi controlled the electoral process determining who got into public office, and when, through the provincial administration. By 1988, Moi had removed the security tenure of Judges eroding their autonomy with the implication that they could only function at the pleasure of the president[259] and Kenya had transited into full-fledged authoritarianism.[260] Detention without trial was widely practised and the critical press was harassed into self-censorship. Like Robert Mugabe in present-day Zimbabwe, Moi turned Kenya into his personal fief, a kleptocracy under which KANU leaders looted with impunity. Corruption became the principal mechanism for regime maintenance. The civil service, the legislature, and the judiciary became impotent, little more than rubber stamps for Moi's

[254] Himbara, D. (1994), p.28
[255] Adar, G. K. (1998), 'Ethnicity and Ethnic Kings: The Enduring Dual Constraint in Kenya's Multi-Ethnic Democratic Electoral Experiment', Journal of the Third World Spectrum, Vol. 5 (2), p.80.
[256] Barkan, J. D. (2004), 'Kenya After Moi', Foreign Affairs 83 (1), p.89
[257] Okumu, J. J. and Holmquist, F. (1984), 'Party and Party-State Relations' in Barkan, J. D. (1984), Politics and Public Policy in Kenya and Tanzania, New York, Praeger Publishers, p.65.
[258] Barkan, J. D. (2004), p.89
[259] Matanga, F. (2003), 'Kenya: A Chequered Path to Democracy', East African Journal of Human Rights, Vol. 1(1), p.34
[260] Masime, K. and Kibara, G. (2003), 'Regime Transitions and the Institutionalization of Democracy in Kenya: The December 2002 Elections and Beyond', East African Journal of Human Rights & Democracy, Vol. 1(1), pp.17-18.

repressive policies.[261] Not surprisingly, it is during this period –the 1980s- that 33 banks and many state corporations collapsed under management dominated by the Kalenjin.

2.3.4.2 The beginning of the end of Kalenjin domination

The 1990s were marked by more bold and open challenges to the Moi presidency as Kikuyu politician-businessmen called for multipartism. The imprisonment of these Kikuyu politician-businessmen did not end the matter as 'intermediaries' were at work.[262] The neutralisation of the Kikuyu political machine in the 1980s had resulted in the church through the NCCK and Law Society of Kenya being the only vocal opposition forces to the Moi presidency, a constituency that was increasing being supported by the international community particularly the World Bank which deemed it politically controversial, yet essential.[263]

In 1991 other progressive forces such as the National Democratic Party (NDP) under Oginga Odinga – who was part of the group that had threatened to form the Kenya Nationalist Socialist Alliance – called for the repeal of section 2a of the Constitution which barred the formation of political parties. NDP was soon joined in its quest by the Forum for Restoration of Democracy (FORD) which gave as its objectives the need to abolish detention without trial, the repeal of s.2a to allow multi-party politics in Kenya, and the need to limit the presidential tenure to two terms. Prior to this period, the West was reluctant to confront the political situation and instead tried to solve it through economic means by introducing structural adjustment programs (SAPs). It was not until the collapse of the communist led USSR in 1989 that the West stopped cuddling authoritarian regimes allied to them and demanded political liberalisation along with economic liberalisation.[264]International donors suspended $250 million in aid to Kenya in November 1991. This buttressed the reform movement as internal and external pressure had converged. Moi's response was swift: within a month, Kenya's constitution had been amended leading to repeal S.2a in December 1991, thereby allowing the formation of opposition parties.[265]The combined internal and external pressure forced Moi to allow multipartyism, something he had vehemently objected to, citing 'African Traditions':

[261] Barkan, J. D. (2004), p.89
[262] Himbara, D. (1994), p.28
[263] Himbara, D. (1994), p.29.
[264] Masime, K. and Kibara, G. (2003),p.18.
[265] Matanga, F. (2003),p.35, Barkan, J. D. (2004), p.89.

> 'Over the years we have put in place a system of government responsive to the needs of our people, based on time-honoured African traditions of **consensus**… . Now we are being told by a few, in words and actions that echo their foreign masters, that we must adopt completely alien systems of government dictated to us by outsiders. We are threatened that if we do not bend to the dictates of foreigners and their hirelings amongst us, we shall perish – perish because they shall see to it that we perish…; [we] are ready to stand up as a united people against any attempt by foreigners, directly or through their proxies in Kenya, to impose their will upon this nation.'[266]

2.3.4.3 The end of Kalenjin domination

The period between 1994 and 1997 was characterised by an opposition movement riddled with ethnic divisions. In the absence of a united and agenda driven formal opposition, civil society organisations continued to spearhead the confrontation with the Moi regime. Due to ethnic divisions amongst the opposition, which Moi capitalised on by pitting one ethnic community against another, the opposition were defeated in the 1997 election by the Moi regime.[267] Although democratic elections were held in 1992 and 1997, on both occasions the opposition was defeated by Moi's KANU due to ethnic divisions and as opposition parties were formed along tribal lines. The formation of parties along tribal lines is the result of the partiality of the state during the periods of Africanisation and tribal balancing which engendered ethnic perceptions of exclusion from the patronage system resulting in '*presidentiasis*' – an appetite for the presidency by each ethnic group.[268] Presidentiasis continues to characterise Kenyan politics.

Amongst the civil society movements that emerged during this period was the Citizens Coalition for Constitutional Change (CCCC) and the National Convention Executive Council (NCEC) which argued for constitutional change. This intense political pressure eventually forced Moi to accept some constitutional changes before holding the 1997 elections to provide for the review of the constitution through an independent commission and create a better environment for multi-party democracy in the country. Although the constitutional

[266] BBC, Summary of World Broadcasts, 22 October 1990.
[267] Matanga, K. F. (2003), 'Kenya: A Chequered Path to Democracy', The East African Journal of Human Rights & Democracy, Vol.1, No.1, p.36
[268] Masime, K. and Kibara, G. (2003),p.18.

review was set in motion, Moi would frustrate it by stage-managing stalemate after stalemate.[269]

The period after 1997 saw the development of multiparty politics. Following their defeat in the 1997 election, the mainstream opposition reorganised their political strategy. The formation of coalitions and alliances to overcome ethnicity which was their weakest link was the order of the day.

2.3.4.4 The return of the Kikuyu

Initial efforts in coalition building were spearheaded by the National Alliance Party of Kenya (NAK) which brought together 14 opposition parties to face the Kenya African National Union (KANU), Moi's ruling party. Mwai Kibaki –a kikuyu- was named the leader of NAK. The ability and capacity of Moi's KANU to hold onto power came under severe threat when the regime unilaterally nominated the former President's son, Uhuru Kenyatta, as KANU's presidential candidate. This nomination angered many of KANU's senior officials as Kenyatta's son was seen as a novice in politics with no track record to speak of. The result of this nomination was a mass exodus of senior officials from Moi's ruling party, KANU to form the Rainbow Alliance. The Rainbow Alliance then merged with NAK to form the National Rainbow Coalition (NARC) which stood firmly together despite ethnic differences. In particular, NARC had to overcome the problem of nominating one candidate for presidency. The acceptance of Mwai Kibaki as the sole candidate for the mainstream opposition led to the defeat of the Moi regime in the 2002 election with an overwhelming majority.[270] Although the constitutional review had been set in motion during the Moi era a new constitution had not been passed by the end of his term in 2002.[271]

2.3.4.5 Economic performance and company formation: 1979 – 2002

When Moi came into power in 1978, he took over a relative strong economy from Kenyatta. However, the growth trend of the Kenyan economy was brought to an abrupt halt by the oil crisis of 1979. Kenya had dealt with a similar oil crisis in 1972 following which it instituted stabilization measures in 1975 under an IMF loan, but these were abandoned following the coffee boom of 1976-1977 which saw coffee prices rise to over 400% generating a current

[269] Masime, K. and Kibara, G. (2003),p.19
[270] Matanga, K. F. (2003),p.39.
[271] Masime, K. and Kibara, G. (2003),p.19

account surplus of over 10% of GDP. Despite the opportunity presented by the temporary coffee boom, the Kenyatta government had failed to address the fundamental weaknesses of the economy and the second oil crisis aggravated it. Pressure from the IMF, the World Bank and bilateral donors helped persuade the government to take a firm grip on the economy and on public spending by late 1982. In a hope to allay the fears of donors and foreign investors following the 1982 attempted coup, President Moi had given his first speech on economic affairs stressing the government's commitment to encouraging private sector and foreign investment, both public and private.[272] His programme of 'corrective measures' included reinstatement of the export compensation scheme, reductions in government spending, more favourable legislation on the repatriation of foreign investors profits and capital, the establishment of an investment advisory and promotion centre, and a plan to end government participation in commercial joint ventures.[273]Some action taken in these areas, earned him approval and promises of continuing support from the IMF. Much of the early 1980s saw an average growth rate of GDP remaining below 5% annual except for 1986 when a 6% rate was recorded. 1984 marked the first time when Kenya's growth rate fell below 1%. This was attributed to severe drought.[274] In June 1986, a radical departure from Kenya's previously liberal policy on foreign investment was indicated in a speech by President Moi, in which he declared that Kenyans should henceforth hold controlling interests in joint ventures with foreigners.[275]Following this change in policy Kenya's economy stagnated recording a growth rate of 3.3% between 1985 and 1996, and 0.9% between 1997 and 2002 with the growth rate in 2000 being 0.2%. [276]

An examination of Kenya's development plans shows an increase in government control of the economy during the Moi era in relation to the Kenyatta era. The development plans covering the period between 1979 and 1988 aimed at enhancing industrialization through import-substitution strategy. The Import Substituting Industrialization is an economic policy that advocates for the replacement of imports with domestic production and is based on the premise that a country should attempt to reduce its foreign dependency through local

[272] Aseto, O. and Okelo, J. A. (1997), Privatisation in Kenya, Basic Books, pp.40-41.
[273] Aseto, O. and Okelo, J. A. (1997),p.41.
[274] Aseto, O. and Okelo, J. A. (1997),p.41.
[275] Aseto, O. and Okelo, J. A. (1997),p.43.
[276] Wambugu, N. N. and Kibua, T. N. (2004), Economic Growth & Poverty in Kenya: A Comparative Analysis of Effects of Selected Policies, Institute of Policy Analysis & Research (IPAR), p.1.

production. The influence of Keynesian economics[277] is evident in Import Substituting Industrialization (ISI) as ISI is based primarily on the internal market and works by having the state lead economic development through nationalisation, subsidization of vital industries and a highly protectionist trade policy.[278] Consequently Kenya's development plans covering the period between 1979 and 1988 put forth an industrial strategy that was backed with massive public sector investment that had the ultimate aim of reducing the high rate of unemployment prevalent in the economy during the period. The development plans that followed during the Moi era were largely a response to 'external politics'. In particular, the development plans covering the period between the years 1989-1993 were aimed at enhancing implementation of Structural Adjustment Programmes (SAPS)[279]as required by the Bretton Woods institutions (World Bank and IMF).[280]The development plan covering the period between 1994-1996 whose theme was, '*Resource Mobilisation for Sustainable Development'* was formulated at a time when sustainable development issues were in the global agenda. The development plan of the years 1997-2001 endeavored to lay the foundation for the transformation of the economy to a newly industrialized country by 2020 in line with the global agenda.[281] In sum, increase in state control coupled with pressure from 'external politics' during the Moi era resulted in a decline in economic growth with the economic growth in 2002 being 0.6%.

There is little information on company formation during the Moi era due to the mismanagement of the Office of Registrar of Companies as a result of government control

[277] Keynesian economics advocates a mixed economy that consists predominant of the private sector but with a moderate role of government and public sector. The argument of Keynesian economics is that private sector decisions sometimes lead to inefficient macro-economic outcomes. Keynesian economics therefore advocates for active policy responses by the public sector for instance monetary policy actions by the central bank and fiscal policy actions by the government to stabilise output over the business cycle. See O'Sullivan, A. and Sheffrin, S. M. (2003), Economics: Principles in Action, Pearson Prentice Hall.

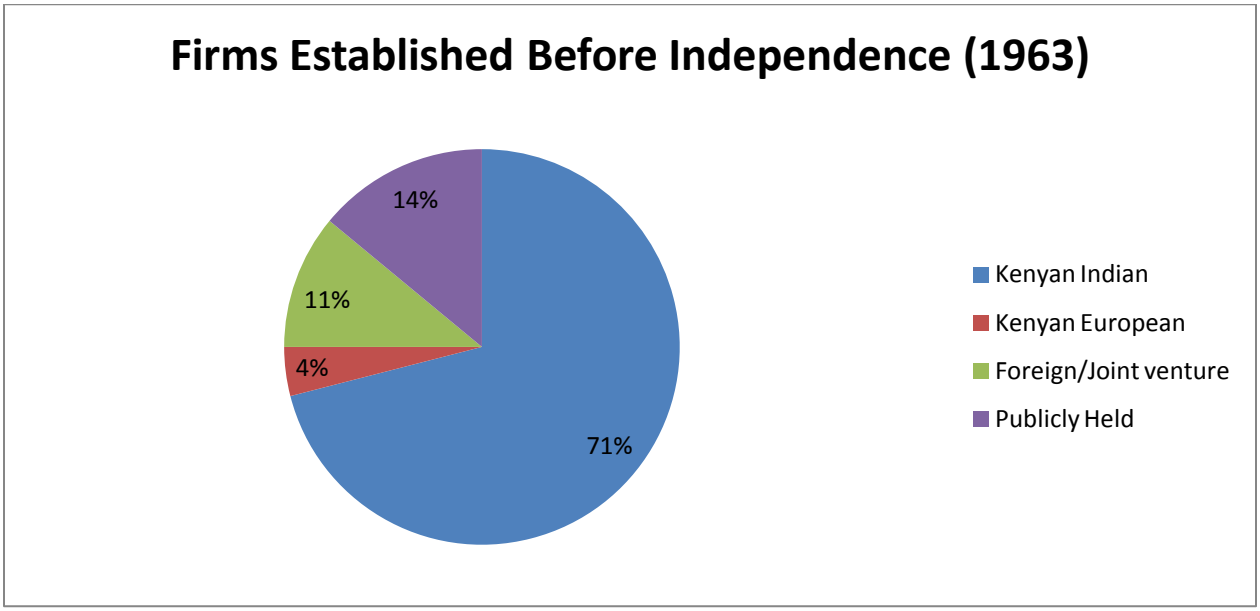
[278]Research shows that the ISI strategy has been gradually abandoned by developing countries due to its disappointing results. On the failure of the ISI strategy in Latin America, see Baer, W. (1972), 'Import Substitution and Industrialisation in Latin America: Experiences and Interpretations', Latin American Research Review, 7 (1), p.95.

[279] See GoK (1986), Sessional Paper No.1 of 1986 on Economic Management for Renewed Growth.

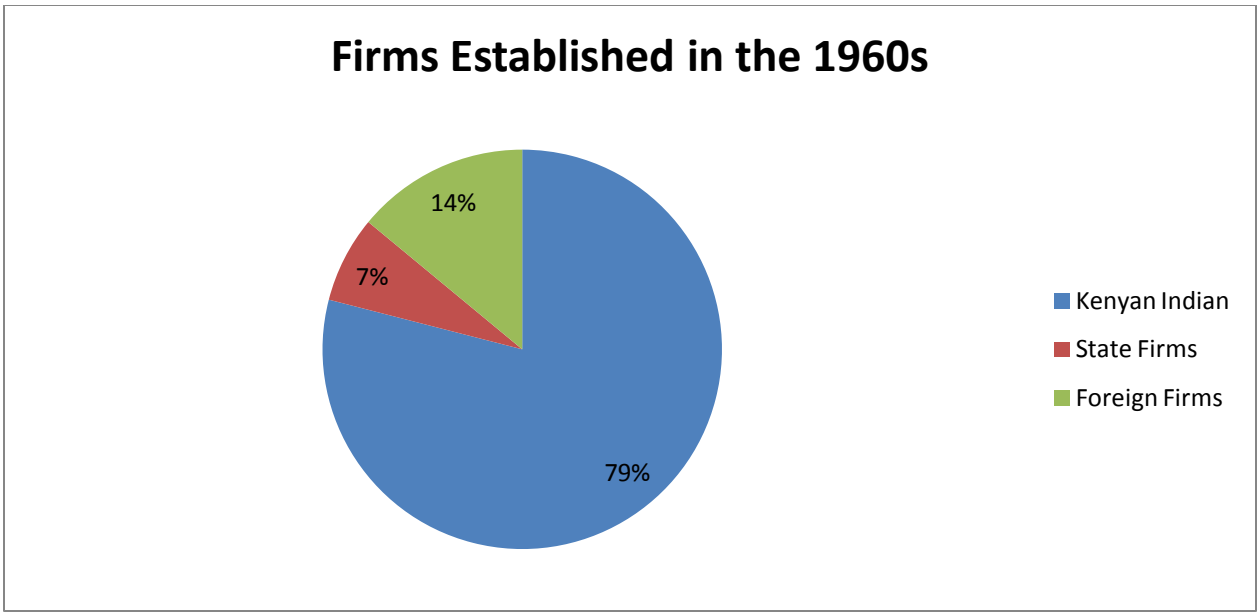
[280] Structural adjustments are policy changes required by the IMF and World Bank as conditions for getting loans. Their goal is to implement free market programs and policy through internal changes such as privatisation and deregulation and external changes such as a reduction in trade barriers. The countries that fail to enact these policies are subjected to fiscal discipline through the denial of funding. See Nwankwo, S. and Richards, D. C. (2001), 'Privatisation – The Myth of Free Market Orthodoxy in Sub-Saharan Africa', International Journal of Public Sector Management, 14(2), pp.165-180.

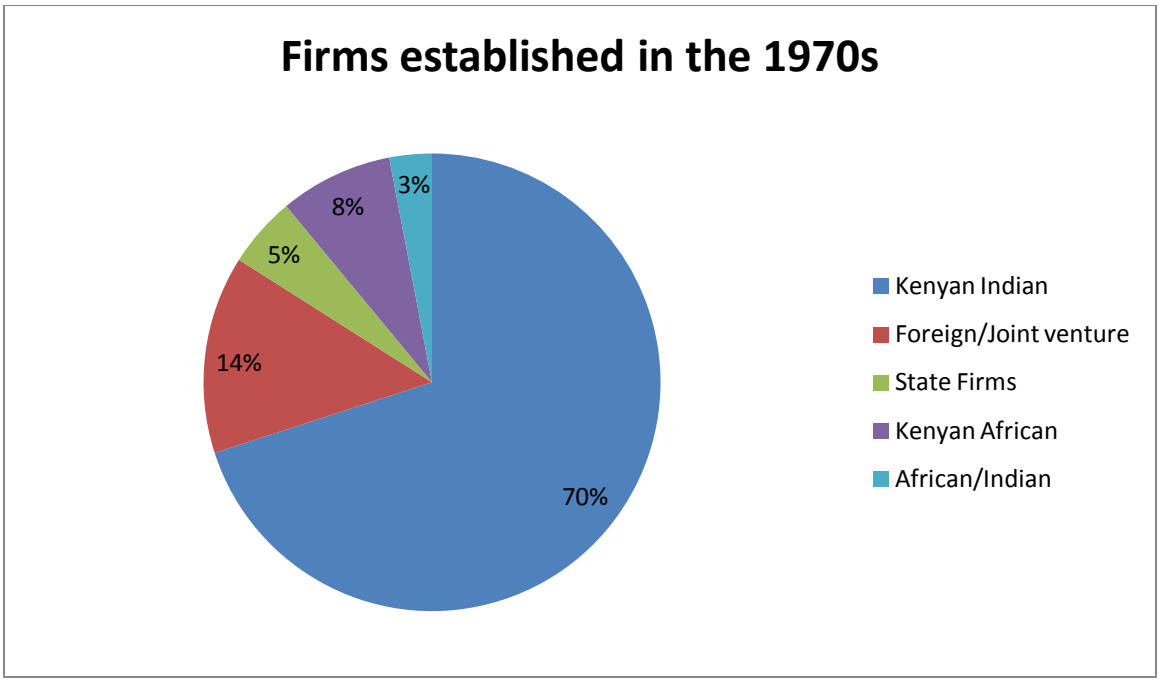
[281] See GoK (1996), Sessional Paper No.1 of 1996 on Industrial Transformation to the Year 2020.

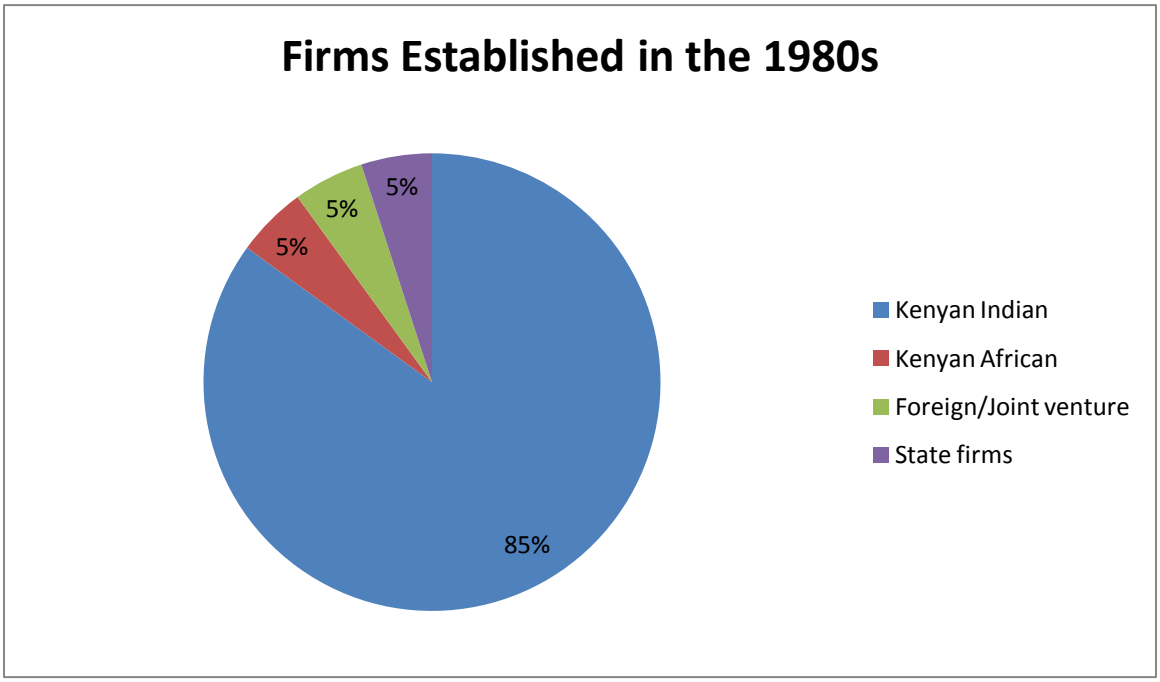
and little academic research on companies in Kenya after the Kenyatta era. Himbara's survey of 100 manufacturing enterprises with over 50 employees in the years 1989-1990 shows that during the Moi era, Kenyan Indians (Asians) continued to constitute the predominant segment of domestic commercial capitalists notwithstanding the 1964 Africanisation policy. Himbara's study found that for the years 1964 – 1990 the share of new manufacturing companies owned by Kenyan Indians was 78%; while from 1977 to 1990 this proportion rose to 84%. By 1990, 75 % of all manufacturing companies and 73% of manufacturing companies with over 100 workers were owned by Kenyan Indian capitalists.[282]Himbara also finds that the firms that were in financial or mismanagement difficulties in 1989 and 1990 were either state firms or Kenyan African. While the role of local Indians in commerce continued to increase, the performance of private African companies and state parastatals has ranged from mediocre to total failure.[283]The following charts are taken from Himbara's study of a sample of 100 large-scale manufacturing firms:[284]

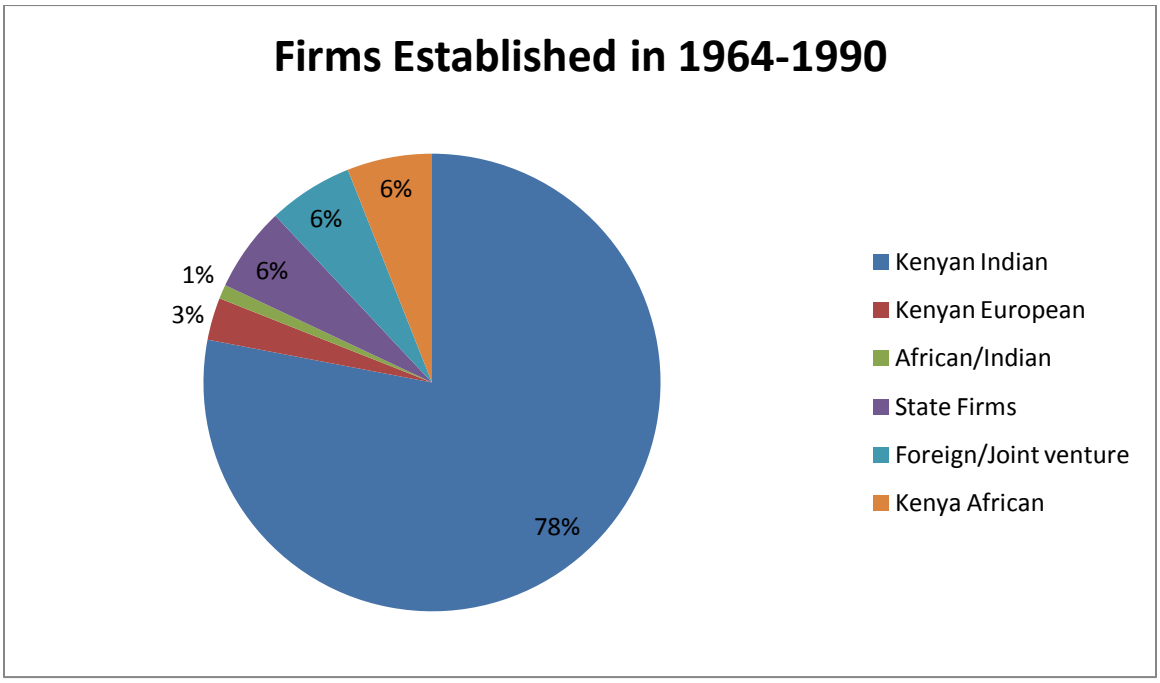


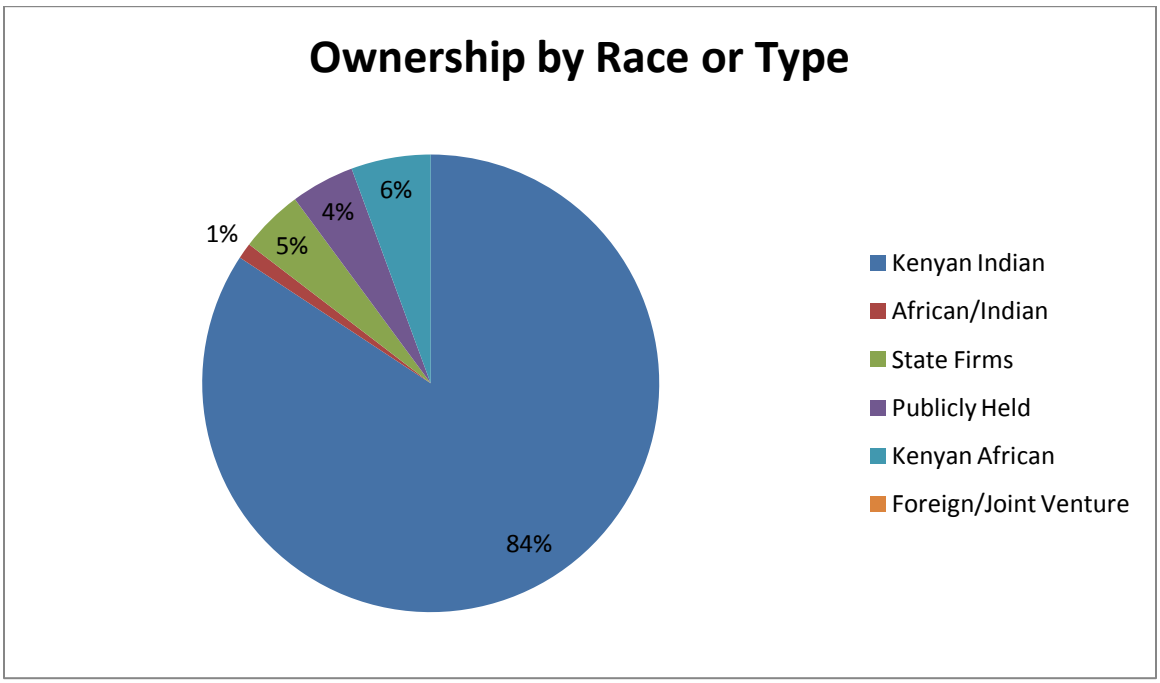
[282] Himbara, D. (1994), Kenyan Capitalists, the State and Development, Boulder & London, pp.44-45.
[283] Himbara, D. (1994), p.51
[284] Himbara, D. (1994), pp.45-50

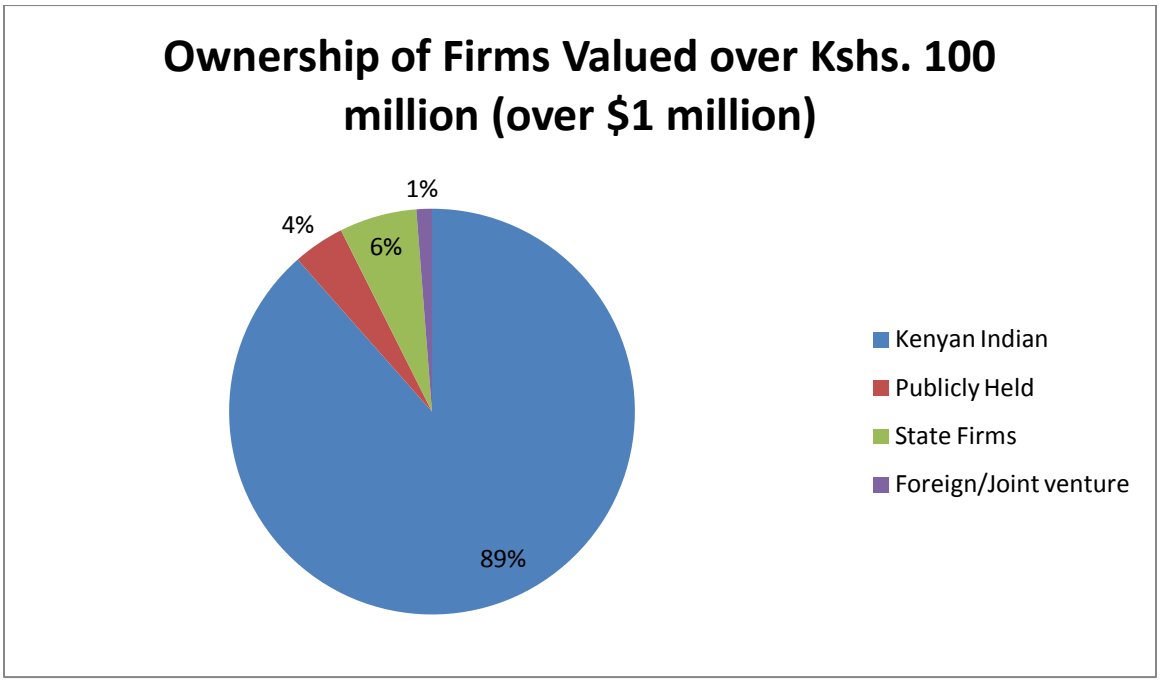

Firms Established in the 1960s
14%
7%
79%
Kenyan Indian
State Firms
Foreign Firms

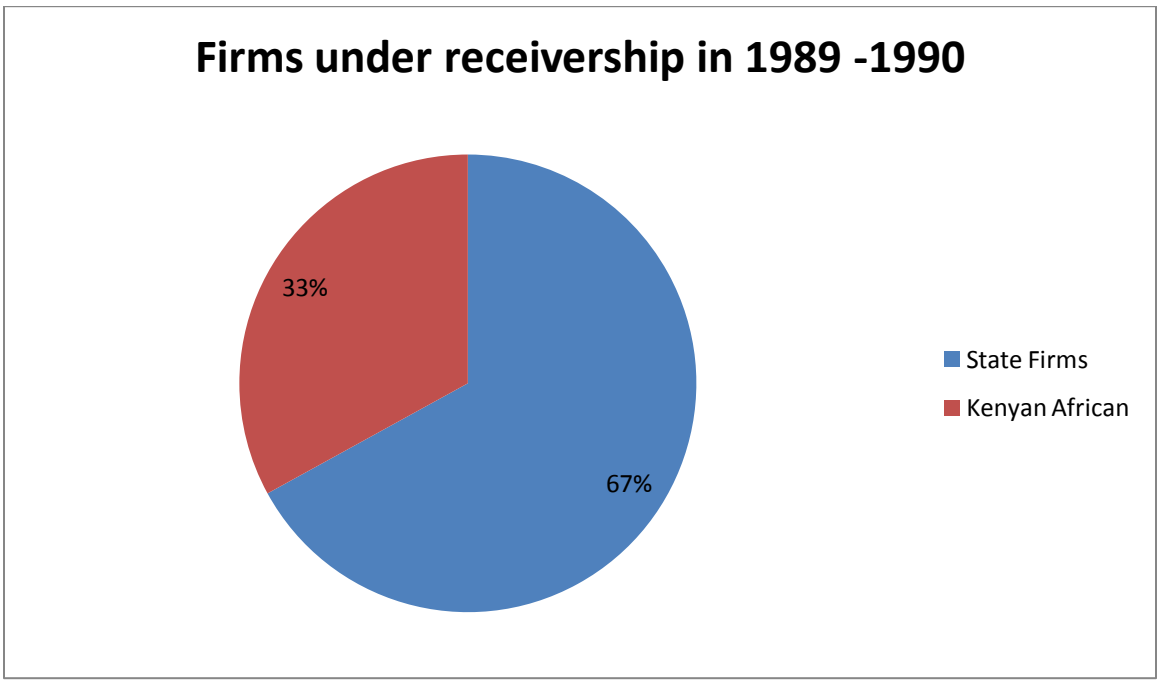

Firms established in the 1970s
3%
8%
5%
14%
70%
Kenyan Indian
Foreign/Joint venture
State Firms
Kenyan African
African/Indian

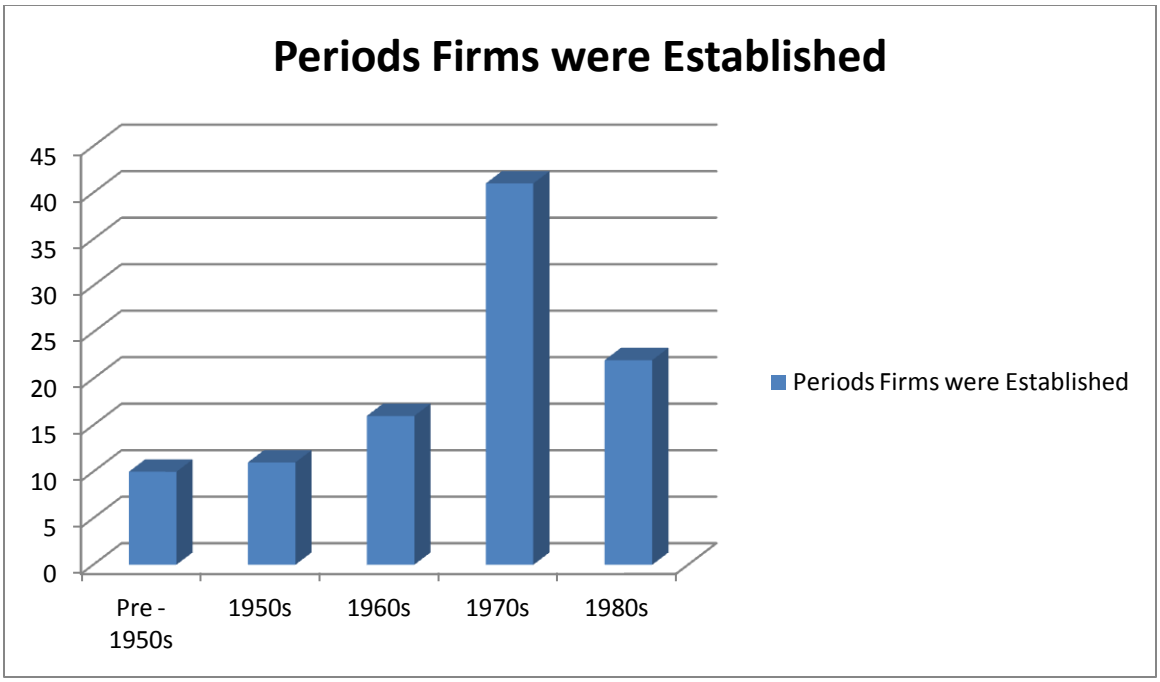

Firms Established in the 1980s
5%
5%
5%
85%
Kenyan Indian
Kenyan African
Foreign/Joint venture
State firms


Firms Established in 1964-1990
6%
6%
1%
6%
3%
78%
Kenyan Indian
Kenyan European
African/Indian
State Firms
Foreign/Joint venture
Kenya African


Ownership by Race or Type
6%
4%
1%
5%
84%
Kenyan Indian
African/Indian
State Firms
Publicly Held
Kenyan African
Foreign/Joint Venture


Ownership of Firms Valued over Kshs. 100 million (over $1 million)
1%
4%
6%
89%
Kenyan Indian
Publicly Held
State Firms
Foreign/Joint venture


Firms under receivership in 1989 -1990
33%
67%
State Firms
Kenyan African



From Himbara's data it is clear that company formation, at least in the area of manufacturing, was quite high in the Kenyatta era (the 1970s). The Moi era saw a decline of the formation of companies in this sector by nearly 50%. Another interesting observation is that most of the firms under receivership were under African management: that is state firms and Kenyan African firms. Kenyan Indian firms, on the other hand, seemed to expand from 70% during the Kenyatta regime to 85% during Moi's regime. A study by Ngugi and Njiru finds that the number of public firms in Kenya has largely stayed the same since independence suggesting that these firms remain unaffected by changes in political regimes.[285]

The poor performance of African companies and state parastatals during the Moi era whilst Asian companies thrived under the same conditions[286]suggests that the root cause of the poor performance of African companies lies in something that is intrinsically African;

[285] Ngugi, R. W. and Njiru, R. (2005), Growth of the Nairobi Stock Exchange Primary Market, KIPPRA, p.2.
[286] Himbara, D. (1994), p.51

probably kinship, and African kinship in particular as Asians do also have the kinship norm in the culture and in their ways of business organisation.[287]

2.3.4.6 The failure of projects based on the kinship norm during the Moi era

The failure of African kinship and its likely effect on corporation development is demonstrated in the performance of Harambee Projects and state corporations (parastals) during the Moi era. The ideal at independence to integrate African Socialism into capitalism resulted in an economy controlled through planning. Planning would guide the allocation of resources.[288]The traditional self help group was integrated into the economy through the notion of *Harambee* (meaning *'lets pull together'*)[289] which would be used to mobilize local resources whilst guaranteeing local participation in development. Development would rely more on Harambee as a way to foster self-reliance.[290]The notion of Harambee would also be subjected to planning:

> 'Self-help schemes will be **planned and controlled** to ensure that they are consistent with our national development plan and that the manpower and recurrent cost implications of these schemes are reasonable.'[291]

Chiefs and a new cadre of community development staff became the administrators and paraprofessionals of the Harambee movement. [292]Planning also had western support at the time. A 1951 report prepared by a group of experts at the UN had outlined measures for the economic development of underdeveloped countries emphasising national planning and calling for readjustments where old social institutions and ancient philosophies would be replaced by modern institutions and technologies.[293] After independence, the enthusiasm for Harambee blossomed to an unprecedented scale. Community development committees (CDCs) were introduced in 1964 to channel the enthusiasm for self-help into useful

[287] This will be explored in further detail in Chapters 4 & 5.
[288] GoK (1965), African Socialism and Its Application to Planning in Kenya, pp. 1-2, 49.
[289] Harambee is the collective and cooperative participation of a community in an attempt to fill the perceived needs through utilization of its own resources. See Ngau, P. M (1987), 'Tensions in Empowerment: The Experience of the Harambee (Self-Help) Movement in Kenya.', Economic Development and Cultural Change, 35(3),p.524
[290] GoK, Development Plan, 1974-78, p.40
[291] GoK (1965), p.36
[292] Ngau, P. M (1987), p.530
[293] UN (1951), Measures for the Economic Development of Under-developed Countries: Report of a Group of Experts, UN Department of Economic Affairs, New York, p.15

directions. CDCs would be organised through the Ministry of Economic Planning and Development but operate under local authorities who would be responsible for approving the Harambee projects to be initiated and recommend government financial aid. Between the years 1965-1984 the total nominal valuation of Harambee projects was Kshs. 3.2 billion. The annual value of Harambee projects had increased from 1.2million Kenyan pounds in 1965 to 21.9 million Kenyan pounds in 1984 as shown in the table that follows. Harambee projects were generally of two types: social development and economic development projects. The former included education, health, social welfare and social welfare amongst others whilst the latter included water supply, transport and communication facilities, agricultural ventures, construction of health centers and so forth. The ranking and relative share of total Harambee value invested in different projects from 1968-1991 was as follows: education – 62%, social welfare and recreation – 14%, water suppliers – 6.2%, agricultural ventures – 6.1%, construction, building and miscellaneous – 5.4%, health facilities – 4.1%, domestic facilities – 1.4%, transport and communication – 0.8%.[294]

Table 10: Performance of Harambee (Self-Help) in Kenya

Period	Valuation of Harambee Capital Formation (Kenyan pounds)	Contribution to National Gross Capital Formation (%)	Contribution Value per Capita (K.Sh)	Completed Harambee Projects[295]
1965-69	16, 431, 854	17.7	6.42	6,711
1970-74	20, 899,750	8.5	6.77	8,160
1975-79	29, 612, 155	8.9	8.13	8,396
1980-84	37, 768, 044	12.0	8.46	14,028

[294] GoK Economic Surveys, 1971-83 (cited in Ngau, P. M (1987), Ngau, P. M (1987), 'Tensions in Empowerment: The Experience of the Harambee (Self-Help) Movement in Kenya.', Economic Development and Cultural Change, 35(3), p.537)

[295] A project is a group undertaking that produces a facility or performs a task by contributing any one or a combination of cash, materials and labour. Data taken from Ngau, P. M (1987), p.526

*Real values in terms of 1975 Kenya pounds. Kenya pounds 1= US $ 2.80 IN 1975 (and 1.14 in 1985). KSh. 20 = 1 Kenya pound; 1 US$ = 7.14 in 1975.

Social development projects formed the larger part of Harambee projects with the share of economic development projects progressively declining. Additionally, the number of completed projects steadily increased while the number of started projects declined. The people (contribution of average 90% of the contributions) were the main contributors to Harambee projects and cash was the main type of contribution.[296]

Table 11: Trends in Harambee Projects: Type and Status[297]

Period	Social Development Projects (%)[298]	Economic Development Projects (%)	Number of Projects Started	Number of Projects Completed
1965 -69	64.1	36.0	18,830	6,711
1970 – 74	73.0	27.0	19.162	8,160
1975 – 79	81.7	18.3	15,050	8,396
1980 - 84	85.6	14.4	17,438	14,028

Table 12: Trends in Harambee Contributions: Source (%)[299]

Period	People	Government Assistance	Other Donors[300]
1965 -69	94.0	3.5	2.5
1970 -74	88.4	7.5	4.1
1975 -79	87.6	6.3	6.1
1980 -84	90.3	5.7	4.0

[296] Ngau, P. M (1987), p.527
[297] Data taken form Ngau, P. M (1987), p.527.
[298] Percentage of total Harambee value.
[299] Data taken form Ngau, P. M (1987), p.528.
[300] These include local and foreign business firms, foreign agencies and governments, foundations, trusts, and NGOs.

Table 13: Trends in Harambee Contributions: Type of Contribution[301]

Period	Cash	Labour	Material
1965 -69	42.4	25.3	32.3
1970 -74	58.2	25.0	16.7
1975 -79	66.8	17.9	15.3
1980 -84	67.7	15.6	16.7

Neither the government nor the people could handle the success of the Harambee. Projects had been started with little thought on how to sustain the recurrent expenditure of projects such as schools and hospitals for example.

> 'It was a boom-and-bust-dilemma. Harambee had become too successful, and its demands were more than the authorities could give or the people could carry.'[302]

By the 1980s, the use of Harambee had become distorted deviating from its traditional emphasis on basic production to the provision of large, costly, social amenity projects. Additionally, local people were taking less and less part in decision-making, management and control of projects[303] with these being increasingly taken up by politicians and the elite. Politicians were keen on controlling these groups as they could use funds extracted from the government and private sources in exchange for political and economic gains.[304]The displacement of local farmers as well as other local groups from leadership by the elite resulted in tensions over 'self-help' leadership, created heightened leadership rivalry and competitiveness leading to dysfunctional consequences such as the abandonment of projects. Between 1965 and 1984, 30% of the old and newly started projects had been abandoned.[305] Not only were large numbers of projects abandoned but a large pool of uncompleted and continued projects had been created over the years as well. In the period 1980 – 84, a total of 64,076 projects were designated as *'uncompleted*

[301] Data taken form Ngau, P. M (1987), Ngau, P. M (1987), 'Tensions in Empowerment: The Experience of the Harambee (Self-Help) Movement in Kenya.', Economic Development and Cultural Change, 35(3),p.528.
[302] Ngau, P. M (1987), p.532
[303] Ngau, P. M (1987), p.523
[304] Ngau, P. M (1987), p.529
[305]While heightened leadership rivalry and competitiveness may have advantages for the cause of local development, generating attention and funds, it also has dysfunctional consequences such as abandonment and duplication of effort with rival groups complaining about project duplication. See Ngau, P. M (1987), pp.529,531.

continuing from previous years' in the provincial annual reports.[306]Leadership squabbles in Harambees led to delays, embezzlement of funds through wasteful projects and resulted in an inability of the people to control the flow of projects. Group rivalry and conflicting interest started to affect choice of projects with politicians preferring large, symbolic and non-basic production projects. Conspicuous leaders tended to initiate 'conspicuous' projects; a 1974 survey found that the bigger the leaders, the bigger and the more costly the projects initiated. Farmers initiated small projects such as nursery schools and cattle dips. The concept of Harambee was now being used for the personal benefit of politicians rather than the benefits of the local community resulting in an agency-like problem between the people and the politicians.[307]This resulted in an increase in regulation. In addition to the CDC, other bureaucratic structures were put in place. Development committees were established to oversee, approve, and ratify the decisions and recommendations on all projects including those made by CDCs. Development committees also had a hierarchical structure: the provincial development committee (PDC), the district development committee (DDC) and the local development committee. Initiation of projects would require completed pro forma regulation compliances to be made to be approved by PDCs and DDCs. Community development assistants would report directly to the central government – rather than to local authorities. These regulatory measures created disincentives to locally based development.[308] The concept of Harambee also tended to amplify regional inequalities in Kenya. For instance, Harambee contributions per capita (in Kenya Shillings) in 1979 showed considerable disparities between provinces: Central -32.4%, Eastern- 28.1%, Rift Valley -27.2%, Western – 20.3%, Nyanza – 10.1%, Coast – 7.9% and North Eastern -5.0%.[309]

In sum, the co-operative 'self help' concept in the form of Harambee failed to take off in lieu of the corporation largely due to the lack of rules regulating this activity. Traditional regulation was through reputational sanction. Such sanctions cannot work on a national scale where leaders are unknown as civil servants leading these projects would not be from the locality. Secondly, government involvement in Harambee activities created tension

[306]GoK (1985), 'Provincial Annual Self-Help Statistics, 1980 -1984', Ministry of Housing and Social Services, p.12
[307] Ngau, P. M (1987), pp.529-530.
[308] Ngau, P. M (1987), pp.531-533
[309] Ngau, P. M (1987), p.529

between the necessity for supervision and control from the top and flexibility and autonomy from the bottom. There were also tensions between community control and professional guidance.[310]Thirdly, politicians took advantage and ran Harambee projects in their interests rather than in the interests of local communities as a result of positional conflicts.[311]

This same pattern – where government control leads to the failure of projects based on the kinship norm can also be seen in the case of parastatals. Parastatals were established in Kenya during the colonial times to provide services that were not provided by the private sector.[312] After independence, the Kenya government established similar parastatals as part of the Africanisation programme. Today they control key sectors of Kenya's economy such as agricultural exports, transport and communications, manufacturing and agriculture trade. The government exercises immense control over parastatals as it has the power to appoint directors, issue directives of a general nature[313] and determine the composition of the board of directors.[314] Due to the political nature of appointments, parastatal boards are composed of many directors who are ex-civil servants with little or no private business experience. The appointment of directors by the President and Ministers politicises directorships as directors act in the interests of the appointing authority rather than in the interests of the parastatal.

> 'In this country, as in the rest of Africa, people seek political power, not to implement programmes or ideologies, but to hand out benefits in the form of jobs and lucrative contracts to their relations and political allies. And, what we call political parties here are institutions, which are bereft of programmes and ideologies. They are **mere patronage structures organised by the elite of various ethnic communities for the purpose of capturing state resources for members of their ethnic communities**.' [315]

[310] Ngau, P. M (1987), p.530
[311] Positional conflicts will be discussed further in Chapter 4.
[312] By 1990 the parastatal sector had 255 firms which employed 115,000 people. Their wage bill represented 40% of the public sector and twenty-two percent of the national wage bill. Mwaura, K. (2007), 'The Failure of Corporate Governance in State Owned Enterprises and the Need for Restructured Governance in Fully and Partially Privatised Enterprises: The Case of Kenya', Fordham International Law Journal, 31(1), p.42
[313] Mwaura, K. (2007), p.36
[314] S.6 State Corporations Act.
[315] Kisero, J. (2001), Political Patronage Mother of Graft, Daily Nation, August 1st 2001.

The main agency problem for parastatals therefore arises from political appointments.[316] The poor performance of the board of directors of parastatals has been attributed to the existence of multiple agents:

> 'Unlike a private company, which has a single principal (shareholders) and agent (managers), a parastatal is governed by **multiple agents, namely managers and state/public officials.** Voters who elect public officials are considered to be the principals of both the board of directors and the State. Inefficiency of the boards of parastatals arises because the agents (public officials) who have the powers to appoint board members and issue managerial directives do not always act in the best interest of parastatals, but in the interest of voters who can vote them out.'[317]

In 2001, the interference in operations of the National Bank of Kenya by directors who were political appointees led the Central Bank of Kenya to intervene and abolish the post of Executive Chairman in finance parastatals.[318] The World Bank has also challenged the irregular appointment of directors.[319]Due to poor management structures, parastatals have often been implicated in Kenya's fiscal problems.[320] In 2001, the Parliamentary Public Investment Committee revealed how directors of the National Social Security Fund abdicated their duties and awarded themselves excessive treats costing the company US$55 million between 1996 and 1998. Similarly at the Kenya Ports Authority, board members paid themselves allowances of between Kshs. 5000 -10000 as opposed to the approved Kshs.1000 per session. The National Housing Corporation (NHC) also became insolvent as a consequence of directors commissioning real estate projects worth Kshs. 319 million without competitive bidding or approval of the NHC board of directors.[321]

Following the mismanagement of parastatals, the IMF and World Bank has pushed for the privatisation of parastatals[322] resulting in the passing of the Privatisation Act (2005), The Anti-Corruption and Economic Crimes Act (2003) and the privatisation of parastatals such as

[316] Mwaura, K. (2007), p.49
[317] Mwaura, K. (2007), p.40.
[318] Daily Nation, Banks to Get Rid of Chairmen, March 3rd 2000.
[319] Mohammed, H. (2001), World Bank Queries Statues of ERB, East Africa Standard, July 28th 2001.
[320] Mwaura, K. (2007), p.34
[321] Gicheru, C. (2001), MPs Watchdog Finds more State Looting, Daily Nation, August 16th 2001.
[322] Munaita, P. (2001), We Shall Not Ease Pressure, IMF Tells Kenya, East Africa Standard, Kenya October 22, 2001.

the Kenya Commercial Bank. It is notable however that the Kenya government did not pass these Acts freely but under the pressure of external bodies. Initially the Moi government had rejected the Kenya Anti-Corruption Authority (KACA) Bill[323] and the Privatisation Bill and it is only on suspension of foreign aid that the government passed these laws.

However, it remains to be seen whether measures such as privatisation will improve corporate governance due to the current state of Kenya's legal framework. The Privatisaton Act 2005 has been inadequate as there is nothing prohibiting concentration of ownership of privatized state assets in the hands of well-connected individuals and multinational corporations hence creating monopolies that do not improve services as is the case in KPLC.[324]

Another weakness of the parastatal as an implementation of the co-operative concept is that the objective of most parastatals as set out by the Kenyan government is to foster the private sector rather than their own growth. After independence, parastatals were generally set up to meet social and political objectives[325]particularly African Socialism goals which were to give political equality, social justice and human dignity to all. This often results in conflicts of interest and inefficiency. Examples are the Agricultural Finance Corporation of Kenya (AFC), the Industrial and Commercial Development Corporation (ICDC)[326] and the Industrial Development Bank whose aim was to finance the agricultural, commercial and entrepreneurship aims of African peasant farmers. Though these parastatals were successful in the 1960s and 1970s, some such as the AFC started experiencing liquidity problems when politically connected farmers with large farms took loans with insufficient collateral and continuously defaulted on payments. By November 2001 for example, unsecured loans owed to the AFC were two billion Kenya shillings.[327] The need to assist the private sector partly undermines the efficiency and solvency of

[323] Wanyonyi, R. (2001), Netherlands Stops Funding Projects, East Africa Standard, Sept 19th 2001. This followed the rejection of the KACA Bill.
[324] Mwaura, K. (2007), p.65
[325] Mwaura, K. (2007), p.37
[326] Was established to assist local entrepreneurs to increase their participation in the industrial sector.
[327] Mwaura, K. (2007), p.34. Also see, Kenya Hansard (2008), National Assembly: Official Report, p.870.

parastatals as the need to have high profits is rarely on the agenda of some parastatals.[328] Despite being nearly half-owned by individuals and institutions, Kenya Power and Lighting Company (KPLC) for example has continued to perform mandatory social roles, such as the rural electrification project.[329]

Another issue for parastatals is excessive foreign ownership.[330]Committees set up to investigate the financing of parastatals in 1979 and 1982 found increasing foreign ownership in parastatals and control of key sectors of the economy. Consequently, despite the government investing in more than 300 parastatals the Treasury received only UK pounds 2.2 million as dividends between 1978 and 1979.[331]Additionally, parastatals are subject to overlapping regulations. For instance, although the directors of the Communications Commission of Kenya (CCK) are appointees of the minister under the Kenya Communications Act,[332]the CCK is still governed by the State Corporations Act 1986 because it is a state corporation. The CA 1948 affects the CCK as it stipulates the conduct expected of directors. Parastatals are also subject to direct regulation by Parliament. Over-regulation and excessive government control has affected the ability of parastatals to make commercially sound decisions.[333]

In sum, the implementation of the co-operative 'self-help' concept through the parastatal has failed for reasons which are quite similar to those that led to the failure of the Harambee concept. First, like Harambee, kinship through the parastatal has resulted in capture by the state leading to government control of parastatals. Secondly, similar to Harambees, social causes have been prioritised over economic causes leading to the poor performance of parastatals. Thirdly, parastatals like Harambees have also resulted in

[328] Mwaura, K. (2007), pp.37,48.
[329] Mwaura, K. (2007), p.48
[330] After independence, most foreign investors were wary of investing in Kenya due to the risk of nationalisation and required the government to be a joint partner in most ventures. The government agreed to this to attract foreign capital technology and management skills. The Foreign Investment Act 1964 was passed to protect foreign investors and encourage government shareholding in joint ventures with private partners.
[331] Republic of Kenya (1982) The Working Party on Government and Expenditure, pp.40-41
[332] S.6 Kenya Communications Act (1998)
[333] Mwaura, K. (2007), 'The Failure of Corporate Governance in State Owned Enterprises and the Need for Restructured Governance in Fully and Partially Privatised Enterprises: The Case of Kenya', Fordham International Law Journal, 31(1), p.56

multiple agency problems as a result of political interference. Over regulation leading to poor business environments and decisions have been the result of government intervention. In a nutshell, it seems that the development of the Kenyan 'self-help' concept into a viable corporation has failed because of the inability to separate African kinship on a large scale and government control. But even then whilst this might explain why kinship seems to have negative effects in the Kenyan context, it does not provide a satisfactory explanation for the success of countries like China which having kinship and significant government control have still managed to have successful corporations.

2.4 The Kibaki Era: 2002 – Present

Following Moi's removal from power, the Kikuyu returned to power under Mwai Kibaki's leadership. Kibaki, an economist, promised much needed economic reform. The victory over Moi's regime carried with it Kenya's hope for the revival of the economy and a political system run on open participatory politics. It was also a victory that was achieved on the promise to rediscover the 'lost' Kenyan nationhood as symbolised by the coming together of many ethnic groups under NARC.[334] The outcome of the 2002 election demonstrated that Kenyans can overcome ethnicity and vote for any candidate who identifies with their problems irrespective of ethnic affiliation – shifting the focus of Kenyan politics from personalities to a more objective stand; that of issues. The 2002 public vote also constituted a rejection of authoritarianism and governmental inefficiency in preference of democracy. Elected leaders can no longer afford to flagrantly ignore the wishes of the electorate as was hitherto the case.[335]

The resulting 2002 NARC government was an experiment in corporate *presidentiasis*. The basic structure of the government remained the same, highly unitary with the president and his government as the focal point.[336] Unlike his predecessor, Kibaki adopted a *laissez faire* administration much like the Kenyatta administration.[337] The need to accommodate as

[334] Matanga, K. F. (2003), 'Kenya: A Chequered Path to Democracy', East African Journal of Human Rights, Vol. 1(1), p.39.
[335] Masime, K. and Kibara, G. (2003) 'Regime Transitions and the Institutionalization of Democracy in Kenya: The December 2002 Elections and Beyond', East African Journal of Human Rights & Democracy, Vol. 1(1), ,p.20
[336] Masime, K. and Kibara, G. (2003),p.22
[337] See Barkan, J. D. (2004), 'Kenya After Moi', Foreign Affairs 83 (1), p.92

many of his coalition partners as possible made Kibaki renege on a lot of NARC's electoral pledges. Similar to the Moi administration, the NARC administration took over KANUs recruitment ethics and did not see professionalism and merit as the exclusive criteria for appointment to public office. Cronyism, ethnic balancing and patronage seemed to be the guiding criteria. The need to reward various constituencies resulted in the retention of myriad state parastatals which NARC had promised to privatise as well as their continued mismanagement. Under NARC, MPs showed total disregard for the people by refusing to pay taxes and hiking their pay packages. Raila was never appointed Prime Minister as Kibaki failed to honour his electoral pledge to pass the new constitution resulting in factionalism within NARC. Factionalism within the ruling coalition and the need to keep various camps happy discouraged meaningful and thorough judicial reforms.[338] Although the NARC government was popular because Moi was gone, professionals and business leaders were increasingly disappointed with its performance.[339]In particular there was disappointment in the slow pace of instituting change and the continued reliance on the machinery of the KANU regime.[340]

With the change of government in 2002, the government formulated the Economic Recovery Strategy for Wealth and Employment Creation (ERS) to guide the country's economic period until 2007.[341] The 2002 development strategy addressed the twin challenges of economic growth and poverty reduction. This policy emanated from the NARC Manifesto and the Ninth development plan, 2003-2008. Like in past strategies, the 2002 development plan stipulated that the best way to increase the rate of economic growth and reduce poverty in Kenya is through strong private-sector driven economic and employment growth. In placing the private sector on a pedestal and by embodying a wealth creation nomenclature, the 2002 development plan did not deviate much from the 'trickle down' development strategies of past years.[342] Private sector development under the 2002 plan hinged on policy advice that stresses on Kenya 'getting its institutions right.' Judicial reforms, enactment of laws to protect property rights, tax incentives, reducing bureaucracy and red tape and eliminating corruption have been cited as important measures that will encourage private investment in

[338] Masime, K. and Kibara, G. (2003).
[339] Barkan, J. D. (2004), p.94
[340] Munene, M. (2003), 'Kibaki's Moment in History: The Election of 2002 and its Aftermath', The East African Journal of Human Rights & Democracy, Vol.1, No.1, p.72.
[341] Wambugu, N. N. and Kibua, T. N. (2004), Economic Growth & Poverty in Kenya: A Comparative Analysis of Effects of Selected Policies, Institute of Policy Analysis & Research (IPAR), pp.1-3.
[342] Wambugu, N. N. and Kibua, T. N. (2004),p.6

Kenya. These policies were intended mostly to attract FDI.[343] Although the ERS had not got 'institutions right' by its expiry at the end of 2007, it resulted in rapid economic growth from 0.6% in 2002 to 6.1% in 2006 and the establishment of the tradition of macro-economic stability.

The 2007 election was contended by 3 candidates – Kibaki, Raila and Kalonzo- representing the factions that had formed in NARC. Kibaki reconstituted his party as the Party of National Unity (PNU), which included members of Moi and Kenyatta's KANU. In the meantime, Raila constructed a coalition of leaders labelled the 'Pentagon' from the spread of Kenyan provinces under ODM. Falling out within Raila's ODM, had formed a splinter ODM-Kenya (ODM-K).[344] The common weakness amongst African coalitions –united more by what they are opposed to rather than what they stand for[345] – resulted in a return to ethnic-based politics as there was nothing to unite Kenyans as Moi was now out of the way. Kalonzo did not receive much support outside his Kamba region and the contest for presidency was between Raila and Kibaki. The 2007 quickly turned into a contest for the leadership of Kenya between the Luo and the Kikuyu respectively as there has been a long history of rivalry between the two groups that dates back to the independence era.[346] Raila and Kibaki respectively targeted different socioeconomic groups – with Raila promoting the cause of the poor whereas Kibaki appealed to the wealthy and the middle-class- making class distinctions a feature of the election. The 2007 election was observed by a number of internal and external organizations, including the European Union Election Observation Mission (EUEOM) which was an independent European body ensuring a high standard for democratic elections and the initial predictions were for a Kibaki defeat. Many observers, including key Kibaki advisors, acknowledged that Kibaki and his party would lose.[347] This prediction however, was proven incorrect when the results were released. Kibaki was declared the winner of the 2007 elections resulting in civil unrest as the election had been characterised by violence and rigging. Efforts were made to mediate a peace agreement

[343] Wambugu, N. N. and Kibua, T. N. (2004),p.33.
[344]Gibson, C., and Long .J. (2009), 'The Presidential and Parliamentary Elections in Kenya, December 2007', Journal of Electoral Studies, p. 2
[345] Barkan, J. D. (2004), 'Kenya After Moi', Foreign Affairs 83 (1),p.92
[346] Horowitz, J. (2008), Power-sharing in Kenya: Power-sharing Agreements, Negotiations and Peace processes, Centre for the Study of Civil War. CSCW Papers. University of California, San Diego, p.3, Available at http://www.prio.no/sptrans/-550291863/Kenya_full_report.pdf. Last accessed 01/05/2011.
[347]Dagne, T. (2008), 'Kenya: The December 2007 Elections and the Challenges Ahead,' Congressional Research Service Report Prepared for Members and Committees of Congress, United States, p.2

which resulted in a power-sharing agreement between Raila and Kibaki to form a Coalition government with Kibaki as President and Raila as Prime – Minister.

The Coalition government of 2007-2012 suffered the same ills as the 2002 NARC government. It was not until the international community intervened and demanded for the passing of a new constitution and the prosecution of the sponsors of the 2007 electoral violence that the Kibaki-led government started to act in the interests of the people resulting in the passing of a new constitution in 2010 following a referendum. The new constitution provides for an overhaul of the executive, legislature and judiciary, together with a measure of devolution to the regions. The country will still be ruled by an executive president who will be constrained by checks and balances, and parliament will vet key appointments that had previously been made by presidential fiat. President and parliament will have fixed terms, with elections every five years. To become president, a candidate will have to win support from across Kenya's 40-plus ethnic groups by winning at least half of all votes cast and at least a quarter of them in more than half of the 47 newly demarcated counties.[348]

Kenya's current development plan, '*Kenya Vision 2030*' [349]was launched in 2008 replacing ERS. Vision 2030 is significant because having been developed through an all-inclusive and participatory stakeholder consultative process,[350] it reflects the general Kenyan position on economic policy (rather than a particular party position) as it resulted from a coalition government having to combine the manifestos of different parties, in this case the left wing ODM party that is more pro-stakeholder and the right wing PNU party that is more pro-shareholder as it supports the market-based ideology of economic regulation. Kenya's Vision 2030 covers the period between the years 2008-2030 and aims to transform Kenya into a new industrialising middle-income country based on three pillars: the economic, social and political. Under the economic pillar, the aim is to achieve an average GDP growth rate of 10% per annum beginning in 2012. The second pillar seeks to build a just and cohesive society with social equity whilst the political pillar aims to realise a democratic system founded on issue-based politics that respects the rule of law and protects the rights and freedoms of every individual in the Kenyan society.

[348] The Constitution of Kenya (2010).
[349] Government of Kenya (2007), Vision 2030, A Competitive and Prosperous Kenya, Nairobi, Government Printers.
[350] See Government of Kenya (2007), pp.1-3.

Of particular significance for corporate governance is the Government's commitment to establish a market-based economy: Vision 2030 aims at, *'adherence to the rule of law applicable to a modern, market-based economy in a human rights-respecting state.'*[351] Amongst the specific strategies contained in Vision 2030 to achieve this is:

> '..aligning the national policy and legal framework with the needs of a market-based economy… ..**changing legislation that is clearly not conducive to the creation of a good business environment in Kenya**.. [and].. inculcating a **culture of [voluntary][352] compliance** with the law and [encouraging] decent human behavior.'[353]

Vision 2030 aims at a 'people-centered and politically engaged open society' which promotes *'open engagement between government and civil society, as well as the flow of information,'*[354]an attitudinal change in the public service that values transparency and accountability to the citizens of Kenya,[355]the introduction of legal and institutional reforms that will enhance transparency in all transactions, build trust and make enforcement of justice more efficient, a commitment to continuing with the tradition of macro-economic stability that was established in 2002, instilling a culture of respect for property rights to land whether owned by communities, individuals or companies and a commitment to address the low savings to GDP ratio and lower transaction costs through institutional reforms. [356]The government also intends to simplify business registration and trade licensing,[357]create a vibrant and competitive financial sector and deepen financial markets by raising capital through amongst other means FDI.[358]Property rights of local and national investors will be protected under the Constitution.[359] In order to ensure full public participation in Kenya's governance process the citizens of Kenya will be made to appreciate the values of tolerance and respect for differences in opinion that are necessary in a competitive environment.[360]

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[351] Government of Kenya (2007), p.23
[352] Government of Kenya (2007), p.25
[353] Government of Kenya (2007), p.23
[354] Government of Kenya (2007), Vision 2030, A Competitive and Prosperous Kenya, Nairobi, Government Printers.
p.25
[355] Government of Kenya (2007), p.9
[356] Government of Kenya (2007), p.13
[357] Government of Kenya (2007), p.13
[358] Government of Kenya (2007), p.15
[359] Government of Kenya (2007), p.22
[360] Government of Kenya (2007), p.23

Because of Kenya's turbulent political past and present, the corporate legal framework has not been a priority for Kenya's politicians in Parliament. The presence of shareholder value in the CA 1948 has meant that it has remained entrenched as the governing principle of companies in Kenya. Inequality in wealth and poor investor protection in the Kenyan society has also meant that the ownership and size of the Nairobi Stock Exchange has hardly changed since independence.[361] Privatisation of all state parastatals has also not been realised and the governance crisis at a national level continues to be reflected at corporate level in state corporations. A lot of progress has however been made in Plcs with the introduction of corporate governance guidelines. A growing number of the companies listing on the NSE have high levels of disclosure in their annual reports. However, there has been little change in the nature of the Kenyan shareholder who is generally passive mirroring the lack of citizen participation at national level resulting from various regimes of political repression, poor resource management and distribution by the government.[362]The phenomenon of undifferentiated political power structures that dominated pre-colonial Kenya coupled with the emergent colonial and post-colonial dictatorships and all powerful executive[363]has resulted in passivity at both national and corporate level. However, following the passing of the new constitution that has put in place a more inclusive system where Kenyans have a say in appointments it is likely that we will see the same in other areas including the corporate sector. Stakeholder interests (including those of minority shareholders in the Kenyan context) are likely to come to the fore-front following the increase in awareness of Kenyan citizens. The increase in demand for accountability at a national level is likely to be transposed to a demand for increased accountability in companies listing in the NSE.

2.4.1 Company formation: 2002 – Present

There is hardly any information on the formation of companies during this period as the Office of Registrar of Companies remains as it was in the Moi era. Information on companies remains difficult to access. Therefore information on company ownership and interlocks continues to be difficult to access. Various concerns raised in the Kenya Hansard over the

[361]See Ngugi, R. W. and Njiru, R. (2005), Growth of the Nairobi Stock Exchange Primary Market, KIPPRA, pp.19-20. Ngugi, R. W. (2003), Development of the Nairobi Stock Exchange: A Historical Perspective, Kenya Institute for Public Policy Research Analysis (KIPPRA), p.27.
[362] See Masime, K. and Kibara, G. (2003),p.18.
[363] Matanga, F. (2003), 'Kenya: A Chequered Path to Democracy', East African Journal of Human Rights, Vol. 1(1), p.32

formation of companies in recent years suggest that statistics at the Registrar's office may not be accurate even if the information were found. First, is the fact that there is a rise in the number of fictitious companies for the purpose of fraud being formed with some individuals registering over 100 companies which are wound up after one transaction. On this Mr. Sungu (MP) states:

> '... we used to call them 'fly-by-night companies.' They are opened today and tomorrow, they are closed after one big transaction. Once the file is closed, it is often quite difficult to trace the owners of these companies.'[364]

Despite the lack of information on company formation, activity on the NSE has increased resulting in newly listed companies and ordinary Kenyans are now more interested in investing in the stock exchange. The challenges facing Kenya's corporate governance however have not reduced. Shareholder protection is still quite low and often minority shareholders are not compensated for losses. This has dampened the enthusiasm on the NSE.

2.5 Conclusion

This chapter set out to give a historical account of Kenya's socio-economic and political context with the aim of highlighting the factors surrounding the introduction and subsequent operation of company law in Kenya. The finding of this chapter was that in terms of organisation in pre-colonial Kenya, the family was the basic social unit of organisation. Agriculture and pastoralism were the main economic activities in pre-colonial Kenya and the basic unit of production and consumption was the household. Politically, most of Kenya's tribes were decentralised and headed by a Chief. Each tribe had its own laws and was governed through a Council of Elders. The main functions of the council included solving land and inheritance disputes, settling civil and criminal cases and presiding over religious functions. The Council of Elders settled disputes by consensus.

Kenya was colonised by Britain between 1895-1963 to provide raw materials and a captive market for British industries. Colonisation marked the transition of Kenya from a mixed-economy to an agricultural-based economy that was run and controlled by the settlers. This led to the displacement of African communities from their land resulting in significant

[364] Kenya Hansard (2004), National Assembly: Official Report, Wednesday 12th May 2004, p.1092.

changes amongst them the creation of the Kenyan state, the move from African customary law to rule of law, the transformation from communal ownership to the introduction of property rights, the establishment of a monetary economy, the introduction of a stock-exchange and the public listing of companies. As the colonial conquest set out to create conditions conducive to the penetration of capitalism the traditional stakeholder-based cooperative that was run on the basis of the kinship norm did not thrive. Company legislation was introduced to serve imperial needs. This legislation was unsuited to the needs and requirements of Kenya at the time as it was based on a concept that was radically different from the co-operative/self-help group.

The long term effect of this mismatch is that Kenyan Africans have struggled to adapt to the corporation as a way of doing business and in particular face challenges such as balancing social and corporate objectives. Kinship has seemed to run down Kenyan African companies. Following independence, ethnic-based government policies such as the Africanisation policy and tribal balancing have resulted in tribal hegemonies forming in Kenya's corporations creating economic inequality between Kenya's tribes. Problems in Kenya's corporations such as factionalism and the misuse of position mirror politics at the national level where presidents misuse political power and use ethnic-based politics to stay in power resulting in factions at a national level. The dominance of the Kikuyu which can be seen all-over Kenya's economy, including on the NSE, can be attributed to path-dependence. The Kikuyu were particularly the Kikuyu-Bantus were able to easily embrace capitalism due to their historical recognition of the concept of 'private ownership' and they were historically politically decentralised amongst other factors. Kikuyu governments have therefore tended to embrace a laissez faire administration thereby giving support to capitalism. Governance by the Kalenjin, who did not historically recognise private ownership, resulted in centralisation not just politically- which Kikuyu regimes have also done – but also economically resulting in a massive decline in economic growth, the poor governance of corporations and mass collapse of corporations. This trend has reduced during the Kikuyu-run Kenyatta and Kibaki regimes. Because of Kenya's turbulent political past and present, the corporate legal framework has not been a priority for Kenya's politicians in Parliament. The next chapter positions Kenya within the corporate governance debate.

Chapter 3: Positioning Kenya within the Corporate Governance Debate

3.1 Introduction

Ch.1 proposed that because England and Kenya have adopted similar frameworks for regulating directors, comparing their regulatory frameworks can enable us to understand why, unlike England's framework, Kenya's legal framework has resulted in concentrated ownership and low levels of shareholder protection. The foregoing chapter gave a historical account of the Kenyan context including the introduction and subsequent operation of the concept of the corporation. The focus of the present chapter is to position the conditions and ideologies that have shaped Kenya's economic development and thus its corporate framework within the corporate governance debate.

This chapter begins by introducing the corporate governance debate in particular the definition of corporate governance and the diversity of corporate governance systems around the world. It then considers the impact of globalisation on corporate governance and the literature that has resulted from it particularly the 'law matters' thesis and the convergence debate. The policies resulting from this scholarship are considered. The author concludes by suggesting a policy that will inform the review of Kenya's corporate framework in the next chapter.

3.2 Introducing the corporate governance debate

Although corporate governance has become a prominent topic in the last two decades, the concept of corporate governance is not new. The corporate governance debate began in the US in 1932 as a result of the work of Berle and Dodd. While Berle argued that the corporation should serve solely the interests of shareholders, Dodd argued that the corporation should serve the interests of the society.[365] However, it was not until 1982 that the corporate governance debate became heated following the publication of Principles of

[365] Berle, A. A. (1931), Corporate Powers as Powers in Trust', Harvard Law Review, 44, p.1049; and Dodd, E. M. (1932), 'For Whom are Managers Trustees?' Harvard Law Review, 45, p.1162.

Corporate Governance by The American Law Institute.[366] Since then the corporate governance debate has been ongoing. In the UK, interest in the corporate governance debate was sparked by corporate governance scandals in the 1980s and early 1990s resulting in the publication of the 1992 Cadbury Report.[367] The Cadbury report was taken to be a blue-print of what constitutes 'good corporate governance' around the world resulting in the development of corporate governance codes globally and the revival of the corporate governance debate. Researchers until this time mainly concentrated on solving the corporate governance problem that resulted from the separation of ownership and control as corporate governance scholarship til then had focused on the US and the UK where ownership was dispersed, market discipline was effective and the common law system was well developed. The literature that resulted from this research was based on understanding the agency problem as being two-way – between management and shareholders.[368]

Research beyond the Anglo-American world started when the US began to pay attention to countries such as Japan and Germany where the ownership structure is concentrated, and therefore unlike that of the US, yet whose economies maintained their competitiveness in the world market (at least in the 1980s).[369] Research then turned its attention to under-developed and developing countries such as East European States and Russia. These countries that had newly adopted capitalism following disintegration of the USSR needed a standard model for their newly formed capital markets.[370]Whilst some research shows that reforms in corporate governance structures of these countries might bring tremendous benefits and corporate value to the countries and investors,[371] a significant amount of

[366] See generally, Fischel, D. (1982), 'The Corporate Governance Movement', Vanderbilt Law Review, 35 (6), pp.1259–1292

[367] Cadbury Report (1992), Report of the Committee on the Financial Aspects of Corporate Governance, Gee Publishing, p.15

[368] Agrawal, A. and C. R. Knoeber (1996).

[369]This literature included Roe, M. J. (1993), Some Differences in Corporate Structure in Germany, Japan, and the United States, 'Yale Law Journal, Vol. 102, p.1927; Gilson, R. J. and Roe, M. J. (1993), Understanding the Japanese Kereitsu: Overlaps Between Corporate Governance and Industrial Organisation, Yale Law Journal, Vol. 102, p.871.

[370] See generally, Kim, H. (2008), p.202.

[371] See Black, B. (2001), The Corporate Governance Behaviour and Market Value of Russian Firms', Emerging Markets Review, Vol. 2, p.89 and Nenova, T. (2003), The Value of Corporate Voting Rights and Control: A Cross-Country Analysis, Journal of Financial Economics, Vol. 68, p.325.

research shows that these countries have struggled with the adoption of corporate governance models based on capitalism.[372]

More recently there has been a surge of corporate governance research on Asia, in particular China and South East Asia. Part of this literature has focused on understanding the role of law and development and the functionality of transplants.[373] Some research has been done on corporate governance in Africa following the turn of the century. This research has concentrated on understanding why Africa remains underdeveloped and with poor corporate governance practice despite adopting western models of corporate governance.[374] In Kenya research into corporate governance is relatively new, beginning following the publication of the Kenya's Corporate Governance Guidelines in 2002.[375] Corporate governance research has now moved to environments where ownership is concentrated, markets are ineffective as disciplinary mechanisms and a significant number of countries of study are civil-law based.[376]

3.2.1 The classification of corporate governance systems

An important contribution of corporate governance research so far has been to highlight the existing differences in corporate governance systems around the world. Corporate governance systems around the world can be classified into different categories. Franks and Mayer classifies corporate governance systems into insider and outsider systems. Outsider systems have large share markets, dispersed ownership and an active market for corporate control (MCC) and are typically found in the US and the UK. A majority of Continental Europe has insider systems with relatively small numbers of quoted companies, concentrated ownership structures and a comparatively small number of takeover

[372] See for instance Tajti, T. (2005), Corporate Governance: An Oversold Elitist Idea of No Interest to or For the Central European Transitory Economies?: Neglected Legacies, Pathological Phenomena From Hungary and Serbia and a Programmatic Agenda for the Region, Corporate Governance Law Review, 21.
[373] See for instance, Clarke, D. C. (2006), 'Lost in Translation? Corporate Legal Transplants in China', GWU Legal Studies Research Paper No. 213.
[374] See for instance, Rwegasira, K. (2000), 'Corporate Governance in Emerging Markets: Whither Africa?', Corporate Governance: An International Review, Vol.8(3), pp.258-267.
[375] See Barako, D.C. et al (2006), 'Factors Influencing Voluntary Disclosure by Kenyan Companies', Corporate Governance: An International Review, Vol 12, 2, 107-125
[376] See for instance Gorga, E. C. R (2003).

activities.[377] Within Franks and Mayer's 'insider/outsider' classification, Kenya can be described as an insider system as it lacks the large share markets, dispersed ownership and the active MCC that characterises the US and the UK and instead has characteristics that mirror those of Central Europe, such as a very small number of quoted companies,[378] a concentrated ownership structure and very little takeover activity.[379] The classification of corporate governance systems as insider and outsider is not perfect as differences can still be found within categories such as the classification of Germany and Japan as insider systems. Whilst Germany and Japan might have the bank playing a major role in corporate governance as their similarity, their differences are even greater.[380]Additionally, in the case of Kenya, the insider classification is not fully accurate as Kenyan companies have unitary boards which are associated with the US and the UK, rather than the two-tier board which characterises corporate governance in insider system countries such as Germany and China.

Another classification is the market-oriented vs. bank-oriented classification where market-oriented systems are the US and UK whilst bank-oriented systems are representative of Germany and Japan respectively. Market-oriented systems are thought of as having high take-over activities, high information disclosure, dispersed shareholding and large equity markets whereas bank-oriented systems are deemed to have low take-over activity, low-information disclosure, concentrated shareholding with banks owning large stakes and high levels of bank finance amongst other attributes. A particular difference between market-oriented systems and bank-oriented systems is degree of arms-length bargaining between the company and shareholders. Relationships play a significant role in bank-oriented systems whereas they play almost no role in market-oriented systems.[381]Under this classification, Kenya can be described as a bank-oriented system as information disclosure levels are low,[382]its equity market is small, banks own large stakes in the few publicly

[377] Franks, J. and Mayer, C. (2001), 'Ownership and Control of German Corporations', The Review of Financial Studies, 14(4), pp.943-944.
[378] 58 todate. This number has largely remained the same since the 1960s. See the NSE website: www.nse.co.ke.
[379] See generally, See Barako, D.C. et al (2006),pp.107-125; Mensah, S. (2003), 'Corporate Governance in Africa: The Role of Capital Market Regulation', Paper presented at the 2nd Pan-African Consultative Forum on Corporate Governance, Nairobi, Kenya.
[380] Lanoo, K. (1999), 'A European Perspective on Corporate Governance', Journal of Common Market Studies, 37 (2), pp.272-273.
[381] Mayer, C and Sussman, O. (2001), 'The Assessment: Finance, Law and Growth', Oxford Review of Economic Policy, 17(4), p.457.
[382]Barako, D.C. et al (2006), 'Factors Influencing Voluntary Disclosure by Kenyan Companies', Corporate Governance: An International Review, Vol 12, 2, 107-125.

quoted companies and relationships play a significant role in Kenya's corporate governance.[383] However, this classification is also not perfect. Whilst Japan has a large banking system, it also has a well capitalised equity market and therefore it does not fit neatly into this classification.[384]

Corporate governance systems have also been categorised as dispersed vs. concentrated. Research has shown the US and UK system as having dispersed ownership while large shareholdings are the norm in the rest of the world including Continental Europe and Asia.[385]Faccio and Lang's study analysing the control of 5,232 corporations in Western Europe from the years 1996-1999 finds that in the UK 63.08% are widely-held whilst in Continental Europe the highest number of widely-held firms is in Scandinavian countries: Sweden - 39.18%, Norway – 36.77% and Finland -28.68%. Germany has the lowest level of widely-held firms at 10.37%. UK firms were also found to have the lowest level of family control at 23.68% whilst in Europe, family-controlled firms are concentrated.[386] Claessens et al, in their study investigating the separation of ownership and control in 2,980 public companies in East Asia, found that more than two-thirds of firms were controlled by a single shareholder. Family-control was also found to be dominant with the top management of 60% of the firms sampled being related to the family of the controlling shareholder.[387]The other controller was the state.[388]Within Facio and Lang's classification, Kenya can be described as a concentrated ownership system as an examination of its few Plcs shows a dominance of the block-holders particularly banks, families and the state.[389]

The dispersed/concentrated ownership classification is less controversial than the previous two as almost all countries can be said to fit into this classification. Additionally, the agency problem that is the subject of corporate governance is more readily analysed under this classification than under the outsider/insider or market-oriented vs. bank-oriented classification. This is because the agency problem is a derivative of ownership structure. In

[383] See Table 16 of this thesis
[384] Mayer, C and Sussman, O. (2001), p.457.
[385] Shleifer, A. and Vishny, R. W. (1997), 'A Survey of Corporate Governance', The Journal of Finance, Vol. LII, No.2, pp.754-755.
[386] Faccio, M. and Lang, L. H. P. (2002), 'The Ultimate Ownership of Western European Corporations', Journal of Financial Economics, 65, p.378.
[387] Claessens, S., Djankov, S. and Lang, L. H. P. (2000), 'The Separation of Ownership and Control in East Asian Corporations', Journal of Financial Economics, 58, p.82.
[388] Claessens, S., Djankov, S. and Lang, L. H. P. (2000),p.101.
[389]See generally, Mensah, S. (2003).

dispersed ownership systems such as the US and the UK, the agency problem is between shareholders and management whilst in concentrated ownership systems, the agency problem is between majority and minority shareholders. Although it can be argued that firms where families are controllers have different corporate governance problems such as conflicts between majority shareholders and management hired from the family, these problems are minor compared to the majority vs. minority shareholder conflict as owners are generally believed to be able to control the firm.[390]As the motivation of this thesis is understanding why Kenya scores poorly on La Porta's index for shareholder protection and ownership dispersion despite having a common-law system, this thesis adopts the dispersed/concentrated ownership classification as it is universally applicable and the agency problem derives from it.

[390] See generally, Berglof, E. and von Thadden, E. (1999), 'The Changing Corporate Governance Paradigm: Implications for Transition and Developing Countries (Working Paper).

Table 14: Low levels of Disclosure of Top 10 Shareholders in Companies Listing on the NSE in 2010.[392]

R.no.	Company Name	1	2	3	4	5	6	7	8	9	10	Other	%Total
36	Centum Investment Co. Ltd	23.51	16.60	5.34	5.15	4.19	0.78	0.78	0.47	0.43	0.37	42.73	100%
14	Uchumi Supermarkets Ltd	**No info**											
43	Unga Group Ltd	**No info**											
49	Crown Berger Ltd	48.06	13.63	4.72	3.29	1.46	0.94	0.85	0.76	0.45	0.43	25.41	100%
33	CFC Insurance Holdings	**No info**											
51	E. A. Portland Cement Ltd	27.00	25.3	14.6	14.6	12.5	-	-	-	-	-	6.0	100%
1	Eaagads Ltd	**No info**											
29	The Co-operative Bank of Kenya Ltd	64.56	1.95	0.75	0.46	0.40	0.35	0.24	0.22	0.22	0.22	30.63	100%
37	Trans-Century Ltd	**No info**[391]											
39	British American Tobacco Kenya Ltd	**No info**											
9	Kenya Airways	26.00	23.00	2.06	2.06	1.71	1.02	0.77	0.65	0.62	0.62	41.49	100%
18	Car and General (K) Ltd	**No info**											
11	Standard Group Ltd	**No info**											
10	Nation Media Group	44.66	8.15	3.63	1.83	1.01	0.67	0.54	0.52	0.48	0.46	38.05	100%
6	Sasini Ltd	41.84	12.13	7.62	3.98	2.58	2.37	0.93	0.86	0.82	0.72	26.15	100%
12	TPS Eastern Africa (Serena) Ltd	37.23	7.35	5.79	5.60	5.19	3.72	2.56	2.44	1.77	1.55	26.80	100%
21	Marshalls (E.A.) Ltd	**No info**											

[391] 2010 annual report available but information not disclosed.
[392] This list was selected using the randomizer at www.randomization.com. To reproduce this permutation, use the seed 28377.

Table 15: Distribution of Shareholding in Companies Listing on the NSE in 2010: Top 10 Shareholders[393]

	Company Name	1	2	3	4	5	6	7	8	9	10	Majority	Minority	%Total
1	Centum Investment Co. Ltd	23.51	16.60	5.34	5.15	4.19	0.78	0.78	0.47	0.43	0.37	57.27	42.73	100%
2	Sameer Africa Ltd	57.24	14.90	2.04	1.59	0.70	0.63	0.58	0.57	0.54	0.46	79.25	20.75	100%
3	NIC Bank Ltd	15.84	9.06	8.13	7.73	4.13	1.98	1.56	1.43	1.28	1.26	52.4	47.6	100%
4	Crown Berger Ltd	48.06	13.63	4.72	3.29	1.46	0.94	0.85	0.76	0.45	0.43	74.59	25.41	100%
5	East African Cables	67.33	1.91	1.07	0.90	0.82	0.56	0.52	0.40	0.30	0.28	74.09	25.91	100%
6	Equity Bank	24.45	11.00	4.30	3.83	3.58	2.73	2.44	2.43	2.22	1.62	58.6	41.40	100%
7	CFC Stanbic Holdings Ltd	41.41	18.59	15.73	6.64	2.56	2.24	1.90	1.59	1.37	1.28	93.31	6.69	100%
8	The Co-op Bank of Kenya Ltd	64.56	1.95	0.75	0.46	0.40	0.35	0.24	0.22	0.22	0.22	69.37	30.63	100%
9	Rea Vipingo Ltd	36.47	20.57	2.29	2.14	1.67	1.44	1.15	1.08	0.93	0.88	68.62	31.38	100%
10	Access Kenya	14.5	6.0	4.8	3.2	3.2	2.8	2.3	1.8	1.2	1.2	41.1	58.9	100%
11	Kenya Airways	26.00	23.00	2.06	2.06	1.71	1.02	0.77	0.65	0.62	0.62	58.51	41.49	100%
12	KenGen Ltd	70.00	1.20	0.46	0.31	0.26	0.25	0.23	0.21	0.19	0.18	73.29	26.71	100%
13	Mumias Sugar	20.00	3.05	1.61	1.28	0.79	0.94	0.64	0.59	0.52	0.49	29.91	70.09	100%
14	Nation Media Group	44.66	8.15	3.63	1.83	1.01	0.67	0.54	0.52	0.48	0.46	61.95	38.05	100%
15	Sasini Ltd	41.84	12.13	7.62	3.98	2.58	2.37	0.93	0.86	0.82	0.72	73.85	26.15	100%
16	TPS Eastern Africa (Serena)	37.23	7.35	5.79	5.60	5.19	3.72	2.56	2.44	1.77	1.55	73.2	26.80	100%
17	Athi River Mining	45.87	7.67	5.51	2.64	1.87	1.40	1.07	1.02	0.95	0.88	68.88	31.12	100%

[393] The author compiled information from available annual reports without using the randomizer to provide a general picture of the ownership structure of a 17 of Kenya's Plcs. 17 companies account for 30 per cent of the companies listing on the NSE and is therefore a statistically relevant sample. From the author's experience, the ownership structure of the remaining companies is generally the same as that reflected in this table.

Table 16: Example of a Company with dominant State and Institutional ownership listing on the NSE

NATIONAL BANK OF KENYA Annual Report 2009 – Shareholder Information

RANK	NAME OF SHAREHOLDER	% OF TOTAL
1	NSSF Board of Trustees	48.05%
2	The Permanent Secretary to the Treasury	22.50%
3	Gidjoy Investments Limited	0.79%
4	Paul Wanderi Ndungu	0.63%
5	Barclays (Kenya) Nominees Limited A/C 9098AJ	0.34%
6	Eng Ephraim Mwangi Maina	0.33%
7	The Jubilee Insurance Company of Kenya Limited	0.29%
8	Barclays (Kenya) Nominees Ltd A/C 9660	0.22%
9	Mumbu Holdings Ltd	0.19%
10	Barclays (K) Nominess Ltd Non Resident A/C 9489	0.13%
11	Insurance Company of East Africa Ltd – Pooled	0.12%
12	Barclays (Kenya) Nominees Ltd Non-Resident A/C 9222AA	0.12%
13	Nilesh Velji Shah	0.12%
14	APA Insurance Ltd	0.10%
15	Barclays (Kenya) Nominees Ltd A/C 9675	0.10%
16	Sanjai & Umesh Raikundalia	0.10%
17	John Peter Mbue Mwangi	0.10%
18	Carbacid Investments Limited	0.08%
19	Onesmus Mwangi Gichuiri	0.08%
20	NIC Custodial Services A/C 012	0.08%
21	Others	25.52%
	TOTAL SHAREHOLDING	**100%**

Table 17: The Boards of 2 Randomly Picked Companies Listing on the NSE in 2010- Board 1

1. NIC BANK LIMITED (e.g. of possible kinship/ relationship-based appointments)

Unitary board:[394]Mr. J. P. M. Ndegwa – aged 47- (Chairman), Mr. F. M Mbiru – 73- (Vice-Chairman & NED), Mr. J. W. Macharia -51- (Group Managing Director), Mr. A. J. Dodd – 56 – (Executive Director), Mr. G. A. Maina – 59- (NED), Mr. F. N. Mwanzia -66 – (NED), Mr. A. S. M. Ndegwa -43- (NED), Mrs. I. Ochola- Wilson -62 – (NED), Mr. L. Somen -74 - (NED), Mr. P. V. Shah -37- (NED), Mr. L. M. Murage – 53 – Group Company Secretary.
Committees: NIC Bank has a credit risk committee, executive committee, risk management committee, audit and compliance committee, nominations committee and human resources and compensation committee. **Auditors**: Deloitte & Touche, Nairobi.
Possible Kinship relations: Mr. J. P. M. Ndegwa -47- (Chairman) and Mr. A. S. M. Ndegwa.-43- (NED). **Possible relationship-based appointments**: Mr. L. Somen -74 - (NED), Mr. P. V. Shah -37- (NED) – both worked at the law firm Hamilton Harrison & Matthews. The following were the ten largest shareholdings in the company on 31st December 2010:

	NAME OF SHAREHOLDER	% OF TOTAL
1	First Chartered Securities Ltd	15.84
2	ICEA Asset Management Ltd	9.06
3	Livingstone Registrars Ltd	8.13
4	Rivel Kenya Ltd	7.73
5	Saimar Ltd	4.13
6	Amwa Holdings Ltd	1.98
7	Duncan Nderitu Ndegwa	1.56
8	Kenya Commercial Bank Nominees Ltd A/C 769G	1.43
9	Thuthuma Limited	1.28
10	Makimwa Consultants Ltd	1.26

Shareholder Profile: Local individual investors: 23.97%; Local institutional investors: 74.82%; Foreign individual investors: 0.55%; and Foreign institutional investors: 0.66%.

[394] Information compiled from NIC Bank Limited Annual Report & Financial Statements 2010.

Table 18: The Boards of 2 Randomly Picked Companies Listing on the NSE in 2010 – Board 2

2. Crown Berger Kenya Ltd and Subsidiaries[395] (Potential Kinship/family ownership)

Unitary board: The Board comprises of 5 directors, of whom 3 are Executive. Mr. Mhamud Charania (Chair), Mr. Rakesh Rao (Managing Director) and Patrick Mwati (Finance Director), Mr. Hussein Charania (Executive Director), Mr. F. G. K. Maina (NED), Conrad Nyukuru (Company Secretary). The NEDs are considered to be independent of management influence.
Committees: The Board has the following committees: the Audit committee and the Finance committee. The Audit committee is chaired by the NED and with attendance by invitation, the Managing Director and other key personnel review the effectiveness of internal controls and discuss the audit reports. The Finance committee chaired by a NED receives reports from management and reviews Company's financial performance against targets, ensures compliance and issues guidelines where necessary. The Board appoints other committees as and when required.
Auditors: Ernst & Young, Kenya. **Lawyers**: Kairu Mbuthia & Kiingati Advocates. **Principal Bankers**: Kenya Commercial Bank Limited, Nairobi.
The following were the ten largest shareholdings in the company on 31st March 2011:

	NAME OF SHAREHOLDER	% OF TOTAL
1	Crown Paints and Building Products Limited, Nairobi	48.06
2	Barclay Holdings Limited, Belize	13.63
3	Lansbury Limed, Nairobi	4.72
4	Paul Wanderi Ndungu	3.29
5	Kanaksinh Karsandas & Sandip Kanaksinh Babla, Mombasa	1.46
6	Mahendra Dahyabhai Patel	0.94
7	Mahendra Fulchan Gandhi & Mrs. Malvika Mahendra Gandhi	0.85
8	John Muriuki Kibuchi	0.76
9	Victoria Furnitures Ltd	0.45
10	Kanaksinh Kasandas Babla & Sandip Kanaksinh Babla, C/o The Standard Motor Co. Ltd, Mombasa	0.43

[395] Information compiled from Crown Berger Kenya Ltd and Subsidiaries 2010 Annual Report & Financial Statements.

Table 19: Positioning Kenya within the Classification of Systems Literature

Definition	**UK**	**Kenya**
Franks and Mayer (2001)	Outsider	Insider
Mayer and Sussman (2001)	Market-oriented	Bank-oriented
Facio and Lang (2002)	Dispersed	Concentrated

3.2.2 The definition of corporate governance

Although corporate governance has been a subject of world-wide interest in various academic disciplines such as law, economics, sociology and politics, there is no universally accepted definition of corporate governance. The reason for this is that scholars, countries and organisations have different conceptions of corporate governance reflecting the variations in their disciplines and the differences in their respective countries and organisational contexts.

Cadbury defined corporate governance as, 'the system by which companies are directed and controlled.'[396] For Shleifer and Vishny, 'Corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment.'[397] Cadbury and Shleifer and Vishny's definitions represent the shareholder view of the corporation; that the company should be run in the interests of shareholders- which reflects corporate law in their respective countries, the UK and the US. Whilst Cadbury's definition can be said to reflect the legal perception of corporate governance, Shleifer and Vishny's definition represents the economics school of thought. Kenya's Corporate Governance Guidelines (CMA Guidelines) define corporate governance as, '... the process and structure used to direct and manage business affairs of the company towards enhancing prosperity and corporate accounting with the ultimate objective of realizing shareholders long-term value while taking into account the interest of other stakeholders.'[398] Kenya's definition of corporate governance reflects a stakeholder view of the corporation; that the company should not be solely run in the interests of shareholders but also stakeholders. In defining the purpose of corporate governance the first OECD Principals of Corporate Governance also embrace a stakeholder view:

> 'A good corporate governance regime helps to assure that corporations use their capital efficiently. Good corporate governance helps, too, to ensure that corporations take into account the interests of a wide range of constituencies, as well as of the communities in which they operate, and that their boards are accountable to the company and to the shareholders. This, in turn, helps to

[396] Cadbury Report (2002), p.15
[397] Shleifer, A. and Vishny, R. W. (1997), 'A Survey of Corporate Governance', The Journal of Finance, Vol.LII, No.2, p.737
[398] S.1.2 CMA Guidelines contained in the Capital Markets Act (2002).

> assure that corporations are operated for the benefit of society as a whole. It helps to maintain and attract the confidence of investors – both foreign and domestic – and to attract more 'patient' long term capital.'[399]

The OECD definition provides a broader definition of corporate governance representing the differences across corporate governance systems in Europe with a majority of systems being stakeholder-based. The divergence in corporate governance definitions is reflective of the differences in each country's or organisations perception of the purpose of the corporation. There are generally two views of the corporation: Berle's shareholder primacy view and the stakeholder theory.

3.2.2.1 Berle's notion of shareholder primacy

Berle in his 1931 paper argued that the powers granted to a corporation should at all times be exercised for the benefit of shareholders.[400] Berle's argument for shareholder primacy is the key assumption underlying the shareholder model, which is the prevailing model in Anglo-American economies. Under the shareholder model, the interests of shareholders are prioritised over those of stakeholders as they are the owners of the corporation. The reason for this is that unlike shareholders, stakeholders – such as creditors, employees and the community- are seen as being protected by the contracts which they have entered into with the company. Consequently, shareholders are seen as being exposed to 'risk' in the lack of contractual protection and therefore entitled to any profit arising from the operation of the company.[401] Proponents of shareholder primacy argue that when management maximises shareholder value, creditors,

[399] OECD (1999), Principles of Corporate Governance,p.7

[400] Berle Jr., A. A. (1931), 'Corporate Powers as Powers in Trust,' Harvard Law Review, Vol. 44, p.1049. Early supporters of shareholder primacy include Adam Smith his work 'The Wealth of Nations' where he states that: ' By pursuing his own interest [an individual] frequently promotes that of the society more effectually than when he really intends to promote it. I have never known much good done by those who affected to trade for the [common] good.' See, Smith, A. (1776), The Wealth of Nations (Published Dent 1975). Following Berle's work, support for shareholder primacy is seen in the work of Friedrich Hayek who argues that market economies provide a more efficient allocation of societal resources than any design could achieve and Friedman who argues that corporations should not concern themselves with stakeholder concerns. See Institute of Economic Affairs (2005), Friedrich A. Hayek: The Road to Serfdom with The Intellectuals and Socialism, p.40; and Friedman, M. (1970), 'The Social Responsibility of Business Is to Increase Its Profits', The New York Times Magazine, September 13.

[401] See Easterbrook, F. And Fischel, D. (1991), The Economic Structure of the Company, Harvard University Press, Cambridge, Massachusetts.

employees and the economy are better off[402] thereby justifying arguments of advocates of shareholder value for instance Friedman who argues that the only social responsibility of business is to increase profits.[403] Under shareholder primacy directors are compelled to focus solely on maximising shareholder value in running the company. The governance challenge under the shareholder model is on how to monitor and control directors to ensure that they are acting in the interests of shareholders.

The focus of the shareholder model of governance is therefore to discipline management to ensure that they act in shareholder interests. 'Ownership of shares confers upon them the right, exclusively of all stakeholder groups, to hold directors and managers accountable.'[404]The result of this focus is legal requirements that require that the director owes his duties to the company and corporate governance codes based on the principle-agent theory with mechanisms targeted at monitoring director behaviour such as the splitting the role of Chairman and CEO and including NEDs on company boards to facilitate more accountability to shareholders. The resulting board structure is the unitary board that characterises corporate governance in the US and the UK. The strength of the shareholder model is seen as ensuring that managers are fully accountable to shareholders and by making management focus on a single clear objective, shareholder theory is seen as leading to the most efficient outcomes.[405]Critics however question the argument that shareholders should be given primacy because they are risk-takers by virtue of being residual-claimants.[406]Shareholder risk is limited as it is 'known in advance' and therefore they can diversify and spread their risk while worker's risk is often 'unknown and unforeseeable.[407] Additionally, emphasis on shareholder value encourages a short-termist, low investment and low productivity approach to business.[408]

[402] Lazonick, W. And O'Sullivan, M. (2000), 'Maximising Shareholder Value: a new Ideology for Corporate Governance', Economy and Society, 29 (1), p.27.
[403] Friedman, M. (1970), 'The Social Responsibility of Business Is to Increase Its Profits', The New York Times Magazine, September 13, p.173.
[404] Deakin, S. (2005), 'The Coming Transformation of Shareholder Value', Corporate Governance: An International Review, 13(1), p.12.
[405] Gamble, A., and Kelly, G. (2001), 'Shareholder Value and the Stakeholder Debate in the UK', Corporate Governance: An International Review, p.110.
[406] Aglietta,M. and Reberioux, A.(2005), Corporate Governance Adrift: A Critique of Shareholder Value, Edward Elgar,p.34
[407] Goyder,G.A. (1951), The Future of Private Enterprise,Blackwell,p.17
[408] Williamson,J. (2003), 'A Trade Union Congress Perspective on the Company Law Review and Corporate Governance Reform Since 1997', British Journal of Industrial Relations,41(3),p.512

3.2.2.2 The Stakeholder Theory

Shareholder primacy is one of the two dominant theories in corporate governance. The other is the stakeholder theory which is markedly different from shareholder theory and advocates a contrasting approach to corporate governance. Stakeholder theory argues that corporate governance must focus on more than maximising shareholder value and consider the interests of stakeholders. Freeman defined a stakeholder as, 'any group or individual who can affect or is affected by the achievement of the organizations objectives.'[409] Therefore, under stakeholder theory, the company is expected to recognise the interest of groups or individuals who have a non-financial stake in the company by including them in the governance process, for example, creditors, employees and the community. The assumption underlying the stakeholder model of corporate governance, which is prevalent in Continental Europe and Asia, is that the participation of stakeholders in the governance is vital to the long-term well-being of the company. Under the stakeholder model, shareholder interests are balanced with relevant stakeholder interests through the provision of a two-tier board which consists of a supervisory board and management board as the governance challenge is to include the interests of relevant stakeholders in the governance process. The supervisory board includes employees and trade union representatives and has the right to appoint, supervise and advise the management board. Amongst the strengths of the stakeholder model of corporate governance is that it is an inclusive approach which, emphasises participation of non-shareholder constituents and provides for representation of stakeholder interests in the governance process thereby providing a framework for sustainable development.[410] In so doing, the stakeholder model provides for the management of relationships in corporate governance. Critics of the stakeholder theory however, see it as a concept that becomes increasingly blurred and confused as its parameters expand diluting the potency of the original concept and reducing it to a vague and innocuous exercise in rhetoric[411]consequently failing as a model of providing clear direction for management in the running of the company.[412]

This thesis adopts as its working definition Cadbury's definition of corporate governance as the system through which companies are directed and controlled as it lends itself to

[409] Freeman, R. E. (1984), Strategic Management: A Stakeholder Approach, Pitman, Boston, MA, p.46.
[410] Stoney, C. and Winstanley, D. (2001), 'Stakeholding: Confusion or Utopia? Mapping the Conceptual Terrain', Journal of Management Studies 38 (1), p.604.
[411] Stoney, C. and Winstanley, D. (2001),p.604
[412] Steinberg,E.(1999), 'The Stakeholder Concept: A Mistaken Doctrine', Centre for Business and Professional Ethics, University of Leeds,p.17

the focus of this thesis although it takes into account aspects of these other definitions in making its argument. Companies are directed and controlled through legal measures such as companies' legislation and norms such as corporate governance codes. It is the suitability and efficacy of these norms in securing good corporate governance in the Kenyan context that is of interest to this thesis. Kenya's Companies Act and Corporate Governance Guidelines, which are based on the Anglo-Saxon model, aim at keeping managerial discretion within reasonable bounds. However, this aim is based on the Berle corporation where there is separation of ownership and control and therefore agency costs from managerial discretion. Where ownership is concentrated, as is the case in Kenya, the agency problem takes the form of a conflict of interest between majority shareholders and minority shareholders and therefore mechanisms aimed solely at limiting managerial discretion may not address the existing agency problem. As the type of agency problem that arises is determined by ownership structure, this thesis argues that the appropriate model of corporate governance should fit a country's ownership structure for it to take.

3.3 Globalisation and the 'law matters' thesis

Globalisation has had a significant impact on corporate governance following the publication of the 1992 Cadbury Report and research in the late 1990s which hailed the US and UK dispersed ownership system as being efficient and a model of economic success. With corporate governance models being perceived as significantly impacting on profitability and consequently economic growth this has resulted in a debate on which system is 'best'. This debate has changed over time. In the 1980s to the early 1990s when Germany and Japan seemed to be enjoying greater economic success than the US[413]the concentrated ownership model was the popular model. German and Japanese companies were seen to offer 'dedicated capital'.[414] This resulted in the thinking that German/Japanese concentrated ownership system was superior as the US legal system forced shareholders to remain diffuse. Policy prescriptions were made that the US should offer a hospitable legal environment for blockholder governance.[415] In recent years the US model has become popular following the success of the US economy in the late 1990s with policy prescriptions being made towards adopting features of the US model such as

[413] Lipton, M. and Rosenblum, S. A. (1991), 'A New System of Corporate Governance: The Quinquennial Election of Directors', University of Chicago Law Review, 58, pp.218-219

[414] Rock, E. B. (1996), 'America's Shifting Fascination with Comparative Corporate Governance', Washington University Law Quarterly, 74, p.379

[415] Porter, M. E. (1992), 'Capital Disadvantage: America's Failing Capital Investment System', Harvard Business Review, 70(5), pp.79-82.

high shareholder protection particularly following the work of La Porta et al and other proponents of the 'law matters' thesis.

Shleifer and Vishny argue that, 'much of the difference in corporate governance systems around the world stems from the differences in the nature of legal obligations that managers have to financiers, as well as in the differences in how courts interpret and enforce these obligations.'[416]La Porta et al develop this argument in the 1998 paper, 'Law and Finance' in which they analyse the importance of law in corporate governance using six indicators: proxy by mail allowed, shares not blocked before meeting, cumulative voting, oppressed minority, pre-emptive right to new issues, and the percentage of share capital required to call an extraordinary shareholder meeting. If a country protects minority shareholders according to their measures it gets a score of 1 or otherwise 0. The finding of their study is that common-law countries generally have the highest level of shareholder protection while civil-law countries generally have low-levels of shareholder protection[417] resulting in the conclusion that common-law countries produce superior economic growth.

The essence of the 'law matters' thesis is that in an unregulated environment, there is a real danger that insiders (controlling shareholders and management) will expropriate outside investors. To curb this, the US system regulates quite closely opportunistic conduct by insiders. This close regulation of insiders makes minority shareholders feel 'comfortable' and protected and thus confident in paying the full value for shares. This in turn lowers the cost of capital for firms that choose to sell equity in financial markets and public offerings easily follow. Under this kind of protective system, controlling shareholders are content to unwind their holdings since the law will largely preclude them from exploiting their position. Therefore dispersed ownership follows.[418] Dispersed ownership is deemed to be advantageous as La Porta et al's 1997 study found that countries with dispersed ownership and high levels of shareholder protection – typically common law countries – perform better economically than countries with concentrated ownership and low levels of shareholder protection.[419]

[416] Shleifer, A. and Vishny, R. W. (1997), 'A Survey of Corporate Governance', The Journal of Finance, Vol. LII., No.2, p.750.
[417] La Porta et al,(1998), 'Law and Finance', Journal of Political Economy, Vol.106, No.6, p.1116.
[418] Cheffins, B. R. (2003), 'Law as Bedrock: The Foundations of an Economy Dominated by Widely Held Public Companies', Oxford Journal of Legal Studies, Vol. 23, No.1, p.6.
[419] La Porta et al. (1997), pp.1131-1150. This proposition has been criticised as civil law countries such as Belgium and Germany have achieved economic development despite low levels of shareholder protection and

Proponents of the law matters thesis therefore lay an emphasis on the importance of law in corporate governance, arguing that legal protection of investors is an essential element of an effective corporate governance system.[420]The policy prescription that has resulted from the 'law matters' thesis is therefore that countries with concentrated ownership and low levels of shareholder protection – such as Kenya – should review their laws to achieve dispersed ownership and therefore the benefits associated with the US model of corporate governance.

The 'law matters' thesis however is not without its critics. Doubts have been cast on the reliability of La Porta et al's anti-director index. Cools points out that Belgium was wrongly rated under this index. For instance, on whether shareholders can send their proxy by mail, La Porta et al gave Belgium a score of zero despite the fact that the Companies Code in Belgium unequivocally specifies that shareholders can vote in person or by proxy. Although the Companies Code does not explicitly stipulate that shareholders can send their proxy by mail, there is no doubt that they can in practice suggesting that Belgium should have got a score of 1 not 0.[421]This finding on Belgium suggests that La Porta et al's indicators have significant shortcomings.

Amongst these shortcomings is the fact that first, while economic analysis of law is interesting, it is often limited in its accuracy. Coding legal provisions as binary variables and giving each indicator equal weight assumes that by counting the number of indicators we can know whether a country offers high shareholder protection. In practice, each of La Porta et al's indicators plays a different role and therefore weighs differently in law, making La Porta et al's study unrealisable. Secondly, some of the indicators used by La Porta et al do not necessarily indicate high protection of minority shareholders. Pistor et al point out that pre-emptive rights for example may benefit existing blockholders instead of minority shareholders as they force the company to return to existing financiers rather than reach out to new investors thereby circumventing the development of dispersed ownership.[422] Thirdly, the practical impact of law cannot be determined by examining the 'law in the books.' Factors outside the

dispersed ownership. See generally Roe, M. J. (2005), Corporate Governance: Political and Legal Perspectives, Edward Elgar Publishing Ltd.

[420] Shleifer, A. and Vishny, R. W. (1997),p.770.

[421] Cools, S. (2004), 'The Real Difference in Corporate Law between the United States and Continental Europe: Distribution of Powers', Discussion Paper, No. 490, 09/2004.

[422] Pistor, K., et al (2003), 'The Evolution of Corporate Law: A Cross-Country Comparison', The University of Pennsylvania Journal of International Economic Law', 23(4), 791, fn.39.

law such as local customs, culture and existing business norms affect the impact of formal laws despite adopting a common-law system. Licht et al point out that although shareholder rights are stronger in English-speaking cultural regions their quality of creditor protection is not higher than that of civil-law countries and developing common-law countries such as Kenya.[423]Therefore, the argument that improving minority shareholder protection will lead to economic development remains unconvincing. The 'law matters' thesis is confounded by Rajan and Zingales who point out that by most indicators, the main countries of Continental Europe were more developed financially in 1913 that the United States demonstrating that common-law countries were not more financially developed in 1913.[424]Therefore legal origin may not matter that as much as La Porta et al claim otherwise by transplanting England's corporate governance system, Kenya should have achieved high shareholder protection and dispersed ownership by now – almost 60 years on.

The main weakness of the 'law matters' thesis is its narrow focus on the rights of minority shareholders in theory as a distinction between common law and civil law. Mahoney points out that the principal drawback of La Porta et al's analysis is the lack of a theoretical reason to expect legal origin to be especially relevant to investor protection[425] and argues that it is difficult to make out a strong case for the superiority of the rules produced by common law or civil law as each performs well on the most important measures, providing for enforcement of property and contract rights and requiring compensation for certain wrongful (tortuous) acts.[426]The 'law matters' thesis also presumes that minority shareholder rules were a pre-condition for dispersed ownership in the US and the UK. Ownership had already dispersed prior to the passing of the Securities Act (1933) and Securities Exchange Act (1934) in the US hence Berle's 1932 argument on separation of ownership and control. In the UK, case-law shows that high minority shareholder protection was not present in 1843 as demonstrated in the ruling in *Foss v. Harbottle*.[427] In Foss v. Harbottle, Wigram VC following precedent insisted that minority shareholders must show that they had exhausted any possibility of redress within the internal forum of the company. Wigram VC stated plainly that the court will

[423]Licht, A. N., et al (2005), 'Culture, Law and Corporate Governance', International Review of Law and Economics, 25, p.232.
[424] Rajan, R. G. and Zingales, L. (2003), 'The Great Reversals: The Politics of Financial Development in the Twentieth Century', Journal of Financial Economics, 69, pp. 5-50.
[425] Mahoney, P. G. (2001), 'The Common Law and Economic Growth: Hayek Might Be Right', Journal of Legal Studies, Vol. 30, p.504.
[426] Mahoney, P. G. (2001), p.506
[427] (1843) 2 Hare 461, at 494-495.

not intervene where a majority of shareholders may lawfully ratify irregular conduct. The ruling in Foss v. Harbottle therefore barred a minority action whenever the alleged misconduct was in law capable of ratification, whether or not an independent majority would ever be given a real opportunity to consider the matter.[428]This ruling stood in the way of minority shareholder protection in the UK for over 100 years. According to Lord Hoffman:

> '… the emancipation of minority shareholders is a recent event in company law. For most of the twentieth century minority shareholders were virtually defenceless, kept in cowed submission by a fire-breathing and possibly multi-headed dragon called Foss vs. Harbottle. Only in exceptional cases could they claim protection of the court. .. A statutory remedy was provided for the first time in 1948 but this proved relatively ineffectual. It was not until 1980 that Parliament forged the sword which is now section 459 of the Companies Act 1985 and which enables the unfairly treated minority shareholder to slay the dragon.'[429]

Going by La Porta et al's 'law matters' thesis the UK should not have had dispersed ownership until the 1980s as its companies legislation did not provide for high shareholder protection. In practice, dispersed ownership in the UK began to develop in the first half of the 20th century following the issuance of shares to local investors on provincial exchanges. Franks et al attribute this development to, 'informal relations of trust between investors and firms rather than formal systems of regulation that allowed equity markets to flourish and ownership to become dispersed...'[430] Trust may therefore have a role to play in determining attributes of a country's corporate governance system such as ownership structure. The UK's experience suggests that if a country such as Kenya wants to transform its ownership structure from concentrated to dispersed so as to achieve La Porta's et al's policy recommendation and achieve economic, it must focus on increasing trust rather than solely reviewing the law.[431]

Despite the above criticism, it is generally accepted that law plays a role in the development of corporate governance. A legal system that provides high protection for minority shareholders will enhance the ability of companies to raise external funding by lowering the costs of such capital and reducing opportunities for minority shareholder expropriation. However, whilst law may be important to corporate governance and

[428] See, MacDougall v. Gardiner (1875) 1 ChD 13 at 25.
[429] Hollington, R. (1999), Minority Shareholder' Rights, Sweet & Maxwell, London, Forward.
[430] Franks, J., Mayer, C. and Rossi, S. (2005), 'Ownership: Evolution and Regulation', University of Oxford, Said Business School Working Paper, p.18.
[431] The relationship between trust and corporate governance will be discussed in further detail in Chapter 4.

therefore development, it may be limited as it solves only part of the agency problem. Roe points out that the institutions that keep managers aligned with shareholders are not primarily corporate law institutions.[432] When we detect weak corporate law in third-world nations, we are not detecting the primary basis for the weakness of securities markets and ownership separation; we are detecting weak economies with little need yet for large business organisations. Once nations have developed, some will have the political will to develop diffuse ownership; others will not.[433]Politics might therefore matter – not just law as La Porta et al suggest.[434]

3.4 The convergence debate

Following from the policy prescription of the 'law matters' thesis and the popularity of the US model in recent years, scholars have argued that the corporate governance systems of major economies are likely to converge towards the US dispersed ownership model. Gordon argues that as cross border mergers have increased in recent years, investors will insist on companies promoting shareholder interests in countries that are stakeholder-oriented causing these jurisdictions to adopt a more shareholder-friendly approach.[435] A similar argument is made by Coffee who highlights the increase in listings of foreign companies on the NYSE and the LSE and argues that these cross-listings will cause companies to adopt Anglo-American practices such as higher disclosure standards to remain competitive in attracting investors in these new markets resulting in a convergence of legal rules.[436]

The passing of German Law on Transparency and Disclosure[437]is arguably a strong sign of legal convergence towards the Anglo-American model. Wojcik finds that the level of ownership concentration in German firms fell significantly between the years 1997-2001. Crossholdings started to dissolve and financial institutions declined in importance as

[432] Roe, M. J. (2005), Introduction, xi.
[433] Roe, M. J. (2005), Introduction, xii.
[434] This will be explored in further detail below.
[435] Gordon, J. N. (1999), 'Pathways to Corporate Convergence? Two Steps on the Road to Shareholder Capitalism in Germany: Deutsche Telekom and DaimlerChrysler', Columbia Law School, Working Paper No.161 (ssrn)
[436] Coffee, J. C. (1999), 'The Future as History: Prospects for Global Convergence in Corporate Governance and Its Implications', Northwestern University Law Review,pp643-648
[437] TransPuG 2002

blockholders.[438]Kanda also points out that following the listing of Japanese companies in the US and UK stock exchanges, the tendency to base transactions on 'friendship' has reduced.[439] The embracing of the contractual norm by Japanese firms can be said to be a sign of convergence towards the Anglo-American model.[440] Further evidence of convergence towards the US model is seen in prescriptions in Codes of Best Practice around the world which promote disclosure and the presence of a high number of NEDs on boards as guardians of shareholder interests. Hansmann and Kraakman argue that convergence towards the US-model is driven by the failure of alternative models – manager, labour and state oriented models – and the competitive pressures of global commerce.[441] In sum, proponents of convergence see global competition as being a strong enough force to trigger law reform across the world as all legal systems have to do to make their companies competitive is to choose from an open-ended menu of legal rules. As such proponents of convergence can be said to adopt Watson's view on transplantation: that legal rules have a nomadic character, they can be transplanted just anywhere – to any country irrespective of ownership structure - and work just as well without any limitations.

Although at the start of this century the leading opinion was that convergence was taking place towards the Anglo-American model, some arguments have been made that convergence is moving towards Germany's two-tier system. As corporate law in civil law countries such as Germany is characterised by mandatory rules on changes in capital structure, minimum capital and pre-emptive rights amongst other issues,[442] the passing of the Sarbanes Oxley Act (2002) can be said to strongly signal convergence towards the German/Japanese model. Additionally, the separation of Chairman/CEO, the introduction of committees in the US and the UK[443] can be said to be a move towards the German/Japanese model. Cadbury has stated that US boards are moving towards a *de facto* two-tier structure by increasing the proportion of non-executive directors on their

[438] Wojcik,D.(2001), Change in the German Model of Corporate Governance: Evidence from Blockholdings 1997-2001, University of Oxford Working Paper (ssrn)
[439] Kanda,H. (1997), 'Trends in Japanese Corporate Governance' in Wymeersch, E.,and Hopt, K.J.(1997), Comparative Corporate Governance, Berlin,p.185
[440] On China see generally, Ruskola, T. (2000).
[441] Hansmann,H. And Kraakman,R.(2001), 'The End of History for Corporate Law, Georgetown Law Journal,89,pp.439-468
[442] Coffee, J. C. (1999), 'The Future as History: Prospects for Global Convergence in Corporate Governance and Its Implications', Northwestern University Law Review,p.651
[443] On the UK, see Kaplan,S.(1997), 'Corporate Governance and Corporate Performance: A Comparison of Germany, Japan, and the US', The Bank of America Journal of Applied Corporate Finance,9(4),pp.86-93

boards and by having committees that consist exclusively of non-executives.[444] Evidence also shows that large shareholders are also on the increase in US and UK firms.[445]

3.4.1 Kenya's position within the convergence debate

Although cross-border mergers have not been common in the Kenyan market, there has been an increase in foreign investment in the NSE. Research has shown that a majority of the top twenty companies[446] listed in the Nairobi Stock Exchange (NSE) are foreign controlled.[447] This is particularly the case in companies representing the agricultural, tourism and banking sector. Research shows that in 2005, the tea sector was controlled by 6 companies which are largely foreign owned: Unilever Tea Kenya, Kakuzi Ltd, Williamson Tea Company, Kapchorua Tea, Limuru Tea Company and Sasini Coffee and Tea. The British-owned Broke Bond Group held 43.1 million shares of the total 48.8 million shares issued in Unilever Tea Kenya and 54% of the shares issued in Limuru Tea Company. In Kakuzi foreign shareholders had a total shareholding of 68.3% of the total 19.1 million shares issued. In the banking sector, the two leading banks controlled 71.4% of the market share. Barclays Bank Plc of London owns a 68% stake in Barclays Bank of Kenya whilst Standard Bank owns an 81% in Standard Chartered Bank Kenya Ltd.[448]

Going by arguments by proponents of convergence, foreign investors in Kenya are likely to insist on the promotion of shareholder-friendly policies – such as higher disclosure standards – resulting in a convergence of legal rules in Kenya which is historically stakeholder-oriented. Practical evidence suggests this to be the case in Kenya to an extent. Kenya's foreign investment policy in particular has become more shareholder-friendly and resulted in the introduction of Kenya's CMA Guidelines which prescribe the unitary board structure, high numbers of NEDs and lays emphasis on disclosure which are all features of Anglo-American corporate governance. As the British are the largest foreign investors on the NSE, Kenya has adopted policies that are Anglo-American friendly to attract foreign investment as well as conform to the requirements of funding bodies such as the IMF and World Bank. Kenya's adoption of Anglo-American friendly

[444] Cadbury Committee (1995), The Report on Compliance with Code of Best Practice, 24th May.
[445] Dahya,J., and McConnell,J.(2002), 'The Cadbury Committee, Corporate Performance, and Top Management Turnover, Journal of Finance,57,pp.461-484
[446] There are about 58 companies currently listed on the NSE. This number has remained almost the same since the 1960s.
[447] For further information on ownership in Kenyan companies see, Ngotho, K. (2005), Kenya's wealth in foreign hands, The Sunday Standard, 17 April 2005 and NCCK (1968).
[448] Ngotho, K. (2005), Kenya's wealth in foreign hands, The Sunday Standard, 17 April

policies also coincided with a time when La Porta et al's 'law matters' thesis was popular; the late 1990s and the early 2000s.

However, although Kenya has adopted shareholder-friendly policies demonstrating a convergence of rules, Kenya's concentrated ownership structure has remained in place preventing a realisation of the good corporate governance practice that was expected from adopting the Anglo-American model of corporate governance. Financial institutions and families have not declined as block-holders and basing transactions on friendship has not reduced. Additionally, although Kenya has embraced the contractual norm on paper, it is yet to fully embrace it in practice. A recent instance of the problems resulting from concentrated ownership and the tension between the contract norm and 'the Kenyan way of doing business'/kinship norm is demonstrated in the ongoing scandal at CMC Holdings where Martin Foster (a British national) was removed from the position of CEO after refusing to alter a contract for the purchase of tractors from CNF to FOB as requested by the then Chairman, Peter Muthoka who is also a majority shareholder. Muthoka also the Managing Director of Andy Freight Forwarders Ltd – the largest supplier of services to CMC – in requesting the change of contract from CNF to FOB was going to ship the containers for the tractors. If the contract remained CNF, Muthoka would lose the business of the shipping. Foster declined Muthoka's request but promised to find out how competitive he was on shipment of containers, resulting in his removal from the board. On learning about the goings on in CMC, the Capital Markets Authority (CMA) suspended CMC Holdings Ltd from trading on the NSE after allegations that Muthoka had overcharged CMC by as much as US$21 million over the past five years.[449] As Muthoka is 'highly connected', the CMC dispute was raised in Parliament where some MPs demanded that the suspension of the company be from the LSE be lifted to allow business to continue as usual.[450]

Therefore although it can be said that there has been convergence of rules in Kenya's corporate governance, Kenya's business norms are far from converging with those of the West. The Anglo-American way of doing business has not replaced the Kenyan way of doing business as demonstrated in the CMC scandal. Other forces outside the law, affect – if not determine - Kenya's corporate governance. This proposition has been recognised in the path-dependence thesis.

[449] Ombok, E. (2011), 'CMC Holdings of Kenya Suspended from Trading for Seven Days', Bloomberg Businessweek, Nov. 4th 2011.
[450] Information compiled from www.nation.co.ke

3.5. The path-dependence thesis

While scholars and commentators generally see convergence as taking place – although their opinions differ on the direction of that convergence - some academics have maintained that convergence cannot occur because path-dependence is country specific. A country's political and socio-economic context matters.

3.5.1 Politics matters

On the importance of the political context, scholars have advanced a 'politics matters' thesis which argues that corporate governance systems arise out of struggles between shareholders, management and workers. Management and workers both want private benefits such as high remuneration. To protect this private interest, they can form a coalition against shareholders, seek to limit shareholder rights and prevent takeovers that could result in dismissal and the loss of private benefits of control. As management remains under the control of shareholders, at least in law, they could offer workers high wages and continued employment to secure their loyalty and membership in this coalition. Consequently, the politics affecting the firm are determined by the resulting coalitions between these three interest groups: shareholders, management and workers with laws and regulations being the result of the bargaining between these interests groups.[451]

Arguing that 'politics matters' Roe contends that, at federal level, it was politics rather than economic efficiency that created US corporate law. In particular, the presence of political movements put restrictions on strong financial institutions - such as the McFadden Act (1927),[452] The McFadden Act (1933),[453]The Glass-Steagall Act (1933)[454] - preventing them from operating nationally consequently curtailing their ability to hold large blocks of shares in public companies.[455]Secondly, Roe points out a correlation between social democracy and concentrated ownership structures and argues that the powerful political pre-condition to ownership separating from control in the US was the

[451] Roe, M. J. (2003), Political Determinants of Corporate Governance: Political Context, Corporate Impact, OUP, New York, pp.29-46.
[452] The McFadden Act allowed national banks to branch but only as state law permitted but only within a city or a town.
[453] Under this Act banks were allowed to branch within the entire state but only if state law permitted.
[454] This Act barred bank affiliates from owning and dealing in securities, thereby severing commercial banks from investment banks.
[455] Roe, M. J. (1994), Strong Managers, Weak Owners: The Political Roots of American Corporate Finance, Princeton University Press, Princeton, New Jersey, pp.94-95.

absence in the US of a strong social democracy.[456] According to Roe, social democracy fits badly with the diffused ownership of the public firm as it frays the ties between shareholders and managers, and seeks a better way to control management, with the best alternative in a social democracy being a concentrated ownership structure.[457] He demonstrates this through the case of Germany where large stakeholders particularly workers are able to influence the political process thereby preventing a change to dispersed ownership even when such a change-over would be efficient. This has resulted in pro-worker regulation - such as The Coal and Steel Codetermination Act (1951), The Supplementary Act to the Coal and Steel Codetermination Act (1956) and The Codetermination Act (1976) - which requires that companies that employ more than 2000 workers have a supervisory board in which half of the members are selected by workers. Companies that employ more than 500 workers are required under The Industrial Constitution Act (1952) to form a supervisory board in which a third of members are selected by employees.[458] Gourevitch supports Roe's argument but refines it by pointing out that it is not so much the form of the present government, but the type of government that was in place when governance structures established themselves that determines corporate governance.[459]

Bebchuk and Roe argue that the obstacle of path-dependence has to be overcome for convergence to take place.[460] They identify two types of path-dependence: structure-driven and rule-driven path dependence. Structure-driven path-dependence occurs because the present distribution of power is a function of the distribution of power that existed earlier. Therefore a country in which companies had large block-holders, such as Germany, has a tendency to continue to have concentrated ownership. If efficiency is what drives development, change will only occur when its benefit outweighs its costs. Rule-driven path-dependence on the other hand assumes that law influences ownership structures and therefore if law succeeds at effectively preventing block-holders from taking advantage of their influence, concentrated ownership will not arise. Bebchuk and Roe see law as being, 'an additional, indirect (but important) channel through which the initial corporate structure might affect subsequent structures.'[461]Similar to the case with

[456] Roe, M. J. (2005), p.7
[457] Roe, M. J. (2005), p.6
[458] Dammann, J. C. (2003), 'The Future of Co-determination after Centros: Will German Corporate Law Move Closer to the U.S. Model?' Fordham Journal of Corporate and Financial Law, Vol. VIII, pp.619-621
[459] Gourevitch, P. A . (2003), 'The Politics of Corporate Governance Regulation', Yale Law Journal, p.1864
[460] Bebchuk, L. A. and Roe, M. J. (1999), 'A Theory of Path Dependence in Corporate Ownership and Governance', Stanford Law Review, 52,pp.127-170
[461] Bebchuk, L. A. and Roe, M. J. (1999), pp.153-154

structural path-dependence, change under rule-driven path-dependence will only occur when law-makers conclude that the benefits of change outweigh its cost. Moreover, pressure from incumbent interest groups that benefit from the current legal regime may prevent changes of legal rules even if these changes would be efficient and in the public interest.[462]

Proponents of the path-dependence thesis adopt Legrand's view of legal rules. As transplanting rules to improve minority shareholder protection and therefore encourage dispersed share ownership is not 'rocket science' one would expect countries with low levels of shareholder protection to have done this to secure economic advantage. However, this has not been the case due to the politics of these countries.[463]Bebchuk and Roe's analysis demonstrates that ownership structure comes first and is in itself a function of politics or historical accident.[464]Ownership structure then influences the law which then influences future ownership structure. Law is therefore a secondary factor in the determination of corporate governance not a primary factor as the 'law matters' thesis argues.

Roe's argument that ownership structure is the result of politics has been criticised by Coffee who points out that Roe's social-democratic thesis does not explain the origin of ownership structure in any other country (other than Germany) and does not fit with situations in Asia and much of the Third World.[465]Additionally, though employee participation in the supervisory organ is also mandated (with qualification) in Austria, Denmark, Germany, Luxembourg, the Netherlands and Sweden,[466]it should be emphasised that employees as members of the supervisory board do not have formal decision-making power.[467]Therefore, although employees as members of the supervisory board can take part in supervising management they have no power to directly influence or determine management decisions. As their influence is limited, this suggests that the coalition between employees only exists in theory and is impossible in practice. The 'politics matters' thesis also suggests that shareholder dividends are likely to be low in social-democracies due to the agency costs resulting from the manager/workers

[462] Bebchuk, L. A. and Roe, M. J. (1999), pp.154-162
[463] Roe, M. J. (2005), Corporate Governance: Political and Legal Perspectives, Introduction
[464] Bebchuk, L. A. and Roe, M. J. (1999), p.129
[465]Coffee, J . C. (2001), 'The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control', The Yale Law Journal, Vol.III, 2.p.74.
[466] Enriques, L. (2003), 'Silence is Golden: The European Company Statute as a Catalyst for Company Law Arbitrage, ECGI Law Working Paper No. 07/2003, p.10.
[467] Licht, A. N. (2004), 'The Maximands of Corporate Governance: A Theory of Values and Cognitive Style', Delawere Journal of Corporate Law, Vol. 29, No. 3, pp.735-736.

coalition.[468]However, empirical studies offer little support for this argument. Banks et al investigate the extent to which politics is a determinant of corporate governance with their focus being the determinants of dividend policy in publicly quoted UK companies between 1949 and 2002. Under Roe's analysis left-wing governments should correlate with low dividend payouts and right-wing governments should be associated with the adoption of more generous dividend payouts. Banks et al's finding is that there was no meaningful statistical correlation between the ideology of the party in power and dividends.

Although the theory that social democracy is a determinant of corporate governance has a plausible ring to it – as it determined Germany's corporate governance system - the results of Banks et al contradict the proposition that politics shape corporate governance.[469]This proposition is supported by the fact that in the US and the UK politics do not appear to have played a huge role in the rise of dispersed ownership. In the case of the UK, research by Cheffins has demonstrated that ownership dispersed during a period when the Labour government was pursuing socio-democratic policies.[470]Additionally, Germany's ownership structure was already concentrated in the late 19th century prior to the socio-democratic movements that resulted in codetermination.[471]Events in practice also do not lend support to the argument that politics determines corporate governance. Politics seems to play catch up to corporate governance following events such as South Sea Company bubble in the UK which resulted in the Bubble Act (1720), the Securities Exchange Act 1934 which was passed in the US following the Great Depression in 1929 and the more recent Sarbanes-Oxley Act passed in the US following financial scandals in the US at the start of this century. Therefore there appears to be no concrete proof for Roe's argument that politics determine corporate governance, including a country's ownership structure. Politics appears to only influence corporate governance; not determine it.

[468] Mueller, D. C. (2005), The Economics and Politics of Corporate Governance in the European Union, ECGI Law Working Paper No.37/2005, pp.3-4.
[469]Bank, S. A., Cheffins, B. R. and Goergen, M. (2004), Dividends and Politics, ECGI Law Working Paper, No.24/2004.
[470] Cheffins, B. R. (2000),'Putting Britain on the Roe Map: The Emergence of the Berle-Means Corporation in the United Kingdom', Draft Paper presented at the 1999 Tilburg Conference on Convergence and Diversity In Corporate Governance Regimes and Capital Markets, p.34
[471] Coffee, J . C. (2001), 'The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control', The Yale Law Journal, Vol.III, 2.p.73.

3.5.1.1 Positioning Kenya within the 'politics matters' thesis

Roe's argument that a country's politics rather than its economic efficiency create corporate law[472] is applicable to Kenya to a certain extent. It was politics rather than economic activity that created Kenya's corporate framework in pre-colonial times. Just a different kind of politics: external politics. External politics have continued to shape Kenya's corporate governance to-date. Colonialism resulted in the introduction of the corporation in Kenya as well as the CA 1948. After independence, Kenya rejected the capitalism that the settlers had tried to introduce and embraced African Socialism and a stakeholder-based view to the governance of corporations.[473] This approach to economic development did not last following the intervention of external bodies such as the World Bank and IMF and pressure from donor countries such as Britain that required Kenya privatises its companies and opens up its economy to foreign direct investment as a condition for funding. This external pressure has resulted in the embracing of Anglo-American ideals of corporate governance. Internal politics, on the other hand, have for a long time stood in the way of legal reform in Kenya, including the reform of the Companies Act. As a certain MP (Mr. Gumo) put it:

> 'There is no way we can eliminate corruption in this country without politics. Corruption is mainly created by politics or by politicians. The day politicians in this country will be clean and will not be corrupt, the Civil Service will not be corrupt.[474]… That is why we cannot reform this country. The moment we have people who are agitated when we say something that they know about, then we cannot reform this country. **We must be ready to correct the mistakes of this country** and develop it.'[475]

Politics therefore matter in the Kenyan context at least to the extent that they shape the regulation of its corporate landscape and stand in the way of reform.

It is also arguable that politics have influenced Kenya's ownership structure. The initial owners of companies were settlers as Africans and Asians were not allowed to own companies before 1945.[476] As settlers had to defend themselves from locals during pre-colonial times it is arguable that Kenya's concentrated ownership resulted from this. Africanisation and other discriminatory policies in post-independent Kenya reinforced

[472] Roe, M. J. (2003), pp.29-46.
[473] Government Printer (1965), African Socialism and Its Application to Planning in Kenya
[474] Kenya Hansard (2010), National Assembly: Official Report, Wednesday 3rd March, 2010, p.26
[475] Kenya Hansard (2010), p.27
[476] See generally Swainson, N. (1980)

Kenya's concentrated ownership structure as the restrictions on participating in the NSE remained high and therefore only accessible to the existing bourgeoisie: politician-businessmen and businessmen-politicians. Due to the Government's social-democratic stance, where the interests of the society are put before all other interests, majority shareholders have hitherto had to defend their interests by block-holding as other systems of reducing agency costs such as the legal system have remained weak confirming Roe's argument that social democracy and concentrated ownership are correlated. The use of block-holding to defend the interests of majority shareholders has resulted in a blurring of the role and composition of the boards of public companies. In calling for amendment/repeal of the CA 1948 Mr. Wetangula, a MP, stated that:

> '… it is absolutely necessary for the change in the law, so that **shareholders of companies do not double as directors.** This has always given a conflict of interest role that has ended up in having major insider activities in companies, that by the time they are discovered, you have lots of losses.'[477]

Mr. Obwocha, a MP, agreeing with Mr. Wetangula emphasised that:

> '... **we need to separate the board and the shareholders because there is a conflict of interest**. **The same shareholders are the same people in the board who manage or receive the report for the management.** This should be addressed.'[478]

However, the effect of politics on Kenya's corporate governance differs from Germany's in that stakeholder interests have not been recognised on the boards of Plcs due to incompatibility of such recognition with the existing Anglo-American-based corporate framework. Kenya's CA 1948 does not provide protection for the interests of workers, an aspect which can be attributed to its British origin. Under the CMA Guidelines, directors are only obliged to, 'take into account the interests of other stakeholders' in their decision-making.[479]

Kenya, unlike Germany's social democracy has a unitary board. Following Gourevitch's argument that it is the type of government that was in place when governance structures established themselves that determines corporate governance,[480] it is arguable that the government that influenced Kenya's corporate governance was the British colonial

[477] Kenya Hansard (2004), National Assembly: Official Report, Wednesday 12th May 2004, pp.1088
[478] Kenya Hansard (2004), pp.1095
[479] Section 1.2 CMA Guidelines.
[480] Gourevitch, P. A . (2003), 'The Politics of Corporate Governance Regulation', Yale Law Journal, p.1864

government. The concept of the corporation, Kenya's CA 1948 and the NSE were all established during colonialism to cater for British, rather than local, interests/needs. The colonial government did not encourage dispersed ownership or high protection of minority shareholders due to two factors: Kenya was an 'extractive colony'[481] and high minority shareholder protection was not present in Britain until the 1980s, and thus not provided for in Kenya's CA 1948, as a result of the ruling in Foss v. Harbottle which denied minority shareholders standing to sue.

According to Bebchuk and Roe's structural path-dependence argument, a country that has large block-holders has a tendency to continue to have concentrated ownership unless the benefits of dispersed ownership outweigh the costs. In Kenya, it is plausible to state that as long as the legal system remains weak the benefits of dispersed ownership for any block-holder will be difficult to see. Following Bebchuk and Roe's rule driven path-dependence argument which assumes that law influences ownership structure, Kenya's present ownership structure can be attributed to Kenya's corporate law which offers low shareholder protection and is unable to prevent block-holders from unduly influencing the board as demonstrated in the CMC scandal.[482] Law makers in Kenya are yet to be convinced of the benefits of good corporate law that encourages dispersed ownership as they are likely to be blockholders in the existing Plcs or to have relationships with existing incumbents and therefore benefit from the existing ownership structure.

An examination of Hansard shows that although the issue of reviewing Kenya's corporate law has not come up that much in Parliament, during the few times it has come up, MPs have been very clear that amendment/repealing of the CA 1948 is necessary. During a Parliamentary sitting, a member of Kenya's first Parliament, Mr. Omweri, asked the Attorney General (AG) (Mr. Njonjo):

> '..whether he would consider amending or repealing the Companies Act which was so foreign, colonial and complicated in the eyes of the Kenyan Africans.'

The AG's response was that:

[481] To be discussed in further detail below.
[482] The intervention in the CMC dispute was done through the Capital Markets Authority whose formation has been attributed to the failure of the Companies Act as an effective mechanism for regulating director conduct. See Kenya Hansard (2004), National Assembly: Official Report, Wednesday 12th May 2004.

> 'Whilst Government appreciates that the Companies Act is a complicated piece of legislation, its provisions are considered essential if the interests of the public and of shareholders are to be properly protected. **Businessmen who… do not understand the requirements of the Act… should seek professional advice**, this is where private practitioners come in… to explain those provisions. For those who want a simpler form of organisation without numerous shareholders or limited liability, a firm can be registered under the Registration of Business Names Act or again the formation of a cooperative society may be more appropriate.'

The AG's response was followed by another question from Mr. Omweri:

> '.. does he [the AG] not agree with me that it would not be easy for our people who want to form companies in the spirit of **African socialism** to understand the clauses which exceed more than 360 in this particular chapter?'

The AG's response:

> 'I thought that the hon. Member was complaining about the complexity of the legislation itself. He is now complaining about the length of the document… Last year, out of seventeen public companies which were formed nine were outright African companies - and therefore there is not any question of an allegation that Africans do not understand the Companies Act – four were joint ventures between Africans, Europeans and Asians, and one was a Government formed and sponsored company. In the case of private companies, out of 427 companies registered last year, seventy-two were outright African companies, registered by Africans. Forty-eight were joint ventures between the Africans, Europeans and Asians. So.. **I do not accept that this legislation is complicated**.'[483]

The appropriateness of the CA 1948 did not come up again in Parliament until 2004 when the question of amending the Companies Act was brought forth by Mr. Obwocha Parliament as follows:

> '… in the view of the fact that the Companies Act… was enacted in 1948 considering the fact that the business environment has changed considerably ever since and that E-commerce world needs to address the changed business world, this House urges the Government to **amend and repeal sections of the Act which are not in conformity with the modern business world**.'[484]

Amongst the reasons Mr. Obwocha cited for the need to amend the CA 1948 were:

[483] Kenya Hansard (1965), The National Assembly House of Representatives Official Report, Second Session (Contd.) Tuesday 1st June 1965- 30th July 1965, Question no. 2192, Repealing of Companies Act, Pp.606-607.
[484] Kenya Hansard (2004), National Assembly: Official Report, Wednesday 12th May 2004, p.1080

- To give greater freedom to shareholders of companies, so as to run the companies, change the boards of directors when they want and change management as and when the need arises;[485]
- To address the issue of fraud that is more sophisticated now than it was when the Act was enacted and obviously try and address the issue of missing files in the registry of the Attorney-General;[486]
- This Act has 13 parts and 406 sections. It is one of the longest and most voluminous Acts.

Mr. Obwocha also pointed out that, the CA 1948:

> '… has not been reviewed despite the fact that a task force was formed by the Attorney-General, headed by the former Registrar, J. N. King'arui and **its findings have not been given out to the public.** ..in the view of the fact that the business environment has changed considerably in the last 42 years, there is need to review the outdated and unworkable provisions and to make the operations of companies more transparent, efficient, simpler and governed by the principles of corporate good governance. This will require a repeal of the Act or amendment to the sections to suit the current trend on corporate good governance. Reforms are needed for instance, to ensure **easier incorporation, improved reporting, greater disclosure of information to shareholders, efficiency in general, annual general meetings, protection of minority shareholders and extension of the responsibilities of auditors and liquidators**.'[487]

Mr. Obwocha's motion was greatly supported in the House however on the said date of the Motion, the AG (Mr. Wako) did not attend Parliament. Therefore the Minister of Finance (Mr. Mwiraria) responded on his behalf:

> '… I want to state quite clearly that the Companies Act, Cap.486 is the responsibility of the Attorney General. As part of our **collective responsibility**, I will accept the challenge since I have been put down here as the Responding Minister, to respond to this Motion. I want to state clearly that the Government of Kenya is fully aware that the present Companies Act is an old law dating back to 1948, and that we need to amend it to make it more up-to-date. Indeed, a lot of work was done about four years ago. There was a team… we appointed through this Parliament, at the suggestion of the Attorney-General, very many working parties on legal reforms. One of the working parties dealt specifically with the review of the Companies Act. The proposed new Act exists and it is in the Attorney-General's Chambers. I propose that after today's meeting, we

[485] Kenya Hansard (2004), pp.1080-1081
[486] Kenya Hansard (2004), pp.1081
[487] Kenya Hansard (2004), pp.1081

> discuss the implementation, or at least the revisiting of that law with the Attorney General. Having said that, let me also add that a good Companies Act is crucial for the future development of this country. … under the NARC Government, we have decided to target poverty for eradication as our first priority. … First..we are targeting the agricultural sector … This area is dominated by small-scale and large scale companies, which need an enabling law to be able to operate effectively.'[488]
>
> '… we need to make a law that will make it easy for people to establish companies and get justice in courts of law when they are wronged. **It is a pity that after a working party finished its work, this law was shelved.** I want to assure this House that we are keen in getting the old 1948 law re-visited, and a new law made as soon as possible.'[489]
>
> '… we expect that following the review of the Constitution, many of our Kenyan laws will need to be reviewed. … we are giving priority to the laws that establish an enabling environment for the running of the company, operation and establishment of businesses in this country.'[490]

Therefore, at present, in addition to the Goyder report and the King'arui report there is a very comprehensive discussion of proposed amendments to the CA 1948 in Kenya's Hansard 2004. The Mover of the 2004 Motion (Mr. Obwocha) ended by questioning what the government is waiting for given all these proposed amendments, a question which remains in the minds of Kenyans even after the draft Companies Bill in 2007 which is yet to be tabled in Parliament. In 2010 however, the issue of amending/repealing the Companies Act was mentioned again in Kenya's Parliament in 2010 by Mr. Lessonet (MP) referring to a Presidential speech:

> '… the President… highlighted… the need to have a business-friendly environment in this country. He was very clear in terms of repealing the Companies Act. The Companies Act which we have at the moment is outdated. You will realise that even as the Government divests its interest in State parastatals, whether it is the Kenya Airways, Kenya Commercial Bank (KCB), or Mumias Sugar Company, **there are still appointees of the Government. This is because that small shareholding of the Government enables them to appoint all directors.** Therefore, the fact that we must repeal the Companies Act as indicated in the Presidential speech is right.'[491]

It is possible therefore that pressure from incumbent groups benefitting from the current state of Kenya's law has hindered efforts at legal reform even when this reform has been

[488] Kenya Hansard (2004), pp.1092-1093
[489] Kenya Hansard (2004), pp.1093
[490] Kenya Hansard (2004), pp.1094
[491] Kenya Hansard (2010), National Assembly: Official Report, Wednesday 3rd March, 2010, p.29

demonstrated to be clearly in the public interest as Bebchuk and Roe argue.[492]Regarding coalitions as tools through which politics operates in corporate governance, a coalition between employees and management has not been possible in Kenya. The community as a stakeholder has been more dominant in corporate governance. Due to the low legal protection of employment rights and the presence of a fluid labour market – as unemployment is a big issue in Kenya's economy –employees in public companies are likely to tow along rather than demand the protection of their interests as replacements for overbearing employees can always be found. Other factors such as ethnicity prevent an employee/managers coalition from effectively functioning as there are so many diverse interests represented among employees due to Kenya's ethnic diversity. Not all employees will support management particularly when the tribe card is in play.[493]

An interesting observation however, is that of Cheffins that the UK's ownership structure dispersed when Labour was pursuing socio-democratic politics.[494] This suggests that Kenya's ownership has a chance of dispersing regardless of the nature of its politics. Politics does not therefore determine corporate governance; it only influences it. For that reason, Kenya's politics will not be a key consideration in adapting Kenya's corporate framework to reflect its conditions and ideologies and therefore one that can guide Kenya to attaining good corporate governance.

Kenya's politics will however be borne in mind as it remains true to say that law and politics have always played a certain role in altering the ownership structure in the US and the UK. Had the US not had nationalisation restrictions it is arguable that it would have had an entirely different ownership structure than it has today. In the UK when the Labour government came to power after WII in 1945, it implemented a nationalisation policy following which the ownership of companies was dominated by the state and thereby concentrated.[495]Nationalisation was supposed to facilitate the socialist objective of achieving an egalitarian distribution of income and offer the advantages of large-scale production, better co-ordination and integration. However, when the Conservative Party took over in 1979, it reversed the nationalisation process by privatising the industries concerned. Therefore, state-ownership was changed to private

[492] Bebchuk, L. A. and Roe, M. J. (1999), pp.153-162.
[493] The effects of ethnicity on Kenya's corporate governance will be discussed in further detail below.
[494] Cheffins, B. R. (2000), p.34.
[495] Murphy, M. E. (1952), 'Nationalization of the British Industry', The Canadian Journal of Economics and Political Science, 18(2), pp.146-162.

ownership.[496]Consequently, politics still have a role to play in shaping corporate governance. It is particularly arguable that changes in the UK's corporate policy are likely to affect Kenya's corporate governance. History has already demonstrated this in Kenya's move from state ownership to private ownership following a change in political parties in Britain. Due to Kenya's dependence on Britain for financial aid, changes on the British corporate landscape will always be reflected to an extent in Kenya's corporate policy unless Kenya becomes economically independent from Britain in terms of foreign direct investment.

3.5.2 Culture and corporate governance

Some scholars within the path-dependence school oppose the convergence thesis on the grounds of culture.[497] Studies have shown that culture influences levels of investor protection. According to Stulz and Williamson, creditor rights are strongest in countries where the main religion is Protestant regardless of legal origin.[498] Bebchuk and Roe also point out in collective cultures incumbents may stand in the way of legal reform.[499] Lawton points out that cultural relativity[500]greatly influences the way in which companies are managed and therefore their level of shareholder protection. In China, the corporation is perceived through the eyes of reciprocal relations rather than as a separate legal entity thereby interlocks and family ownership is common. As such corporate governance mechanisms such as NEDs might be met with resistance[501] and where they are appointed they will have difficulty saying 'no' to an executive director as this represents a breach of trust.[502] Cultural factors may also influence ownership structure as shareholders may only be willing to surrender control to family members whom they trust.[503]This observation is echoed in the works of Khanna and Palepu,[504]and

[496] Jenkins, S. (1996), Accountable to None: The Tory Nationalization of Britain, Penguin Books, London, p.23.
[497]Licht, A. N. (2001), 'The Mother of All Path Dependencies: Towards a Cross Cultural Theory of Corporate Governance Systems, Delawere Journal of Corporate Law, 26, p.149; Licht, A. N. (2004), 'Legal Plug-ins: Cultural Distance, Cross-Listing and Corporate Governance Reform', Berkley Journal of International Law, 22, p.195; Licht, A. N., Goldschmidt, C. and Schwartz, S. H. (2005), 'Culture, Law and Corporate Governance', International Review of Law and Economics, 25, p.229; Hope, O. K. (2003), 'Firm-Level Disclosures and the Relative Role of Culture and Legal Origin', Journal of International Financial Management and Accounting, Vol. 14 (3), p.2003;
[498] Stulz, R. M. and Williamson, R. (2003), Culture, Openness and Finance', Journal of Financial Economics,70, p. 346.
[499] See generally, Bebchuk, L. A. and Roe, M. J. (1999), p.153.
[500] The view that beliefs, ethics and customs are relative to individual in his own social context: 'right and wrong' are culture specific.
[501] Lawton, P. (1996), 'Berle and Means' Corporate Governance and the Chinese Family Firm', Australian Journal of Corporate Law, 6, p.14.
[502] Lawton, P. (1996), p.15
[503] Lawton, P. (1996)

Claessens et al[505]who argue that where formal institutions are underdeveloped investors will develop their own informal guarantees such as the use of network relationships and cross-ownership to ensure appropriate returns from investments. Where trust is low, investors will hold more shares in a firm to protect themselves from expropriation thereby slowing down economic growth.[506]

Licht points out that a legal regime that is incompatible with the prevailing culture is likely to be ignored in a nation.[507]The experience of the European Union in attempting to pass the Draft Fifth Directive on Company Law[508]also exemplifies this. The draft went through many revisions and changes in response to cultural-based conflicts between member states.[509] The significance of culture's influence on corporate governance has also been acknowledged by US-based pension fund CalPERS which recognises that the culture of each market is different and takes into account a country's culture in developing their policies on foreign corporate governance.[510]The experience of emerging economies in Eastern Europe which have transplanted the Anglo-American model in the hope of turning their economies around from communism to market-based economies lend support to the culture-based path-dependence argument. Culture has reinforced the existing ownership structures of these former socialist countries. In the case of Russia and the Czech Republic mass privatisation through the distribution of privatisation vouchers to citizens initially created dispersed ownership during the transition period only for concentrated ownership to re-emerge.[511]Based on this evidence, it is arguable that culture's influence on corporate governance is stronger than that of law or politics and therefore one that policy-makers should give serious consideration.

Research supporting such an approach includes Stout's work which points out that US corporate insiders often behave like fiduciaries not because of external constraints but

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[504] Khanna,T. and Palepu, K.(2000), 'Emerging Market Business Groups, Foreign Investors, and Corporate Governance', in Morck, R.K.(2000), Concentrated Corporate Ownership, University of Chicago Press,pp.265-294

[505] Claessens, S., Djankov, S., and Lang, L. H. P. (2000), 'The Separation of Ownership and Control in East Asian
Corporations', Journal of Financial Economics, 58, pp.81-112

[506] See generally Knack, S., and Keefer, P.(1997), 'Does Social Capital have an Economic Payoff? A Cross-Country Investigation', The Quarterly Journal of Economics,112(4),p.1251

[507] Licht, A, Goldschmidt, C and Schwartz, S. H. (2001), 'Culture, Law and Finance: Cultural Dimensions of Corporate Governance Laws', Working Paper 1, Law and Economics Workshop, University of California, Berkeley.

[508] For the 1988 text, see Dine, J. (1991), EC Company Law, paras. A8.20-A8.93.

[509] Licht, A. N. (2001),p.157

[510] Licht, A. N. (2001),pp.150-154.

[511] Coffee, J.C. (1999), 'Privatization and Corporate Governance: The Lessons from Securities Market Failure', Journal of Corporate Law, 25 (1), pp.1-39

because of internal ones.[512]Corporate insiders act like fiduciaries not only because they fear external sanctions, but also because they have internalized a sense of obligation or responsibility toward others, including that abstract other, 'the firm and its shareholders.'[513]Therefore, transplants of US rules are unlikely to succeed unless the citizens of the importing nation adopt a similar pattern of altruistic compliance.[514] Due to stark differences in culture between England and Kenya, it is therefore debatable whether measures based on Berle's notion of shareholder primacy such as England's Companies Act 1948 and the Anglo-Saxon model of corporate governance should have been adopted as the mode of governance of Kenyan Plcs. Although Kenyans can be said to have internalised a sense of obligation towards others due to their collective culture, that 'other' is limited to family or tribe. Unlike the US, that obligation towards others does not apply on a national scale. The law on the other hand applies on a national scale. Therefore voluntary compliance with fiduciary duties at a similar level to that in the West is unlikely in the Kenyan context. The cultural argument best represents Legrand's view on transplantation arguing that the workability of laws following legal reform largely depends on their compatibility with the prevailing culture. Under Licht's argument, convergence of form is possible – where laws are reviewed to ensure high shareholder protection – but convergence of function – where the new laws result in dispersed ownership as a result of existing institutions is highly unlikely due to the cultural obstacle.[515]

3.5.2.1 Ethnic diversity and economic development

An important component of culture in the African context is the presence of many ethnic groups. Kenya, for example, has over 40 tribes each with its own culture and other ethnic groups. Does the presence of tribes and different ethnicities determine a country's corporate governance?

Research in the field of economics has found a negative correlation between ethnic diversity and economic growth. Alesina points out that society's polarisation and the

[512] Stout, L. A. (2002), 'On the Export of U.S.- Style Corporate Fiduciary Duties to Other Cultures; Can a Transplant Take?', University of California, Los Angeles, School of Law Research Paper Series, Research Paper No. 02-11.p.10
[513] Stout, L. A. (2002),p.10
[514] Stout, L. A. (2002),p.34
[515] The political and cultural arguments are just some of the arguments for path-dependence. Other scholars highlight the importance of the economic context and the existing social and commercial norms. See Bratton, W. and McCahery, J. A. (1999), 'Comparative Corporate Governance and the Theory of the Firm: The Case against Global Cross Reference', Columbia Journal of Transnational Law, 38 (2); Charny, D. (2004), 'The Politics of Convergence', in Gordon, J. N. and Roe, M. J. (2004), Convergence and Persistence in Corporate Governance, Cambridge University Press, p.293.

degree of social conflict are key factors underlying policy decisions. Ethnic diversity may increase polarisation and thereby impede agreement about the provision of public goods and create positive incentives for growth-reducing policies, such as financial repression and over-valued exchange rates that create rents for the groups in power at the expense of society at large.[516]In a different work, Alesina at al point out that when individuals have different preferences, they may want to pull fewer resources together for public projects. Research on US cities shows that in cities where ethnic groups are polarized, and where politicians have ethnic constituencies, the share of spending that goes to public goods is low. Representatives of interest groups with an ethnic base are likely to value only the benefits of public goods that accrue to their groups, and discount the benefits for other groups for two reasons: First, different ethnic groups have different preferences over which type of public goods to produce with tax revenues. Secondly, each ethnic group's utility level for a public good is reduced if other groups also use it. It is hardly a new insight to argue that urban problems in America have something to do with ethnic conflict.[517] Age has also been found to have a role to play the effect of ethnicity. Poterba finds a larger fraction of elderly in a jurisdiction leads to lower public spending on education. This reduction is particularly large when the elderly residents and the school age population are from different racial groups.[518]This suggests that ethnic diversity and age (when a society is ethnically diverse), can affect the pooling together of resources for public goods and the making of good public policies. An interesting feature of Alesina et al's work is that higher spending in more ethnically diverse jurisdictions is financed in part by intergovernmental transfers rather than by local taxes. This pattern is consistent with political economy theories in which heterogeneous and polarized societies will value public goods less, patronage more and will collectively care less about fiscal discipline.[519]

Easterly and Levine see ethnic diversity differences as important in explaining Africa's growth tragedy versus Asia's miracle. In their paper, 'Africa's Growth Tragedy'[520]they argue that ethnic diversity influences economic performance and most of this effect

[516] Alesina, A. (1994), 'Political Models of Macroeconomic Policy and Fiscal Reforms', in Haggard, S. and Webb, S. (1994), Voting for Reform: Democracy, Political Liberalization, and Economic Adjustment, OUP, p.38 cited in Easterly, W. and Levine, R. (1997),p.1206.
[517] Alesina, A., Baqir, R. and Easterly, W. (1999), 'Public Goods and Ethnic Divisions', The Quarterly Journal of Economics, 114 (4), pp.1243-1244.
[518] Poterba, J. M. (1997), 'Demographic Structure and the Political Economy of Public Education', Journal of Policy Analysis and Management, 16 (1), pp.48-66.
[519] Alesina, A., Baqir, R. and Easterly, W. (1999), p.1275.
[520] Easterly, W. and Levine, R. (1997), 'Africa's Growth Tragedy: Policies and Ethnic Divisions', The Quarterly Journal of Economics, 112 (4), pp.1203-1250.

works indirectly through public policies, political stability and other factors. Polarised societies, such as those in Africa, will be both prone to competitive rent-seeking and have difficulty agreeing on public goods such as good policies hence Africa's growth tragedy.[521]Additionally, Easterly and Levine argue that ethnically diverse societies are also empirically less likely to have the kind of political institutions that create effective checks and balances, that is, democratic institutions and rule of law.[522] They give Kenya's ethnic divisions as an example: Kenya has more than 40 ethnic groups including the Kikuyu (21% of the population), Luhya (13%), Luo (13%), Kalenjin (11%), Kamba (11%), Maasai (2%) and Somali (2%). A large Indian business community and some remaining white Kenyans add to the mix. They point out that the Kikuyu led the fight for independence and dominated politics under Kenyatta in alliance with the Luo and then with the Kamba until 1978. The Kalenjin during the Moi era dominated with the Kamba, Luhya and smaller groups. In the 1992 Presidential elections the Luo candidate won 75% of the vote in the Luo region, the two Kikuyu candidates together received 96% of the vote of the Kikuyu region, and the Kalenjin candidate (Moi) received 71% of the vote in the Kalenjin region.[523] Easterly and Levine refer to the findings of Barkan and Chege's research on the allocation of road building investments in Kenya between the home regions of Kenyatta and the Moi ethnic coalitions during their respective governments. Barkan and Chege find that after Moi took over in 1978, the road-building investment share of the Kenyatta coalition home regions fell from 44% in 1979-1980 to 16% in 1987-1988. The share of the Moi coalition's home regions rose from 32% to 57%. The share of health expenditures in 1987-1988 going to the regions of the Kenyatta ethnic coalition was 18% while the regions of the Moi coalition received 49%.[524]Therefore Kenya's ethnic diversity has resulted in ethnic-based rent-seeking coalitions and affected decision-making on public goods such as good policies due to weaknesses in checks and balances that are attributable to ethnic diversity. Neutralising the negative effect of ethnic-diversity should therefore be a key consideration in the drafting of policies for the Kenyan society.

[521] Easterly, W. and Levine, R. (1997),p.1205-1207.
[522] Easterly, W. and Levine, R. (1997),p.1215.
[523] Easterly, W. and Levine, R. (1997),p.1216.
[524] Barkan, J. and Chege, M. (1989), 'Decentralising the State: District Focius and the Politics of Reallocation in Kenya', The Journal of Modern African Studies, XXVII, pp.431-453 cited in Easterly, W. and Levine, R. (1997),p.1217.

3.5.2.2 The endowment theory: history matters

Recent research shows a relationship between high ethnicity and the development of corporate governance systems. Easterly and Levine, in their paper 'Africa's Growth Tragedy', find that high ethnic diversity in Africa is closely associated with under-developed financial systems.[525]In a subsequent paper Levine advances the endowment theory which argues that during European colonisation, differences in climate, crops, the indigenous population and disease environment influenced long-run property rights.[526]The endowment theory is important for an ethnically diverse country, such as Kenya, following Mahoney's study which argues that the association between common law and growth in finance literature is not the result of different rules for investor protection (the 'law matters' thesis), rather, it is the result of a fundamental divergence between the security of property and contract rights in common-law and civil-law systems.[527]Mahoney's argument is supported by Milhaupt who states that property rights institutions are the principal source of diversity among national corporate governance systems.[528] Milhaupt points out that property rights cannot simply be 'put in place' as standard economic analysis assumes; rather, they develop in evolutionary processes shaped by the market and social interactions as well as state coercion.[529]Agreeing with this argument, Levine points out that property rights are self-propagating – they endure over centuries even when the importance of the original endowments for economic activity declines.[530]Therefore, history matters. History matters because property rights are partly artefacts of past and present social practices. According to Milhaupt, a comprehensive approach to governance would focus on the different ways in which control over physical and human assets is allocated and enforced in different systems and complementary institutions that have grown up in support of these control mechanisms.[531]

[525] Easterly, W. and Levine, R. (1997),p.1241.
[526] This thesis will focus on difference in indigenous population.
[527] Mahoney, P. G. (2001),p.523
[528] By property rights Milhaupt means simply the rules (legal, political or social) by which control over assets is allocated and enforced. See, Milhaupt, C. J. (2004), 'Property Rights in Firms', in Gordon, J. N. and Roe, M. J. (2004), Convergence and Persistence in Corporate Governance, Cambridge University Press, p.211.
[529] Rapaczynski, A. (1996), 'The Roles of the State and the Market in Establishing Property Rights', Journal of Economic Perspectives, 10(2), p.87
[530] Levine, R. (2005), 'Law, Endowments and Property Rights', Journal of Economic Perspectives, 19 (3), p.73
[531] Milhaupt, C. J. (2004), pp.216-217.

Acemoglou et al search colonial history for evidence on the determination of property rights and point out that in some colonies, Europeans sought to extract as much wealth from the colonies as possible. In these 'extractive colonies', such as Congo, Ivory Coast, the Caribbean and Brazil, Europeans did not develop institutions to support property rights for all (such as institutions focused on limiting government coercion and facilitating private contracting); rather they developed institutions to enrich and protect the elite. Europeans only developed institutions to support the rights of all in colonies where they intended to settle, 'settler colonies' such as the US, Australia and New Zealand.[532]As property rights created by European colonisers endured after the end of colonisation according to the endowment theory, in extractive colonies post-colonial rulers tended to assume control of the pre-existing tools designed to enrich the elite, and then exploit these colonial institutions in the post-colonial regime.[533]Thus, according to the endowment theory differences in endowment shaped the initial formation of property rights; and the initial systems for defining, defending and interpreting property rights have had long-lasting ramifications on property rights and private contracting today.[534]

Critics of the endowment view question the cause and effect relationship in the endowment theory, that is, that the causal chains runs from endowments, to colonisation strategy, to property rights and onto the level of development (endowment -> property rights -> economic growth) and argue that perhaps endowment affect economic growth in a direct way which then affects property rights (endowment -> economic development -> property rights). For instance, Machiavelli argues that in fertile tropic lands where it is easy to pick food from trees, people become lazy and unproductive. Montesquieu and Landes argue that in hot humid climates people become lethargic and enervated.[535]This critique has been recently rebutted by empirical research which finds that the only way endowments influence economic development is by affecting property rights. Easterly and Levine find no evidence that endowments affect economic development beyond the channel through property rights.[536]

[532] Acemoglu, D., Johnson, S. and Robinson, J. A. (2001), 'The Colonial Origins of Comparative Development: An Empirical Investigation', American Economic Review, 91 (5), pp.1369-1401
[533] See Young, C. (1994), The African Colonial State in Comparative Perspective, Yale University Press.
[534] Levine, R. (2005), p.76
[535] Machiavelli, N. (1519) [1987], Discourses on Livy, OUP New York; Montesquieu, C. S. (1748) [1990], 'The Spirit of Laws, Cambridge University Press and Landes, D. (1998), The Wealth and Poverty of Nations, New York cited in Levine, R. (2005), p.80.
[536] Easterly, W. and Levine, R. (2003), 'Tropics, Germs, and Crops: How Endowments Influence Economic Development', Journal of Monetary Economics, 50 (1), pp.3-39.

Beck et al categorically state that diverse ethnicity is one of the causes of under-developed financial markets.[537]Building on Acemoglu et al's endowment view, they argue that in an extractive environment, colonisers will not construct institutions that favour the development of free, competitive financial markets because competitive markets may threaten the position of the extractors.[538]Countries with poor geographical endowments, as measured by settler mortality, tend to have less developed financial intermediaries, less-developed stock markets and weaker property rights protection. Beck et al's study confirms that initial endowments in the colonies are important determinants of stock-market development and property rights protection and specifically find initial endowments to be more robustly associated with financial intermediary development than legal origin. According to Beck et al, initial endowments explain more of the cross-country variation in financial intermediary and stock market development than legal origin.[539]

Beck et al's finding of a robust link between endowments and financial development is important for Kenya's corporate governance as institutions that favour the development of free, competitive financial markets are important for good corporate practice at least under the Anglo-American model. Amongst these institutions is secure property rights. Milhaupt points out that property rights shape corporate governance in two fundamental ways: First they determine what types of firms will emerge in a given environment as firms arise in response to the incentives and transaction costs generated by the existing institutional framework. For example, large firms with dispersed ownership are not prevalent in insecure property rights environments as it is too costly to establish the required corporate control mechanisms. Secondly, the specific mechanisms available to firms, are constrained by existing property rights institutions which specify the legitimate forms of control in any given community. For instance, stock options and shareholder derivative litigation will not serve as managerial incentives and constraints where institutional settings disfavour the use of these governance devices.[540]

As the endowment school of thought is historically based – and therefore history matters and each country's history is different – it is not optimistic about convergence. Milhaupt sees property rights institutions as obstructing convergence. According to Milhaupt,

[537] Beck, T., Demirguc-Kunt, A. and Levine, R. (2003), 'Law Endowments and Finance', Journal of Financial Economics, 70 (2), pp.137-181.
[538] Beck, T., Demirguc-Kunt, A. and Levine, R. (2003),p.140.
[539] Beck, T., Demirguc-Kunt, A. and Levine, R. (2003),p.176.
[540] Milhaupt, C. J. (2004), p.216.

convergence will only occur where the political and social structures that account for institutional inertia can be overcome. Even then, Milhaupt points out that there appears to be no optimal corporate governance system, only collections of complementary mechanisms that fit or fail within a country's institutional framework. 'Just as property rights cannot simply be put in place to promote economic exchange, successful corporate governance mechanisms cannot simply be imported into diverse institutional frameworks.'[541]

3.5.2.3 Ethnicity, endowment theory and Kenya's corporate governance

Ethnicity as a determinant of corporate governance is a relevant consideration in reviewing Kenya's corporate law as ethnic diversity has been shown to negatively correlate with economic growth by impeding agreement, resulting in a reluctance to contribute towards public goods and creating positive incentives for growth-reducing policies such as financial repression.[542]

Kenya's policy on foreign direct investment is a good example of the effects of ethnic-based politics on corporate governance. Kenya's policy on foreign investors has historically encouraged a stakeholder-value view on the objective of the corporation with the interests of the community being put ahead of the interests of shareholders. Following independence in 1963, the government adopted an Africanisation policy whose primary goal was to transfer economic and social control to Kenyan citizens by ensuring that a majority of businesses were in the hands of Kenyan citizens except where some overriding national advantage was demonstrated.[543]Foreigners only held majority interest in companies if sufficient capital was not available from domestic sources and where there was an advantage to the country in retaining foreign ownership for instance, technology & skills. Africanisation was achieved through trade licensing legislation under which lists of companies owned by non-Kenyans and targeted for transfer to Kenyans by sale within a specific period were published periodically. The Government also provided loans to Kenyans who were able to take over such businesses. To protect the interests of foreign investors the Government passed the Foreign Investment Protection Act (1964)

[541] Milhaupt, C. J. (2004), p.251
[542] Alesina, A. (1994), 'Political Models of Macroeconomic Policy and Fiscal Reforms', in Haggard, S. and Webb, S. (1994), Voting for Reform: Democracy, Political Liberalization, and Economic Adjustment, OUP, p.38 cited in Easterly, W. and Levine, R. (1997),p.1206.
[543] Ngugi, R. W. (2003), Development of the Nairobi Stock Exchange: A Historical Perspective, Kenya Institute for Public Policy Research Analysis (KIPPRA), p.8.

under which any foreign investment contributing significantly to the development got approved status certificate and owners were allowed to repatriate earnings and capital.[544] However this was soon to change.

The 1970s were characterised by the Government's effort to directly monitor the NSE to ensure that capital raised in the NSE was not used for investment outside the country. The Governments first attempt to regulate the stock market was in 1971 when it established the Capital Issue Committee (CIC). This desire to regulate was triggered by a sabotage of the Africanisation policy where foreign companies selling shares to local investors were following up with the request to remit the funds realised overseas. The Government did not encourage such a move except where it resulted in full local control of the company or had approved status.[545] In the 1970/74 Development Plan the Government indicated its intention to introduce legislation aimed at safeguarding the interests of the investing public. This legislation was expected to establish a committee representing the Government and stockbrokers to control and approve new issues of company shares to the public. Issues were to be screened by this committee before they were presented to the public.[546] The screening exercise was to involve receiving details on how funds raised by the issue would be used and the amount the company wished to repatriate after the issue had been completed. In the 1971/72 Budget speech, the Minister of Finance insisted that the Government was not ready to allow the limited local capital to be used to finance repatriation of capital as this would not result in any long-term benefits for the country but a significant loss of short-term balance of payment.[547] The CIC was set up in 1971 under the Ministry of Finance – consisting of representatives from the Treasury, the Ministry of Commerce and Industry and the Central Bank of Kenya - with its key responsibility being to advise the Ministry of Finance on terms, priority and timing of all new issues of equity, rights issues to existing shareholders in publicly-traded companies, debentures and loans issues. It also had the responsibility of approving the price of issues, timing of sales and allotment of shares between institutions and individuals and also between residents and non-residents. There was no clear criteria upon which these decisions were made and the lack of full information had a great impact on the ability of firms to raise capital publicly.[548]

[544] Ngugi, R. W. (2003), p.11.
[545] Ngugi, R. W. (2003), p.13.
[546] Ngugi, R. W. (2003), p.13.
[547] Ngugi, R. W. (2003), p.14.
[548] Ngugi, R. W. (2003), p.14.

A discriminative tax policy that penalised share investors heavily was also introduced to reduce the repatriation of funds by foreigners and to raise Government revenue. Dividend income was double-taxed making it more expensive for corporations to provide adequate after-tax-return on equity. In addition to the 1971 policy which imposed a tax of 12.5% on dividends and interest paid by corporations to residents and non-residents, a 20% tax on all fees and royalties payable to non-residents was imposed. This capital gain tax was aimed at generating additional revenue and curbing excessive speculation. In 1974/75 fiscal year, the rate of tax on dividend paid to non-residents was raised from 12.5% to 15%; the rate of withholding tax on resident dividends also went up to 15%. Local borrowing was restricted to 20% of investment for a few exceptions. Foreign-controlled companies were allowed to turn more to overseas markets for financial requirements. To ensure compliance, the Central Bank withdrew permission for foreign firms to remit profits prior to the finalisation of the annual accounts of their firms. The general permission for local borrowing by firms whose non-resident ownership exceeded 15% was also withdrawn. In addition, the withholding tax paid by non-residents was raised from 15% to 20% and the interest rate from 12.5% to 20%. Stamp duty was raised to 3% in 1973/74 while the withholding tax for dividends was raised to 15% in 1974/75. A capital gains tax of 36% introduced in 1975, which was progressively reduced by 50% in 1981 and 25% in 1982.[549] This inhibited capital and share mobility and consequently economic growth and led to a preference for debt financing.[550]

As a result of the decline in economic growth 1990s were a reform period in which the government decided to reform the system by introducing mechanisms that were friendly to shareholders such as an incentive-based tax policy regime to enhance the competitiveness of financial assets and reduce the barriers to listing new issues. Capital gains tax was suspended in the 1985/86 fiscal year following the government's reaffirmation of its commitment to the reform process in *Sessional Paper no.1 of 1986*.[551] Amongst the propositions in this paper was the need to remove taxation differences between debt and equity finance and the need to establish a regulatory authority with the powers to provide regulatory measures for improvement and proper functioning of a fair and orderly market. The reform process was implemented simultaneously with financial sector reforms being put in place and a statutory regulatory framework being adopted to protect the interests of investors and facilitate the development of the stock

[549] Ngugi, R. W. (2003), p.15.
[550] Ngugi, R. W. (2003), p.13.
[551] GoK (1986), Sessional Paper No.1 of 1986.

market.[552] This resulted in the establishment of the Capital Markets Authority (CMA) in 1990 through the Capital Market Authority Act, Cap.485A.

During the reform period, tax policy was relaxed to reduce transaction costs and listed companies were exempted from stamp duty, capital gain tax and value added tax.[553]There were important changes regarding taxation policy; in the 1990/91 fiscal year, the withholding tax of 15% on dividend income paid to residents was made final tax thereby reducing the incidence of double-taxation on corporate dividends and incomes to individuals arising from investment in securities. The withholding tax was further reduced in 1992/3 to 10% and rationalized with the rate of applicable interest income. In the 1996/97 fiscal year, withholding tax on dividend income was lowered from 10% - 5% for local investors while it went down to 7.5% for non-residents. In the 1997/98 period, in order to encourage equity in medium sized companies with growth prospects, venture capital funds were allowed to enjoy a 10-year tax holiday on their dividend incomes. Further tax reductions were made in the 2001/2002 fiscal year. Newly listed firms were to pay a corporate tax of 25% compare to 30% for unlisted firms.[554]The inflow of foreign trade increased from 3% in 1995 to 44% in June 1997 to 52.5% in December 1996. Market performance during the 1996-1997 period was to a large extent controlled by foreign investors.[555]

The CMA had been established to develop all aspects of the capital market and in particular remove impediments and create long-term investment in productive enterprises as well as protecting investors' interests.[556]To meet its developmental role, the CMA (Amendments) Act of 1995 spelt out regulations providing for foreign investors participation in the domestic capital market which facilitated the expansion of market scope. To facilitate its regulatory role, the CMA in its 1996 review spelt out the requirements on take-overs and mergers and delisting to protect minority shareholders.[557]The CMA also issued guidelines to promote good corporate governance in January 1999 which were incorporated in the CMA Act (2002) thereby encouraging foreign investment.

[552]The establishment of a statutory framework was recommended by the IFC/Central Bank of Kenya study (1984) and reaffirmed in Sessional Paper No.1 of 1986.
[553] CMA Annual Report 1997/98.
[554] Ngugi, R. W. (2003), p.39.
[555] Ngugi, R. W. (2003), pp.30-31.
[556] Ngugi, R. W. (2003), p.20.
[557] Ngugi, R. W. (2003), pp. 18-22.

Kenya's policy has therefore until recently discriminated against foreign-investors largely based on the ethnicity argument following from Kenya's colonial history. Ethnicity will therefore affect participation in the NSE. If the NSE is dominated by a particular group, ethnic-based policies – such as the foreign policies above – are likely to be passed and other ethnic groups may avoid participating in the NSE. For public companies, ethnic diversity reduces the size of equity finance market and contributes to block-holding as companies will find it easier to get finance from banks as opposed to the stock-market. Ethnic diversity will also encourage a block-holder to hold on to his stock as trust in polarised society is ethnic-based. Information is also likely to be limited in ethnically diverse societies due to under-investment in public goods such as the protection of property rights, hence reinforcing concentrated ownership.

With ethnicity affecting the levels of disclosure, the quality of decisions on the boards of Plcs in Kenya which is ethnically diverse is likely to be compromised as directors are likely to support strategies that accrue benefits to their groups[558]as opposed to strategies that benefit the company as a whole. As the interests of other groups will be side-lined, conflicts of interests are therefore likely to result at a board level, affecting shareholder value. Age may also affect the quality of decisions in ethnically diverse boards[559]resulting in patronage and less fiscal discipline[560]as directors compete in rent-seeking on the board making agreement/consensus difficult.[561]Checks and balances will be affected where boards are ethnically diverse[562] as members of the board pledge their allegiance to their tribesmen instead of putting the company first.

Ethnicity also affects corporate governance through property rights as property rights institutions are the principal source of diversity among national corporate governance systems.[563] Historically, ownership in Kenyan society was communal. Therefore, a board which is dominated by Kenya's different local tribes may have a blurred diction between company property and personal property with decisions being made in the interests of directors rather than in the interests of the company. Boards dominated by communities

[558] See generally, Alesina, A., Baqir, R. and Easterly, W. (1999), 'Public Goods and Ethnic Divisions', The Quarterly Journal of Economics, 114 (4), pp.1243-1244.
[559] Poterba, J. M. (1997), 'Demographic Structure and the Political Economy of Public Education', Journal of Policy Analysis and Management, 16 (1), pp.48-66.
[560] Alesina, A., Baqir, R. and Easterly, W. (1999), p.1275.
[561] Easterly, W. and Levine, R. (1997),p.1205-1207.
[562] See generally. Easterly, W. and Levine, R. (1997),p.1215.
[563] By property rights Milhaupt means simply the rules (legal, political or social) by which control over assets is allocated and enforced. See, Milhaupt, C. J. (2004), 'Property Rights in Firms', in Gordon, J. N. and Roe, M. J. (2004), Convergence and Persistence in Corporate Governance, Cambridge University Press, p.211.

that historically recognised private ownership are likely to do better than those dominated by tribes that were centred on communal ownership. However, this is beyond the scope of this thesis. As Kenya was an extractive colony, we would expect the protection of property rights in Kenya to be weak and as such less recognition of minority rights in law and in practice.[564]In accordance with Beck et al's research, institutions that favour the development of free, competitive financial markets are likely to be under-developed in ethnically diverse countries such as Kenya. Therefore a system that is market-based is likely to fail in Kenya unless it is adapted to suit Kenya's particular conditions and ideologies.[565]

An example of the effects of ethnicity on the corporate law framework through the property rights channel is evident in the strained relationship between the Office of the Registrar of Companies and a majority of Kenyans and the special relationship that the same office has had with some members of society.

Mr. J. M. Mutiso (MP) pointed out that:

> '... the running of the office of Registrar of Companies at the Attorney-General's Department is cumbersome and outdated.[566]We have other isolated incidents, which have also affected the business environment in this country. …sometime back in 2001, we… had a foreign investor who wanted to invest in the Kenya Railways Corporation. He happened to come to this country with an intention to invest and create business opportunities in this country. However, on approaching the Registrar of companies in the Attorney General's Office, he received the same rude shock. First, **he was told that in order for the company to be registered, he needed to pay a bribe**. Secondly, registration would depend on the **shares he would be able to give to those who were assisting him** to establish the company. This is outright corruption.'[567]

The state of affairs at the Registrars was confirmed by Mr. Sungu (MP) who stated that:

> '… day in, day out, we hear of various companies that have been used to steal money from the public. Even in this House, we have often wondered who owns which company. If you go to the Office of the Registrar of Companies, you will never find those records, particularly if those companies were, or are being owned by big cats. That anomaly could only be addressed if the Companies Act is changed. The world is becoming a global village. There is

[564] See generally, Levine, R. (2005), p.76
[565] Milhaupt, C. J. (2004), p.251
[566] Kenya Hansard (2004), pp.1090.
[567] Kenya Hansard (2004), pp.1090

> no way we, as a country, can survive in that global village if we do not modernize our laws to go in line with modern developments such as computerisation.'[568]

Kenya's ethnic diversity has therefore affected its commitment to investing in public goods thereby affecting corporate governance directly through tribalism/ethnicity on boards and indirectly through weak protection of property rights which has facilitated and entrenched corruption at corporate governance level.

3.6 The intermediates and convergence

There also exists an intermediates school in the convergence debate. Clarkham argues that no system is best otherwise the different systems would not have existed for so long.[569] Another argument in support of this position is Gilson's argument that the effect of globalisation is to produce a more varied response that goes beyond the convergence/path-dependence debate which will result in the creation of a mixed bag of formal, functional and hybrid convergence. The outcome for each country will depend on its local conditions.[570] Gilson argues that even though corporate law is different around the world, management is judged against the same performance indicators in all developed corporate systems. Therefore, even though there has been no formal convergence, there has been 'functional' convergence in performance indicators regardless of whether a country embraces the shareholder or the stakeholder model.[571]Functional convergence occurs when existing governance institutions are flexible enough to respond to the demand of changed circumstances without altering their formal characteristics. Formal convergence, on the other hand, occurs when an effective response requires legislative action to alter the basic structure of existing institutions.[572]According to Gilson, convergence of function will occur first as convergence of form is more costly as new institutions require investment and incumbent interest groups will support existing institutions making political action to facilitate investment in new institutions difficult.[573]

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[568] Kenya Hansard (2004), pp.1092
[569] Clarkham, J.P.(1994), Keeping Good Company,OUP,p.349
[570] Gilson, R. J. (2001), 'Globalizing Corporate Governance: Convergence of Form or Function', American Journal of Comparative Law, 49, pp.336-337
[571] Gilson, R. J. (2001), pp.336-337
[572] Gilson, R. J. (2001), p.356
[573] Gilson, R. J. (2001), p.338

In sum, the convergence debate is on whether forces of globalisation are stronger than a country's socio-economic and political context. The underlying theme between both the convergence and path-dependence thesis is that legal rules are affected by external forces such as globalisation and can be reviewed to any desired degree subject to incumbent interests. The convergence and path-dependence schools of thought do not differ on the theoretical possibility of transplants but on whether these transplants will take and achieve the desired effect – in this case high levels of shareholder protection that will result in dispersed ownership. An examination of the 'law matters' thesis has found that ownership structure is not determined by law and therefore legal reform is unlikely to result in a different ownership structure. The same has been found on the 'politics matters' thesis: politics only influences rather than determines corporate governance and therefore ownership structure.

3.7 Conclusion

The aim of this chapter was to position Kenya within the corporate governance debate. It classified Kenya as a concentrated ownership system and found that Kenya's corporate governance system mirrors that of Continental European countries in all aspects apart from its regulatory framework which is Anglo-Saxon based resulting in corporate governance structures that are often associated with the US and the UK such as the unitary board. This chapter also found that despite transplanting England's regulatory framework to the Kenyan context, Kenya's institutions have remained resilient: Kenya's ownership structure remains concentrated and its levels of minority shareholder protection remain low. Like Continental European countries and Asia, Kenya takes a stakeholder-based view of the corporation in its corporate governance guidelines as opposed to the Anglo-Saxon shareholder primacy view.

Additionally Chapter 3 argued that the appropriate model of corporate governance should fit a country's ownership structure for it to take. In this regard, Ch.3 considered the effect of globalisation on Kenya's corporate framework and found that politics only influences a country's corporate governance: it does not determine it. Cultural values determine ownership structure and whether a legal regime is accepted in a nation. Ethnic diversity was identified as an important component of culture in the Kenyan context. Ethnicity determined the allocation of public resources during the Kenyatta and Moi era with each leader favouring his community. Therefore, neutralising these negative effects of ethnicity should therefore be a key consideration in reviewing Kenya's laws including its corporate framework as ethnic diversity has been closely

associated with under-developed financial systems. The next chapter reviews Kenya's corporate framework, taking into account its ethnic diversity, with a view to adapting it to Kenya's local conditions and ideologies therefore making it more suitable to the Kenyan context.

Chapter 4: Reviewing Kenya's Corporate Framework: a comparative analysis

Chapter 3 considered the effects of globalisation on corporate governance in Kenya and found politics and law to affect but not determine corporate governance. Culture was found to be a stronger determinant of a country's corporate governance especially through ethnic diversity. This chapter carries out a comparative study between England and Kenya's corporate framework taking into account the effects of culture and ethnic diversity on corporate governance. The aim is to evaluate the extent to which culture is reflected in Kenya's framework using Hofstede's cultural dimensions and make suggestions for review considering the role of trust in corporate governance.

England is used as the primary country of comparison as Britain remains the largest foreign investor on the NSE. As such, changes in the UK's corporate policy are likely to affect Kenya's corporate governance structure, in terms of regulation. Additionally, as Kenya is a common law jurisdiction and heavily reliant on developments in English law, developments in England's corporate law are likely to continue influencing Kenya's corporate framework. For that reason, it is necessary to compare England and Kenya's framework, to pick what is beneficial for Kenya from developments in England's framework and to amend what is incompatible with Kenyan culture. The experience of other common-law countries particularly Australia and outside the common-law world, South Africa will be considered. South Africa's experience is considered as Kenya is culturally similar to South Africa in terms of ethnic heterogeneity and its cultural philosophy –ubuntu. This chapter will explore ubuntu as a means of creating trust in the corporate legal framework of Kenya's ethnic-diverse context. The main aim of this comparative study is to facilitate legislative reform.[574]

This chapter is divided into three parts: Part I considers the importance of trust for Kenya's corporate governance. Part II deals with creating trust in Kenya's companies' legislation. Part III deals with creating trust in Kenya's CMA Guidelines.

[574] Hill, J. (1999), 'Comparative Law, Law Reform and Legal Theory,' Oxford Journal of Legal Studies, 9, p.102; See Zweigert, K. and Kotz, H. (1998), An Introduction to Comparative Law, OUP, p.34

4.1 Part I: The importance of trust for Kenya's corporate governance

Alesina and Ferrara find that racial heterogeneity is negatively associated with trust.[575] England is largely homogenous society as most of its population has one identity: the British identity.[576]Kenya, on the other hand, is highly ethnically heterogeneous with a total of over 50 identities, none of which is dominant. Whilst Kenyan Africans can be said to be dominant as they form more than 90% of the Kenyan population, they do not identify with being Kenyan. For many Kenyans tribal ethnicity is the single most important part of their personal identity.[577]Therefore according to the findings of Alesina and Ferrara England can be classified as a high trust society as it is fairly equal and homogenous whilst Kenya is a low trust society.[578]Low trust can be very costly for corporations.[579]Amongst the costs of low trust are fraud, controls, fear, uncertainty and a loss of energy, momentum and value.[580] Therefore, it is necessary to understand the concept of trust and its role in Kenya's corporate governance.

Like corporate governance, there is no generally accepted definition of trust. For Hardin, 'trust involves giving discretion to another to affect one's interests.'[581] O'Brien states that trust is confident expectation 'based on a consistency of feeling rather than a continuous assessment of evidence.'[582]For Fukuyama, trust is the, 'expectation that arises within a community of regular, honest, and cooperative behavior, based on commonly shared norms, on the parts of other members of that community.'[583]A common theme in most of these definitions is that there is a connection between trust and vulnerability. Trust involves risk and has no guarantees. According to Hardin, trust is, 'inherently subject to the risk that the other will abuse the power of discretion.'[584]

[575] Alesina, A. and Ferrera, E. (2002), 'Who Trusts Others?', Journal of Public Economics., 85, pp.207-234.
[576] The ethnic groups in England mainly consist of the English, Scottish, Welsh, Irish, the Asian-British and the Afro-Caribbean-British. See Norbury, P. (2003), Culture Smart! Britain: a quick guide to customs & etiquette, Kuperard Publishers, p.64.
[577] Gustavson, R., Kimani, N. N., Ouma, D. A. (2006), 'Perceptions of the Anglo-American Model of Corporate Governance in Sub-Saharan Africa: A Pilot Study', presented at the Workshop on Corporate Governance, Regulation and Development, University of Manchester, 17th November 2006, p.26.
[578] Alesina, A. and Ferrera, E. (2002), 'Who Trusts Others?', Journal of Public Economics., 85, pp.207-234.
[579] O'Brien, R. C. (2001),p.25
[580] O'Brien, R. C. (2001),p.17
[581] Hardin, R. (1993), 'The Street-Level Epistemology of Trust, Pol & Socy, p.507
[582] O'Brien, R. C. (2001),p.21
[583] Fukuyama, F. (1995), 'Trust: The Social Virtues and the Creation of Prosperity, Penguin Group, p.26
[584] Hardin, R. (1993),p.507

However, despite the vulnerability that trust inevitably exposes us, it cannot be ignored in today's globalised world. The importance of trust in society has been acknowledged by political scientists, economists and sociologists alike. Within political science Almond and Verba's study on civic culture found trust to be essential for the work of democratic political institutions.[585] Sociologists, for instance Seligman, have argued that trust is an essential foundation for the implementation of agency in intricate societies.[586] The important role of trust in the market economy gained early recognition in the study of economics. Adam Smith argued that the market depended on sympathy. Erode that sympathy and you risk destroying the basis of trust on which the dealings of the market ultimately depend.[587]Recent empirical studies in economics such as that of Raiser et al have found trust to be vital for the working of a market economy.[588] On the value of trust, Luhmann, a social theorist whose work on trust has been widely influential, characterises trust as a mechanism that reduces complexity and enables people to cope with the high levels of uncertainty and complexities of contemporary life.[589] According to Luhmann, trust makes uncertainty and complexity tolerable as it enables us to focus only on a few possible alternatives.[590]If forced to acknowledge and calculate all decision nodes of all possible outcomes, humans would freeze in uncertainty and indecision and not be able to act in situations that call for action and decisiveness. Trust, by the reduction of complexity, discloses possibilities for action which would have remained improbable and unattractive without trust – which would not, in other words, have been pursued.[591]Put simply, trust can simplify the complexity of a situation and enhance the likelihood of cooperation thereby facilitating the achievement of social and economic goals. For that reason, trust is important for corporate governance. The importance of trust in Kenya's corporate governance is demonstrated in Ken Arrow's statement that:

> 'Virtually every commercial transaction has within itself an element of trust, certainly any transaction conducted over a period of time. ...much of the economic backwardness in the world can be explained by the lack of mutual confidence.'[592]

[585] Almond, G. and Verba, S. (1963), The Civic Culture: Political Attitudes and Democracy in Five Nations, Princeton University Press.
[586] Seligman, A. B. (1997), The Problem of Trust, Princeton University Press.
[587] Handy, C. (2001), 'Tocqueville Revisited: The Meaning of American Prosperity', Harvard Business Review, January,60
[588] Raiser, M., Rousso, A. And Steves, F. (2003), Trust in Transition: Cross-country and Firm Evidence, European Bank for Reconstruction and Development, Working Paper No. 82.
[589] Luhmann, N. (1979), Trust: A Mechanism for the Reduction of Social Complexity, in Trust and Power: Two Works by Niklas Luhmann, p.8.
[590] Luhmann, N. (1979),p.20
[591] Luhmann, N. (1979),p.25
[592] Arrow, K. J. (1972), 'Gift and Exchanges', in Philosophy and Public Affairs, 1,4, p.357

Arrow's sentiments are echoed in Fukuyama's work which argues that trust plays a critical role, not just in personal relationships for example those between families, but also impersonal ones such as trade and commercial transactions.[593]This suggests that for Kenya to develop economically and attain similar results to those England has had with the Anglo-American model of corporate governance, it must aim at raising its levels of trust.

This is particularly important as Kenya is in a period of transition and the corporation is still a new concept in the Kenya. The nearest form to the corporation in the Kenyan context is the traditional self-help group/co-operative that was run in accordance to the kinship norm. Loyalty in the co-operative was to the community. Under the new company concept, loyalty is to an abstract other – the company. Additionally, the membership of the traditional self-help group was small – everyone knew the other as they were often members of the same clan. Therefore reputational sanctions were effective in ensuring accountability in these groups. However, as directors and shareholders in the classic Berle-Means corporation are less likely to be family members/clansmen such co-operation requires trust as the traditional forms of ensuring cooperation such as reputational sanctions based on kinship will not be as effective once the firm goes public as demonstrated in the application of the traditional self-help group/co-operative concept to Harambee in Chapter 3. La Porta et al point out that trust is more essential for ensuring cooperation between strangers, or people who encounter each other infrequently, than for supporting cooperation among people who interact frequently and repeatedly such as families as reputations and ample opportunities for future punishment would support cooperation in families even with low levels of trust.[594]

Most of Kenya's directors have grown up under the kinship norm – where loyalty is primarily to the community- and are now expected to pledge their loyalty to the company. A former director of a state corporation in Kenya described this conflict as follows:

[593] Fukuyama, F. (1995), p.7
[594] La Porta, R., Lopez-de-Silanes, F., Shleifer, A. and Vishny, R. (1997), Trust in Large Organisations, The American Economic Association, p.311.

> 'Africa is in a state of confusion. Two cultures are in conflict. We want to be part of the modern world through urbanisation and at the same time to be associated with our roots. **One's thinking is influenced by both. ...there is a conflict within the individual.** We are in a state of transition going until the corporations and how they are run. ' [595]

Kenyan directors are therefore to use Curtis description, *'participating in social and economic structures which do not conform to models of capitalism alone.'*[596] Trust is therefore needed as a mediator between the kinship and the contract norm. The role of trust as a mediating norm is noted in the work of Hart, an anthropologist, on the Frafas of Ghana where the Frafas were caught between two types of system: the traditional form of social organisation predicated on ties of kinship and a more modern one based on the workings of the market and the contract norm. The Frafas in this study were literally coerced into finding a third mode of establishing social relations – trust.[597] According to Hart, *'trust is located in the no man's land between status and contract, the poles of primitive and modern society in evolutionary theory...'*[598] Trust emerged among the Frafas in a situation marked by the disintegration of social systems and is therefore necessary in periods of transition. This inference is supported by Seligman who points out that the breakup of local, territorial and crucially primordial ties (attachment to kith and kin) in Western Europe led to the establishment of new forms of generalised trust, that is, trust among strangers who share no ties of affinity, kinship, or even shared belief.[599]According to Seligman, generalised trust plays a key role in the construction of modern social and political orders.[600] Fukuyama argues that high trust among citizens accounts for the superior performance of all institutions in a society, including firms. According to Fukuyama, for firms in particular, trust replaces another mechanism of cooperation – the family. He believes that strong family ties are bad for the development of large firms.[601]For Kenya to harness the benefits of the Anglo-American model Kenya will have to make a transition from ethnic-based trust to generalised trust. Generalised trust will overcome ethnicity and increase investment in public goods such as strong minority shareholder protection. This will in turn increase confidence in the company

[595] Informal interview with Joseph Mutemi, former director of Kenya Roads Board 2007-2008, Interviewed in June 2011 in Nairobi, Kenya.
[596] Curtis, J. W. (1995),p.4
[597] Hart, Keith (2000), 'Kinship, Contract, and Trust: The Economic Organization of Migrants in an African City Slum', in Gambetta, Diego (ed.), Trust: Making and Breaking Cooperative Relations, electronic edition, Department of Sociology, University of Oxford, Chapter 6, pp.176-193.
[598] Hart, Keith (2000), p.188 (citing Maine, H. S. 1861, Ancient Law, London, Murray.)
[599] Seligman, A. B. (1997), The Problem of Trust, Princeton University Press, p.15.
[600] Seligman, A. B. (1997),p.16
[601] Fukuyama, F. (1995).

concept, encourage investment in the NSE and improve corporate governance in Kenya's Plcs.

To create trust in corporations, common law recognises the relationship between shareholders and management as being fiduciary and as such requires directors as trustees to act in the interests of the company: all shareholders.[602] However, although the common law has made trust-related behaviours mandatory, it is limited in its ability to ensure trust-worthy behaviour as the costs of enforcement are too great to police every interaction and too much regulation would create untrustworthiness.[603] This is the case particularly where there is information asymmetry and consequently ample opportunities for management or majority shareholders to abuse trust. Usually, management in Plcs has a lot of information on the company as they are actively involved in its operations. Shareholders, on the other hand, have almost no information and are totally reliant on the information management chooses to disclose to them in annual reports, at the general meeting and through mandatory disclosure. As shareholders, particularly, minority shareholders do not have the resources to determine whether directors in Plcs are acting in the interest of the company as whole and whether directors are giving a true picture of the company's position in its financial statements trust acts as a mediator between the kinship and the contract norm allowing minority shareholders to trust directors. As such, it has been argued that trust is more important than loyalty as Plcs are only possible where trust exists[604] and an environment of high trust is necessary for management to perform their obligations beyond the call of duty: that is beyond fiduciary duties and contract.[605] Therefore, even in the process of trust-generating institutions such as the law, trust remains a necessary ingredient in social and economic cooperation.[606]This inference is supported in Stout's work which argues that U.S. corporate insiders often behave like fiduciaries not because of external constraints, such as law and contract, but because of internal ones,[607]such as trust. Creating and maintaining trust in a corporation is therefore important as trust could reduce inefficiency and the need to spend resources on constant monitoring of management. As Lewis puts it,

[602] Re Smith & Fawcett Ltd [1942] Ch 304,at 306
[603] Ide III, R. W. and Yarn, H. D. (2003), 'Public Independent Fact-Finding: A Trust-Generating Institution for an Age of Corporate Illegitimacy and Public Mistrust', Vanderbilt Law Review, 56, pp.1121
[604] Mitchell, L. E. (1993), 'Fairness and Trust in Corporate Law', Duke Law Journal, 43(3),pp.425-491
[605] O'Brien, R. C. (2001),p.42
[606] Ide III, R. W. and Yarn, H. D. (2003), p.1121.
[607] Stout, L. A. (2002), On the Export of U.S.-Style Corporate Fiduciary Duties to Other Cultures: Can a Transplant Take?, University of California, Los Angeles, School of Law Research Paper Series, Research Paper No. 02-11, p.10.

> '... trust is the glue that holds organizations together. More powerful than contracts or authority, trust enables... companies... to achieve results that exceed the sum of the parts.'[608]

This is not to suggest that law and contract are unimportant in solving Kenya's corporate governance problem – law creates trust through the existence of fiduciary duties- rather, it is to say that law is limited.[609] First, no matter how carefully laws and contracts are drafted, it is impossible to predict all outcomes and therefore draft laws that cover all possible contingencies.[610] Secondly, the enforcement of laws and contracts when directors are in breach is often too expensive for the minority shareholder. Thirdly, as instruments of creating trust, excessive use of law and contract harm the development of trust.[611]Trust must therefore be internally generated.[612]

That said, trust as a solution to Kenya's corporate governance problem is not without its limits. According to Putman trust is a habit formed during a centuries-long history of 'horizontal networks of association' between people, covering both commercial and civic activities.[613] Therefore, not only does trust take time to create but it is more easily created in horizontal relationships than in vertical relationships. Secondly, trust will be difficult to create where there is insufficient information. Although O'Brien states that trust is a confidence based on a consistency of feeling rather than a continuous assessment of evidence,[614] it is difficult to see how trust can be created based on feeling alone in the Kenyan context where there is overwhelming evidence of mismanagement of corporations. Therefore, due to separation of ownership and control resulting in information asymmetry, shareholders will occasionally find it difficult to trust management. While trust alone may increase participation in the NSE, it will not be enough to maintain it. A strong legal framework is necessary.[615] The third difficulty with trust is that it is a personal thing, initially formed in the family environment and reflected, fostered or discouraged in the institutions in which we participate later in life

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[608] Lewis, J. D. (1999), Trusted Partners: How Companies Build Mutual Trust and Win Together, Free Press, Front Flap. See description of product on www.amazon.co.uk

[609] On the limitations of law in reducing agency costs, See Roe, M. J. (2005), Corporate Governance: Political and Legal Perspectives, Edward Elgar Publishing Ltd., p.282.

[610] Leigh points out that as complete contracts are often infeasible, high trust societies can potentially overcome a costly market failure. See, Leigh, A. (2006), 'Trust, Inequality and Ethnic Heterogeneity', The Economic Record, Vol. 82, No.258, p.268.

[611] Ide III, R. W. and Yarn, H. D. (2003), p.1121; Malhotra, D. and Murnighan, J. K. (2002), 'The Effects of Formal and Informal Contracts on Interpersonal Trust', Administrative Science Quarterly, 47, pp.535-559

[612] See generally, Stout, L. A. (2002), p.10 and Ide III, R. W. and Yarn, H. D. (2003), p.1121.

[613] Putnam, R. (1993), Making Democracy Work: Civic Traditions in Modern Italy, Princeton University Press.

[614] O'Brien, R. C. (2001),p.21

[615] Mitchell, L. E. (1993), pp.425-491

– be they civic, social, occupational or professional,[616]where it is absent or limited for instance in Kenya due to ethnic diversity, trust will be very difficult to create as it is the outcome of trustworthiness by others over a long time. As trust is very difficult to assess, investing in Plcs in low trust societies such as Kenya remains a high risk undertaking. Even in Anglo-American countries considered to be 'high trust' and which have highly developed institutions such as markets, law and contract, corporate governance scandals continue to happen demonstrating that even when trust is created, maintenance remains a challenge. Its maintenance ultimately remains a matter of moral suasion that no one apart from the individual concerned can control.[617]Trust however, where it can be formed can reduce the agency problem in corporations.

The comparative study that follows will consider how to create trust in Kenya's Plcs. The author will rely on the influential work of Hofstede, a Dutch expert who defines culture as, 'the collective programming of the mind which distinguishes the members of one group or society to another.'[618] According to Hofstede, cultural differences can be defined in the following five dimensions: Individualism/collectivism, power distance, uncertainty avoidance, masculinity/femininity and long-term time orientation.[619] Compared to other competing cultural frameworks such as those of Schwartz and Trompenaars,[620]the advantage of Hofstede's model is its inclusion of the uncertainty avoidance dimension which does not have a direct equivalent in other frameworks.[621] The dimension of uncertainty avoidance is important for the purposes of this thesis as notions such as risk and uncertainty are central to finance theory, and consequently, to corporate governance analysis. Hofstede's uncertainty avoidance dimension purports to

[616] O'Brien, R. C. (2001),pp.5-6

[617] Ide III, R. W. and Yarn, H. D. (2003), p.1121; Stout, L. A. (2002), p.10.

[618] Hofstede, G. (1984), 'Cultural Dimensions in Management and Planning,' Asia Pacific Journal of Management, January, p.82. Critics of Hofstede's model argue that his data was generated mainly from one industry and in particular one company and cannot therefore be used to analyse the culture of nations. See Young, A. (2008), 'Rethinking the Fundamentals of Corporate Governance: the Relevance of Culture in the Global Age', Company Lawyer, p.173. A particular critique of Hofstede's model as it relates to this study is that it is limited in what it says about Kenya specifically as Hofstede's findings on Africa were published as Kenya's Hofstede considers the culture of East Africa (Kenya, Ethiopia, Tanzania and Zambia). Therefore an exclusive picture of Kenya's cultural classification is not depicted. In spite of these critiques, Hofstede's work remains influential and although Hofstede's criteria has been criticised for its simplicity, it has been cited extensively in literature for the same reason. See Kuada, J. E. (1994), Managerial Behaviour in Ghana and Kenya – A Cultural Perspective, Aalborg University Press, Denmark, p.10.

[619] Hofstede et al (2005), p.29.

[620] See generally, Schwartz, S. H. and Bilsky, W. (1990), Toward a theory of the universal content and structure of values: Extensions and cross cultural replications, Journal of Personality and Social Psychology, 58, 878-891; Trompenaars, F., and Wooliams, P. (2003), Business Across Cultures, Capstone Publishing Limited

[621] See generally, Licht, A. N. (2001), 'The Mother of All Path Dependencies: Toward a Cross-Cultural Theory of Corporate Governance Systems', Delaware Journal of Corporate Law, p.191.

capture these notions directly whereas other models do not.[622]Additionally, there are significant interrelationships between Hofstede's uncertainty avoidance dimension and the concept of trust. High trust is positively correlated with uncertainty acceptance. Understanding the inter-relationships between Hofstede's cultural dimensions and trust will enable the author to make suggestions for reform that can increase trust in Kenya's corporate governance, thereby overcoming the negative effects associated with ethnic heterogeneity.

[622] See generally, Licht, A. N. (2001), p.191.

Table 20: The Hofstede Cultural Value Dimensions

Individualism/Collectivism: Valuing loosely knit social relations in which individuals are expected to care only for themselves and their immediate families versus tightly knit relations in which they can expect their wider in-group (e.g. extended family, clan) to look after them in exchange for unquestioning loyalty.
Power Distance: Accepting an unequal distribution of power in institutions as legitimate or illegitimate.
Uncertainty Avoidance: Feeling uncomfortable or comfortable with uncertainty and ambiguity and therefore, valuing or devaluing beliefs and institutions that provide certainty and conformity.
Masculinity/Femininity: Valuing achievement, heroism, assertiveness, and material success versus relationships, modesty, caring for the weak, and interpersonal harmony.
Long-term Time Orientation: A willingness to delay rewards or returns.

4.2 How to create trust in the Kenyan context

According to Zucker, trust can be created through a sense of shared commonality resulting from, amongst other things similar values, with the other party or possessing a characteristic perceived to be desirable.[623]Cazier et al point out that it is important that the values of an organisation are based on the perception of the potential customer.[624] Therefore if Kenya's Anglo-Saxon framework is to take, it has to contain Kenyan values or values that are deemed desirable by the Kenyan people. The first challenge facing Cazier et al's suggestion of value congruence as a way of creating trust within the Kenyan society is that there is no agreement on what passes for Kenyan culture. Each of the over 40 tribes has its own customs and culture.[625] However, although there are many differences in the customs and cultures of Kenya's ethnic groups, there are also many commonalities.[626] Barsby points out that for many Kenyans tribal ethnicity is the single most important part of their personal identity.[627]However, tribalism is negatively correlated to Kenya's economic development.[628]Therefore tribalism is a value that Kenyans need to do away with as it limits the scope for creation of generalised trust and therefore economic development. The author explores the creation of generalised trust through ubuntu[629] (African Philosophy).[630]

4.2.1 Creating trust through 'Ubuntu'

Trust can be created through the recognition of 'ubuntu' as a national value. An ubuntu ethic is credited for helping to ground a restorative, rather than punitive, response to

[623] Zucker, L. G. (1986), pp.53-111. See also Fukuyama, F. (1995), p.26; Leigh, A. (2006), p.269
[624] Cazier, J. A., Shao, B. B. M., St. Louis, R. D. (2006),p.21.
[625] See Gustavson, R., Kimani, N. N., Ouma, D. A. (2006), 'Perceptions of the Anglo-American Model of Corporate Governance in Sub-Saharan Africa: A Pilot Study', presented at the Workshop on Corporate Governance, Regulation and Development, University of Manchester, 17th November 2006.
[626] Amongst these are tribal identity, respect for elders, a 'we' mentality, 'relationships come before schedules', indirect communication and saving face. See, Musyoki, M. (2006), Kenya Culture, presented at St. Paul's on-the-Hill Mission Kenya 2007 on 11th July 2006.
[627] Barsby, J. (2007), Culture Smart! Kenya: the essential guide to customs & culture, Kuperard Publishers, p.38.
[628] Miguel, E. (2004), 'Tribe or Nation?: Nation Building and Public Goods in Kenya versus Tanzania', World Politics, 56(3), pp.327-362.
[629] Translated to 'utu' in Kiswahili. See Lutz, D. W. (2009), 'African Ubuntu Philosophy and Global Management', Journal of Business Ethics, 84, p.315
[630] Other African approaches particularly the Nyerere philosophy which eliminated tribalism in Tanzania were considered but dismissed because of their links to authoritarianism and socialism which Kenya is moving away from. See Miguel, E. (2004).

apartheid-era political crimes in the form of the TRC[631] therefore creating generalised trust in South Africa. Ubuntu to put it simply is the 'African way'; it is the collective consciousness of the African people.[632]According to Tutu, 'Ubuntu... speaks of the very essence of being human.' Under Ubuntu, 'I am human because I belong. I participate, I share.'[633] In ubuntu 'a person is a person through other persons'[634] or 'I am because you are'.[635] The essence of ubuntu is that people only exist 'in relation to' others and 'in relationship with' others: co-existence, consultation and consensus are the key values of ubuntu.[636] Ubuntu is an acknowledgement that one's very existence is tied up to the wider community[637]and thus distinguished from Eurocentric concepts in that it elevates the community above 'self.'[638]The construction of a national value - the protestant ethic[639]- is evident in the creation of an ethnically homogenous society in England resulting in capitalism.

The potential of the concept of ubuntu as a basis for creating generalised trust in Kenya is great not only because it is an African ideal, but also because it is one that has been applied to corporate governance in an African context: South Africa.[640] Secondly, ubuntu as a form of trust is an African ideology that has remained ingrained in the African people despite the introduction of capitalism and market-based ideals based on western individualism. Therefore ubuntu does not have to be created; it only needs to be applied to a wider scope – beyond the tribe- in the Kenyan context. A particular weakness of ubuntu is that it is not a rational philosophy.[641]Whilst England's protestant ethic is oriented toward the rational organisation of labour and capital[642] with respect being based on one's work ethic, respect under ubuntu is based merely on a person being a person– not on his work. Irrational persons such as negligent directors thus fit within ubuntu and cannot be sanctioned. Inclusiveness matters under ubuntu therefore a

[631] Metz, T. (2007), 'Toward an African Moral Theory', The Journal of Political Philosophy, 15(3), p.325
[632] Khoza, R. (1994), 'Ubuntu as African Humanism', cited in Prinsloo, E. D. (1998), 'Ubuntu Culture and Participatory Management' in Coetzee, P. H. and Roux, A. P. J. (1998), The African Philosophy Reader, Routledge, London, p.41)
[633] Tutu D. M. (1999),pp.34-35
[634] Makhudu, N. (1993), 'Cultivating a Climate of Co-operation through Ubuntu', Enterprise, 68, pp.40-41
[635] Prinsloo, E. D. (1998),p.43
[636] Rossouw, G. J. (2005), 'Business Ethics and Corporate Governance in Africa', Business & Society, 44(1),p.94.
[637] Mbigi, L. (2005), The Spirit of African Leadership, Knowres Publishing, Randburg, p.69
[638] Tomaselli, K. G. (2009), '(Afri)Ethics, Communitarianism and Libertarianism', International Communication Gazette, November 2009, 71, p.584
[639] Colley, L. (1992), Britons: Forging the Nation, 1707-1837, Yale University Press.
[640] See South Africa's King III 2009
[641] Rationality here is taken to mean, based on reason/logic.
[642]Weber, M. (1920), The Protestant Ethic and the Spirit of Capitalism', 3rd ed., translated by Kalsberg, S, Boston University, xxii

director who takes a decision that is detrimental to the company is likely to be viewed as having done his best. This problem originates from the fact that in the traditional African setting, the patriarch of the home owed a duty of care to the family whilst the family owned him a duty of loyalty regardless of how he performed. He was not required to give any rational accounts of why he performed or did not perform. He was trusted to perform and if he did not, it was generally accepted that the matter was beyond his control as he would definitely have acted in the family's interest. The problem with this thinking is that when it is transferred to corporate governance, it creates room for expropriation of minority shareholders by majority shareholders or of shareholders in general by miscreant directors. The objectivity that underlies the protestant ethic, and thus English culture, is one that Kenya would do well to adopt to create trust on grounds of desirability rather than similarity in values.

4.2.2 The application of ubuntu to corporate law and corporate governance

Of particular interest is how far we should go in Africanising Kenya's corporate framework.[643] Should the culture of ubuntu infuse the legal duties of directors or should it be restricted to the code of corporate governance. In a recent South African case – *South African Broadcasting Corporation Ltd (SABC) v. Mpofu,*[644] *Jajbhay J.* in giving his reasons for supporting the judgment of Victor J. stated that in addition to all their other duties: 'All directors serving on state-owned enterprises must take cognisance of [the value system of ubuntu] in the determination of their duties as directors.'[645] However, a South African law firm *'Brink Cohen Le Roux'* (Brink) has raised concerns about the compatibility of ubuntu and common law stating that:

> '…the proposition [incorporation of ubuntu] must be kept within strict bounds, for other interpretations and extensions of the proposition [beyond how directors should relate to one another on the board for instance with courtesy] in the context of directors' duties would, in fact be extremely damaging to the core legal principles of company law.'[646]

It is easy to see why the incorporation of ubuntu is perceived as being damaging to common law as its application would require a complete overhaul of the corporate concept (from separate legal identity to community) and the company objective (from

[643] See for example, McDonald, D. A. (2010), 'Ubuntu Bashing: the Marketisation of African Values in South Africa', Review of African Political Economy, 37(4), pp.139-152.
[644] [2009] ZAGPJHC 25. South-African case law is referred to only for persuasion purposes.
[645] [2009] ZAGPJHC 25, para63
[646] Brink Cohen Le Roux (2011), 'Should the culture of ubuntu infuse the legal duties of company directors in South Africa?', Step Ahead Newsletter, p.2

shareholder primacy to community interest) would be necessary. This would affect all the rules resulting from the view of the company as a separate legal personality with shareholder primacy as its objective such as the requirement that directors 'act in the interests of the company.'[647] For instance, the ruling in SABC v. Mpofu puts the 'fiduciary duty the directors owe to each other' above the duties the directors owe to the company.[648]Brink support this proposition to the extent that ubuntu requires that directors treat each other with courtesy but state that directors' relationship with one another should be at the professional level and it is undesirable that directors should form bonds of close personal friendship with one another. Brink adds that it is wholly undesirable and indeed improper for directors to form bonds of personal loyalty to one another that may conflict with or transcend their duty to the company or its shareholders. Thus directors should not be constrained from speaking their mind fearlessly and independently at board meetings on any matters that affect the interests of the company and its shareholders in the name of ubuntu – 'no matter how many feathers they ruffle or how many feelings they hurt.'[649]

From a common-law lawyer's view-point, one can sympathise with Brink's position on preserving the common law regardless of feelings. However, from an African viewpoint, preserving the common law has not enabled nearly all African nations that adopted it, including Kenya, to achieve good corporate governance or economic development. Instead, it has resulted in a corporate framework that is largely ignored with related-party transactions and non-independence being rife. Arguably, keeping a framework that ruffles feathers and hurts feelings is not going to create trust between the people who are subject to it and 'the system.'[650] The consequence will be that it will continue being ignored. It is a fact that for most Africans, 'an organisation symbolises ubuntu hence they do not see the legal artifact but focus on the human beings who preside over the organisational activities and should exude ubuntu.'[651]For the common law to work effectively in an African context either Africans would have to learn how to think individualistically prioritising their 'self-interest' and at an abstract level based on rationality, or the common law would have to be adapted to the African social context.

[647] Re Smith & Fawcett Ltd [1942] Ch 304,at 306
[648] [2009] ZAGPJHC 25, para9
[649] Brink Cohen Le Roux (2011),p.2
[650]Hohmann, H. H. and Welter, F.(2005), Trust and Entrepreneurship: A West – East Perspective, Edward Elgar,Ch.7
[651] Ndiweni, E. (2008), 'Towards a Theoretical Framework of Corporate Governance: Perspectives from Southern Africa', Corporate Governance in Less Developed and Emerging Economies: Research in Accounting in Emerging Economies, Vol.8, p.349

The former proposition is not inconceivable, but one which has shown itself to have little power to dilute the inner core of the African – ubuntu. Arguably, the directors, shareholders, auditors and lawyers of today's African Plcs are educated on western norms and most know that a company is a separate legal entity – that knowledge however has not resulted in relating to the company at an abstract/independent level and the keeping of 'relationships' out of the company. Africans are simply unable to do that as their inner core – ubuntu- is about co-existence, consultation and consensus. Therefore a compromise has to be reached to achieve value congruence.

That Kenya is part of a globalised world means that having a framework that is predominantly based on ubuntu limits Kenya's prospects for FDI to the African market. At present the largest investors in the NSE are Anglo-American. Therefore, having a framework that they can understand and have confidence in is important in retaining and attracting foreign investment.[652] Secondly, Kenya's lawyers are common-law trained. Overhauling the entire common law framework is going to be too costly for Kenya as contracting is based on it. As the aim is to review Kenya's framework to make it more suitable for the Kenyan context and thereby provide higher minority shareholder protection (MSP) and increase accountability of directors, the author will adapt the entire framework – the companies legislation and corporate governance code to reflect the values underlying England's protestant ethic – that is objectivity and a respect for work- so as to maintain the integrity of the common law. As Kenya is institutionally underdeveloped and therefore cannot keep track of its own legal precedent, English common law provides the certainty that is needed for what the law is in an international capital market such as the NSE. The author will however highlight parts of companies' legislation that are compatible with ubuntu. Before adopting ubuntu at the legislation level, it is wise to first see how it performs at the corporate governance code level. If it is adopted successfully at this level, that will provide ground for adapting Kenya's companies legislation entirely along the lines of ubuntu.

4.2.3 Ubuntu in relation to existing corporate governance theories

Prior to applying ubuntu to the corporative section of this chapter, it is important to outline the two dominant theories in corporate governance- shareholder primacy and the

[652] West, A. (2006), 'Theorising Sounth Africa's Corporate Governance', Journal of Business Ethics, 68, pp.433-448.

stakeholder theory- as well as the managerial hegemony theory[653]and state where ubuntu lies in relation to them. The differences between the shareholder and stakeholder theory reflects their different perceptions of the corporation. Under shareholder primacy the corporation is seen as nexus of contracts and therefore existing for the benefit of its members (shareholders).[654] The result of this view is that the directors of the corporation are only expected to be accountable to shareholders who are regarded as the owners of the corporation.[655] Underlying the theory of shareholder primacy is the right to private ownership[656]and a view of people as being pursuers of their own 'self' interest. Theories such as the principal-agent theory which perceive the agency problem as existing between shareholders and management follow from the individualist shareholder view of the corporation.[657]Reforms following from the shareholder-view of the corporation aim at aligning the interests of shareholders as the principal and directors as the agent with market forces being seen as the protector of shareholder interests.[658]As such, the agency problem within the shareholder view of the corporation is seen as best addressed by removing restrictions on factor markets and the market for corporate control as well as strengthening the incentive system by introducing a voluntary code of corporate governance and appointing NEDs.[659]

In contrast, the stakeholder theory sees the corporation as a social entity that is accountable to stakeholders; stakeholders being all those who can affect or are affected by the activities of the firm.[660]The stakeholder theory takes the view that in addition to shareholders, other groups have claims on the property as they contribute to its capital.[661]Cragg argues that companies are deemed to owe their existence to a partnership between shareholders and the community that is based on an understanding that companies have a categorical obligation to treat shareholders ethically while

[653] Letza, S., Sun, X. and Kirkbride, J. (2004), 'Shareholding versus Stakeholding: A Critical Review of Corporate Governance', Corporate Governance an International Review, 12(3),pp.242-262.
[654] See Coase, R. (1937), 'The Nature of the Firm', Economica, New Series, IV,p.386; Alchian, A. and Demsetz, H. (1972), 'Production, Information Costs, and the Economic Organisation' American Economic Review,62,p.777
[655] Friedman, M. (1970), 'The Social Responsibility of Business Is to Increase Its Profits', The New York Times Magazine, September 13, p.33.
[656] Kiarie, S. (2006), 'At Crossroads: shareholder value, stakeholder value and enlightened shareholder value: Which road should the United Kingdom take?' International Company and Commercial Law Review,p.332
[657] See generally, Jensen, M. C. and Meckling, W. H. (1976), 'Theory of the Firm, Managerial Behaviour, Agency Costs and Ownership Structure', Journal of Financial Economics, 305-360.
[658] See generally, Fischel, D. (1982), 'The Corporate Governance Movement', Vanderbilt Law Review, 35 (6), pp.1259–1292.
[659] Letza, S., Sun, X. and Kirkbride, J. (2004),p.244
[660] Freeman, R. E. (1984), Strategic Management: A Stakeholder Approach, Pitman, Boston, MA, p.46.
[661] Karmel, R. (1993), 'Implications of the Stakeholder Model', George Washington Law Review,61,p.1171

creating shareholder wealth.[662]According to Hutton, stakeholders do not have contractual protection or the protection afforded by fiduciary duties and therefore their interests deserve consideration by directors.[663]For Donaldson and Preston, each group of stakeholders merits consideration 'for its own sake and not merely because of its ability to further the interests of... shareowners.'[664] Freeman argues that stakeholders should be regarded as an end, not a means to an end.[665]

Another theory on the corporation is Galbraith's managerial hegemony theory which perceives the corporation as a legal fiction and questions the assumption that shareholders are the ultimate controllers of the corporation arguing that management are in fact in control of the board; shareholders and directors are powerless. For that reason, the board as a mechanism is ineffective in alleviating conflicts between management and shareholders.[666] The board as opposed to being a protector of the shareholder's interest becomes a passive and compliant 'rubber stamp' for management proposals and decisions[667]as management has the power to appoint directors and only choose compliant directors. The passivity of the board is further attributed to their relative lack of knowledge on company affairs[668] and their dependence on information and insights provided by management[669] directors' remuneration that is not tied to performance, the association of board positions with prestige and status, and the reciprocation of favours between management and members of the board.[670]As such directors are expected to restrain from overt criticism of management as they owe them their seat on the board. Although Galbraith's managerial hegemony theory has not been as popular as the shareholder/stakeholder theory from the 1990s til present, it remains quite relevant in discussing the efficiency of a lot of the corporate governance mechanisms that are contained in Anglo-Saxon corporate governance codes as the board is seen as representing the shareholder's interests under the agency theory. The distinction between the two dominant theories and Galbraith's theory is that the

[662] Cragg, W. (2002), 'Business Ethics and Stakeholder Theory', Business Ethics Quarterly, 12(2), pp.113-142.
[663] Hutton, W. (1997), 'An Overview of Stakeholding', in Kelly, G., Kelly, D. and Gamble, A. (eds), Stakeholder Capitalism, McMillan,p.3
[664] Donaldson, T. And Preston, L. (1995), 'The Stakeholder Theory for the Corporation: Concepts, Evidence and Implications,' Academy of Management Review, 20,p.67
[665] Freeman, R. E. (1984),p.97
[666] Galbraith, J. K. (1984), 'Galbraith and the theory of the Corporation', Journal of Post Keynesian Economics, 7(1),p.44
[667] Herman, E.S. (1981), Corporate Control, Corporate Power, Cambridge University Press.
[668] Estes, R. M. (1980), 'Corporate Governance in the Courts', Harvard Business Review, 58,pp.50-58.
[669] Wolfson, N. (1984), The Modern Corporation: Free Market versus Regulation, New York, McGraw-Hill.
[670] Vance, S. C. (1983), Corporate Leadership: Boards, Directors and Strategy, New York, McGraw-Hill.

shareholder and stakeholder theory see the corporation as an entity existing within a state whereas Galbraith see the corporation as having become more powerful than the state. A similarity is that all these theories – shareholder, stakeholder and managerial- analyse the actors within the corporation from a view-point of being 'self-interested'.

Corporate governance viewed from the context of ubuntu – 'a person is a person through other persons' – implies that corporations exist because of people and their communities. Without people, there would be no corporation.[671] By extension, the Plc is a person through other persons, particularly minority shareholders. This suggests that Plcs should have a basic respect and compassion for other persons[672] such as minority shareholders without whom they would not exist. Under ubuntu, people are inter-dependent and co-responsible for each other[673] and therefore a director should act in the interests of all shareholders – majority and minority shareholders. Majority shareholders under an ubuntu ethic should not act in ways that marginalise the interests of minority shareholders to whom the Plc owes its existence as an over-arching aim among African communities is that of achieving social harmony.[674] This treatment of corporate governance requires the recognition of the firm as a member of the community. As such the firm's objective is to benefit the community, as well as the larger communities of which it is a part.[675]The key principle under communitarianism[676] is that the interests of the individual are subordinate to those of the group. The Bantu people – from whom ubuntu is derived- believe that by ensuring the good of the group, benefits will flow to each individual member.[677]

The main drawback of adopting an ubuntu approach to corporate governance is that, ubuntu is susceptible to the problem of 'group think.' Groupthink is a psychological phenomenon that occurs when the desire for harmony in a decision-making group overrides a realistic appraisal of alternatives – group members try to minimize conflict thereby reaching a consensus without critical evaluation of alternative ideas and viewpoints. Amongst the costs of group think are the loss of unique individual creativity

[671] See generally, Ndiweni, E. (2008), 'Towards a Theoretical Framework of Corporate Governance: Perspectives from Southern Africa', Corporate Governance in Less Developed and Emerging Economies: Research in Accounting in Emerging Economies, Vol.8, p.339.
[672] Ndiweni, E. (2008),p.340
[673] Ndiweni, E. (2008),p.340
[674] Ndiweni, E. (2008),p.341
[675] Lutz, D. W. (2009),p.318
[676] Which loosely denotes the importance of community values, see Ndiweni, E. (2008).
[677] Ndiweni, E. (2008),pp.341-342; Lutz, D. W. (2009),p.314

and independent thinking [678]– these are arguably quite huge costs for corporate governance. Despite this drawback, the incorporation of ubuntu in Kenya's framework is likely to provide African managers with a framework they can relate to and therefore practice. At present, African management educated on Western management concepts cannot practice what they have been taught as it contradicts their culture.[679] The author will mitigate this weakness through the introduction of rationality – one of the values underlying England's protestant ethic into Kenya's corporate governance. Contemporary Chinese business management, for example, is not influenced solely by Confucian tradition: other influences include China's various religions, Marxism and Western Capitalism.[680]Therefore, the potential weaknesses of a framework based on ubuntu noted above can be mitigated by drawing on the philosophies of other countries – this study limits itself to England's protestant ethic.[681]

4.3 Part II: The comparative study and suggestions for reform

This comparative study will begin by identifying the problem that this thesis hopes to address through law review. It will then evaluate the effectiveness of Kenya's corporate framework in creating trust against that of England and make suggestions for reform.

4.3.1 The problem in Kenya's Plcs

The first problem affecting Kenya's companies is fraud. A 2011 economic crimes survey by PWC found that Kenya has the highest incidences of fraud in the world. Theft/misappropriation of assets was found to be the most common type of crime in

[678] Janis, I.L.(1972), Victims of Groupthink A Psychological Study of Foreign-Policy Decisions and Fiascoes, Houghton Mifflin, Boston.
[679] Lutz, D. W. (2009), p.317
[680] Lutz, D. W. (2009),p.321
[681] Although there are many similarities between Confucianism and Ubuntu (See Lutz, D. W. (2009), p.320.) there are many differences between China and Kenya that militate against drawing on China's experience to adapt Kenya's framework. Politically, China is a centralised dictatorial state whilst Kenya is a democracy moving towards decentralisation. Economically, China is communist whilst Kenya is capitalist. China, unlike Kenya, is largely homogenous. Kenyans are also very religious in relation to the Chinese who largely equate religion to the Party. The most significant difference for corporate governance is that China is a civil law country whilst Kenya is a common law country. Therefore Chinese legal solutions are not going to fit well with Kenya's existing institutional framework. For this reason, this chapter concentrates on what it can learn from England – England and Kenya are similar in their economic and political aspirations; the only difference is social. With China, the only similarity with Kenya is in social relations. There are vast differences between China and Kenya's economic and political context.

Kenya's companies.[682]Consequently, Kenyans who have invested in Plcs stand a higher risk of losing their wealth in fraudulent transactions initiated by directors due to the high incidents of theft and misappropriation of assets particularly through self-dealing than their counterparts in other parts of the world.[683] This has become even more evident in recent scandals in which majority shareholders and directors have been sued for making decisions that were not in the interest of all shareholders.[684] Key examples are Uchumi, AccessKenya and the ongoing CMC case.

4.3.1.1 The 2006 Uchumi Scandal

In 2006, Uchumi, a Plc, nearly collapsed due to irrational expansion.[685]In May 2011, Chris Kirubi, a former chairman of Uchumi supermarkets and part of the BoD of Uchumi was charged with breach of public trust[686] - by approving the sale without an independent valuation[687]- and conspiracy to defraud[688] the supermarket chain through the irregular sale of the retail chain's prime property in Nairobi for Kshs.147million to a company associated with its core suppliers -[689] which then leased the building back to Uchumi at a price of 1.7million per month in 2004. However there was no evidence to support the charge and the directors were acquitted. One of the reasons the directors in ***R v. Kirubi***[690] were acquitted was because the court found that in approving the sale of the Aga Khan Walk property, the directors did not breach any internal procedures of Uchumi Supermarkets Ltd. Further, the Public Procurement Act and regulations did not apply to the supermarket chain since it is not a parastatal. Although Uchumi is a Plc and therefore subject to the CMA Guidelines, the prosecution did not produce any evidence to show that the board flouted these guidelines as they do not have the force of the law- thus breach of the same does not attract civil or criminal penalties.[691]

[682]Business Daily, Kenya Ranked Top in World's Fraud Incidences, November 30th 2011. For the actual report, See PWC (2011), A Step Ahead: Economic Crime in Kenya, Global Economic Crime Survey 2011.
[683] Mugwe, D. (2011), Listed Firms Found at High Risk of Theft by Director, August 21st.
[684] Mugwe, D. (2011)
[685] Nyanducha, E. (2008), 'Uchumi Supermarkets Case Study', Strathmore Research and Consultancy Centre, pp.1- 4
[686] Under s.127Penal Code.
[687] Mugwe, D. (2011)
[688] Under s.317 Penal Code
[689] According to the charge sheet in R. v. Kirubi (Unreported)
[690] Unreported
[691]Kilonzo, K. D. (2011), 'Uchumi Case Sheds Light on Corporate Governance Gaps in Public Companies, Business Daily, June 10th.

4.3.1.2 The 2010 AccessKenya scandal

AccessKenya Group, a listed internet service provider in 2010 had its share of boardroom wars that nearly threw its operations off-balance. The board was split down the middle over the manner in which the company planned and procured suppliers for the terrestrial fibre network.[692] Some board members alleged that the procurement of its inland fibre optic cable had been inflated by Kshs.200 million.[693]As the war raged, a special audit by Deloitte was conducted. The results saw three directors resign - Eddy Njoroge, Ngugi Kiuna and Mungai Ngaruiya (all Kikuyus) in protest over lack of transparency in financial matters and weak management. The CMA despite receiving a copy of the special audit putting four directors of the firm on the spot merely sent a warning letter to the company. Since AccessKenya's listing on the NSE in 2008 shareholders have complained that decision-making at AccessKenya has remained in the grips of the Somen family (Kenyan European) - the controlling shareholders - to the exclusion of independent directors, despite the firm going public. The family has since been forced to dilute the Somen's family influence on the Board to reduce friction between shareholders and management.[694]

4.3.1.3 The 2011 CMC Scandal

The scandal at CMC was characterised by corporate infighting which split the board into two factions centred on the hiring of its current managing director (MD), Mr. Lay a replacement of former MD, Mr. Foster. One of the factions was led by Mr. Ndung'u and Mr. Kibe supported the hiring of Mr. Lay whilst the other led Mr. Muthoka and Mr. Githai was against it. The allegiances of the other board members Jeremiah Kiereni, Charles Njonjo, Richard Kemoli and Mr.Shah leaned on either side whenever it came to voting on different issues. Mr. Muthoka's faction is said to have rooted for competitive hiring of Mr. Foster's replacement, a position that the opposing faction blocked. In the end, Mr. Ndung'u's faction had its way and Mr. Lay assumed office. Mr Lay earns Kshs.3million every month, more than double the salary of his predecessor. It is alleged that Mr. Ndung'u head-hunted Lay and although Muthoka, the then chairman, signed his employment contract, he did not know the details of his remuneration package which

[692] Bowry, P. (2011), Taming Corporate Criminal Activities, The Standard, December 6th. (Advocate Opinion)
[693] Juma, V. (2010) Investor Apathy Sparks Corporate Governance Alarm, Business Daily, 20/09/2010.
[694] Mwanza, K., Somen leaves AccessKenya board after 10 years in chair, Business Daily, July 9th 2010.

was written as a separate addendum to the employment contract.[695]Although Mr. Muthoka seemed to be the proverbial 'apostle of good corporate governance' here, he was ousted from the board after allegations of doing business with CMC through a company, Andy Forwarders, at inflated prices.[696]At only 6 months in office, Mr. Lay is already facing questions about his credibility. He has been accused of signing anti-competitive contracts with the government at massive losses to shareholders.

Commenting on the CMC scandal, the CMA Chairman, Mr. Gatabaki stated that, 'As a regulator, we rely on information as told to us by the board. If the board does not tell us some of these issues, we cannot know about them. A market analyst who requested anonymity states that, 'Cooper Motor Corporation is just one example that has come to the fore. There are several others where directors and top managers supply materials to the same company they serve.' This has resulted in a problem of low trust in the NSE.

4.3.1.4 The treatment of minority shareholders in Kenya's courts

Another problem standing in the way of trust and good governance in Kenya's Plcs is the treatment of minority shareholders in law. To-date, there has been no successful prosecution brought by a minority shareholder under s.211 CA 1948. Kenyan courts, following the English ruling in ***Burland v Earle***[697] where it was held that the court will not interfere with the internal running of the company, have remained ambivalent in their approach towards company affairs largely preferring to remain cautiously and purposely aloof rather than getting directly involved in company affairs. This has resulted in rulings that are heavily skewed in favour of majority shareholders.[698] Additionally, Kenyan courts place too much weight on procedure that in the end substantive issues are seldom brought to the fore. Derivative actions are often decided using injunction principles with injunctions being treated as an end rather than a means of giving redress to the aggrieved shareholder.[699]A lack of legal competence in a substantial number of lawyers

[695] Wambugu, B. (2011).
[696] See Chapter 3 of this thesis.
[697] [1902] 71 LJPC 1
[698] Tricor Enterprises v. Mwok-Handa (Civ. Suit 2836 of 1990); Joseph Njuguna v. Githunguri Ranching Company Limited HCCC 1555/2001; R v Kirubi (2011)(Unreported)
[699] Lucy Wanjiru Njunge vs. Akuisi Farmers Co. & 9 others Civ. Suit 158/2005; Samuel Githitu v. Duncan Nyaga Kariuki Civil Appeal No.157 of 1998

handling these cases remains a challenge for minority shareholders.[700]The burden of proof also lies with the minority shareholder in a derivative action.[701] In sum majority shareholders and directors are 'untouchables' in the Kenyan context.

The problems facing corporate governance in Kenya's Plcs can be summarised as low trust hence the prevalence of board factions, misappropriation of assets particularly through related party transactions and weak regulatory institutions. The following section considers how Kenya's framework can be reviewed increase accountability of directors and minority shareholder protection and thus trust.

4.4 A comparative review of Kenya's companies legislation

According to Migliore and DeClouette, trust increases when behaviour is in accordance with the expectation of how a person should behave and decreases when behaviours and outcomes are not in accordance to expectations.[702]Expectations of director behaviour are usually contained in corporate law, particularly within the corporate objective and in directors' duties. A company's corporate objective is critical as it provides guidance for directors in carrying out their functions, enables us to assess director performance and to formulate corporate governance mechanisms.[703]The corporate objective should therefore be compatible with a country's culture for it to gain the trust of the people.[704]

4.4.1 The Corporate objective

Hofstede classifies England as being a weak uncertainty avoidance[705]culture and Kenya as having medium uncertainty avoidance. Amongst the manifestations of medium uncertainty avoidance in organisations is a preference for a clear organisational structure that must be respected at all costs; a preference for clearly laid out rules and regulations that should not be broken.[706]Therefore one would expect directors and shareholders in Kenya to prefer laws that give clear-cut instructions on what the

[700] Sultan Hasham Lalji v. Ahmed Lalji HCCC 189/1998; Lucy Wanjiru Njunge vs. Akuisi Farmers Co. & 9 others Civ. Suit 158/2005; Joseph Njuguna v. Githunguri Ranching Company Limited HCCC 1555/2001; Mohamed Eltaff v. Dream Camp Kenya ltd Civil Suit No.450 of 1999;
[701] Re Ngenda Location Ranching Company Ltd (Winding up Cause 2/2004) at 4
[702] Migliore, L. and DeClouette (2011), 'Perceptions of Trust in the Boardroom: A Conceptual Model', Journal of Leadership and Organisational Studies, 18 (3), p.321
[703]Keay, A. (2008), p.665.
[704] Zucker, L. G. (1986), 'Production of Trust: Institutional Sources of Economic Structure 1840-1920', Research in Organization Behavior, 8, pp.53-111
[705] Hofstede et al (2005), p.169.
[706] Blunt, P., and Jones, M.L.(1992), Managing Organisations in Africa, Walter de Gruyter,p.191

director's role is and what passes for acceptable director conduct whilst English laws might allow for some flexibility.

England's corporate objective has recently been codified allowing for it to be contained in one source, that is, s.172 CA 2006.[707]S.172, a reformulation of the common law duty in *Re Smith & Fawcett Ltd* to act bona fide in the interests of the company,[708]provides that a director 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 so doing have regard to stakeholder interests.[709]Success is to be measured in terms of long-term shareholder value.[710] However, despite codification there is still evidence of England's culture of weak uncertainty avoidance. Although the CA 2006 replaces the common law duties, regard must be had to the common law rules in interpreting the duties of directors under the CA 2006.[711]Directors will still have to refer to common law or at least seek legal advice to know their duties. The requirement to rely on common law rules maintains the preference for flexibility that is characteristic of weak uncertainty avoidance cultures and is perhaps best expressed in Arden J's ruling in *Item Software (UK) Ltd v Fassihi* where Arden LJ stated:

> '... the fundamental duty to which the director is subject, that is the duty to act in what he in good faith considers to be the best interests of his company... The duty is expressed in these very general terms, but that is one of its strengths: **it focuses on principle not on the particular words** which judges or the legislature have used in any particular case or context. It is **dynamic** and capable of application in cases where it has not previously been applied but **the principle or rationale** of the rule applies. It reflects the **flexible** quality of the doctrines of equity.[712]

While s.172 might seem to be radical in that it extends the category of persons that directors should take into account beyond shareholders to include stakeholders given England's individualistic culture, the duty is enforceable in the same way as other duties and ultimately only enforceable by the company.[713] Accordingly, the duty imposed by

[707] Keay states that s.172 for the first time in UK company law states what the objective of directors in the performance of their duties is. See generally, Keay, A. (2007), 'S.172 (1) of the CA 2006: An Interpretation and Assessment', Company Lawyer, 28 (4),pp.106-110.
[708] [1942] Ch 304,at 306
[709] S.172(1) CA 2006
[710] S.172(1)(a) CA 2006 originating from The White Paper, Company Law Reform (Cm 6456, 2005)
[711] Robinson, S. (2007), 'United Kingdom', Getting the Deal Through – Corporate Governance, p.216.
[712] [2005] ICR 450 at 41
[713] S.172 has been criticised as a 'mere-rebranding of shareholder value.' See Kiarie, S. (2006), 'At Crossroads: shareholder value, stakeholder value and enlightened shareholder value: Which road should the United Kingdom take?' International Company and Commercial Law Review,p.332. There have been calls for review, See Cerioni,L.(2008), 'The Success of the Company in s.172.(1) of the UK Companies Act 2006: Towards an Enlightened Directors' Primacy?' The Original Law Review,4(1),pp.8-38. Most concerns have

s.172 is owed to the company – not to stakeholders. In so doing, England's corporate law has conserved and reflected England's individualistic viewpoint.[714]

In Kenya, on the other hand, the objective of directors in running the company is found in two sources: case law and the objects clause in the CA 1948. This is likely to create difficulties for Kenya's directors and investors as Kenya has a medium uncertainty avoidance culture which prefers clarity of rules and direction.[715] Case law, through the ruling in *Hutton v West Cork Rly,*[716] points to the fact that Kenya's legal and corporate governance framework embraces the shareholder paradigm which is an individualistic ideology whose sole objective is the maximisation of shareholder value. The Hutton case concerned a company that was in the process of being wound up when a general meeting endorsed a proposal of the directors to compensate corporate officers for loss of employment as a gratuity. It was held that the payments would be *ultra vires* the company thereby cementing shareholder primacy. Kenya's framework therefore contradicts its collective culture where 'other' interests are important.

S.5 CA 1948 provides for the *ultra vires* doctrine in company law, namely that a company is formed only to pursue the objects specified in its memorandum of association and if it acts outside those objects the transaction is *ultra vires* and void.[717] Whilst the explicit statement of the objects in which a company can be involved in is likely to reduce uncertainty for both shareholders and directors thereby dealing with Kenya's preference for clear direction and rules as a result of its medium uncertainty avoidance culture, it is questionable whether an explicit statement of objects is in the interests of the company. It is arguable that such restriction in fact jeopardises the interests of shareholders and creditors in today's Plcs. Shareholders and creditors may actually be better off when directors are given the flexibility to act outside the objects of the company where doing so is in the interest of the company. Nowadays, companies have diversified their portfolios and Plcs in particular are not likely to serve the interests of their shareholders by constraining themselves to certain business activities even when such investments are

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regarded the scope of its interpretation and how it is to be interpreted. This is unlikely to be a problem in Kenya's uncertainty avoidance context where courts do little in the way of rationalising corporate legal issues.

[714]However, England's CA seems to acknowledge a hierarchy between stakeholders as s.247 CA 2006 permits a company to make payments to its employees on ceasing to trade or on transfer of its business which was previously ultra vires if the financial gain from this could not be demonstrated. Parke v Daily News Ltd [1962] Ch 927

[715] See generally, Kuada, J.E. (1994), p.129.

[716] Co(1883) 23 ChD 654.

[717] Poole, J. (1991), ' Abolition of the Ultra Vires Doctrine and Agency Problems', Company Lawyer, 12 (3), p.43

no longer profitable. Davies asserts that the value of the company might in fact be enhanced, to the benefit of both shareholders and creditors, by moving into new fields of operation, so that a prohibition on such a step would be too strong a rule.[718]By listing the activities the company can be involved in, Kenya's object clause restricts the activities Kenya's Plcs can engage in, making Kenyan companies less competitive in the global market. In contrast, England's CA makes the objects clause optional for English companies[719] reflecting its uncertainty acceptance culture. Therefore unlike Kenya's directors, the directors of English companies have a more flexible system to work with in meeting the general expectations of shareholders.

4.4.1.1 Suggestion

This thesis recommends that Kenya should learn from England's experience with difficulties resulting from having an objects clause[720] and repeal s.5 CA. This would allow Kenya's companies freedom of operation and clarity which is necessary for success in business and effective functioning of directors irrespective of the culture of the country in question. Repealing s.5 would also be advantageous as the objective of the company would be contained in one source taking on board England's experience; that is, case law. Due to the uncertainty that could result from the objective of the company being case law-based, codification of the ruling in *Hutton v West Cork Rly*[721] by adopting England's s.172 which prioritises shareholder interests whilst allowing for the consideration of stakeholder interests in decision-making would not only make the ruling that states Kenya's corporate objective more accessible to directors and shareholders thereby increasing accountability in Kenya's corporate governance but it would also put this corporate objective in line with ubuntu by allowing for consideration of stakeholder interests in decision-making.

Although the retaining of the shareholder primacy norm through adopting England's s.172 may seem to be a contradiction of ubuntu, it is arguable that the survival of the company is paramount as, if it collapses all stakeholders and therefore the community is harmed. Consequently, if prioritising shareholder interests is in the long-term interest of the company especially its sustainability, then it is to the benefit of the community and therefore compatible with ubuntu as ubuntu is about the common good. Adopting s.172

[718] Davies, P. L. (2008), Gower and Davies: Principles of Modern Company Law, 8th Edition, p.153.
[719] S.31 CA 2006.
[720] See generally, Poole, J. (1991)
[721] Co (1883) 23 ChD 654.

would also make the CA compatible with Kenya's corporate governance guidelines which require the consideration of stakeholder interests.[722]

4.4.2 Directors Duties: the duty of loyalty

In common law, the primary fiduciary duty of a director is the duty of loyalty.[723] For director to perform his duty of care and skill with diligence his loyalty must be to the company. All the director's duties under the CA 2006, except the duty of care and skill (s.174), are fiduciary duties, which are commonly referred to as the duty of loyalty.[724]In England which has an individualistic culture, a director's loyalty is primarily to self whereas in Kenya where the culture is collective, a director's loyalty is primarily to 'others' other than the company. The director in England will therefore find it natural to put his interest first whereas the Kenyan director will find it second nature to put the interest of others, for instance stakeholders, first in the performance of his duties. Therefore the aim of the duty of loyalty is to ensure that the director is loyal to the company by requiring him to prioritise the interest of the company over his 'self' interest in the English context and over his 'other' interest in the Kenyan context.

The importance with which England treats the duty of loyalty is reflected in the fact that despite having an uncertainty accepting culture, England considers a director's loyalty to the company to be of absolute necessity and therefore an issue that cannot be solved without formal rules. This has resulted in the codification of this duty in s.171 CA 2006. S.171 states that a director should only exercise their powers for the purpose for which they are conferred and act in accordance with the company's constitution. The drafting of s.171 reflects the understanding that directors in England are likely to be self-interested utility maximisers as a result of their individualistic culture. S.171 does not go into detail on what constitutes the proper use of power. It is therefore necessary to refer to case law for the meaning of this provision.[725] This is an aspect of England's uncertainty accepting culture.

The need to codify the duty of loyalty is a lesson that Kenya can draw from England's experience. Whilst the director's duty of loyalty in England is now codified in law under s. 171 – s.177 (with the exception of s.174)[726], the greater part of the directors' duty of

[722] S.1.2 CMA Guidelines
[723] Mitchell, L. E. (1993), 'Fairness and Trust in Corporate Law', Duke Law Journal, 43(3), p.425
[724] This is implied in S.178(2) CA 2006 which provides that the duties, other than the duty of care and skill are to be enforced in the same way as other fiduciary duties.
[725] See Hogg v Cramphorn Ltd [1967] Ch 254.
[726] S.174 deals with the duty of care.

loyalty in Kenya is common law-based[727] with some aspects of it being found in statute.[728] This makes it extremely difficult for directors to know their duties[729] to the company and this lack of clarity is likely to detract a director's loyalty to the company in a medium uncertainty avoidance culture where unclear rules are likely to place undue stress on directors and therefore be ignored.[730]

The main elements of the duty of loyalty are the provisions that require disclosure of conflicts of interest and the 'no profit rule.' Disclosure rules and the 'no profit rule' are of absolute necessity as they help in preventing management from getting away with managerial misbehaviour *ex post*.[731] Therefore these rules need to be stated expressly in law for a framework to be effective in taking away a director's incentive to expropriate the company especially through self-dealing as demonstrated in the AccessKenya and CMC case. Self-dealing occurs where the director contracts with his company and where the company enters into a contract with a third party in which the director has an interest, perhaps because the third party is a company in which the director has a major shareholding.[732] For trust to exist in Plcs, shareholders – particularly minority shareholders – need to trust in the directors fairness; that is, that in dealing with the corporation on their behalf that the director will treat the corporation fairly.[733] The common law system does this through the no conflicts approach and the 'no profit rule.'

[727] The director's duty of loyalty in Kenya contains five obligations: The duty to act in the best interest of the company (Re Smith v Fawcett [1942] Ch. 304); The duty to exercise powers conferred upon them only for the particular purpose for which they were conferred (Punt v. Symons (1903) 2 Ch. 506); The duty not to fetter their discretion (Kregor v Hollins (1913) 109 LT 225); The duty to avoid conflicts of interest in the performance of their duties (Aberdeen Railway v Blaikie (1854) 1 Macc. 461) ; and the duty not to profit from position as director (Regal Hastings v. Gulliver (1942) 1 All E.R. 378)

[728] Amongst the duties expressly laid down in the Act include: The director's duty to give correct information in the company's prospectus in S. 45 CA 1948;The director's duty to produce to any inspector all books and evidence of or relating to the company and to give to the inspectors all assistance in connection with the investigation which they are reasonably able to give under s. 168 (1) CA 1948;The director's duty to disclose his age to the company if he is under or over the required age in S.187 CA 1948;The director's duty to disclose payment for loss of office made in connection to a transfer of shares in the company under s. 194 CA 1948; The duty to disclose the shareholding of the director in the company, to disclose in accounts presented in the annual general meeting the combined amount of the directors' remuneration, the aggregate amount of the directors' pensions and the total amount of any compensation to directors for loss of office (s.197(1) CA 1948); as well as the amount of any loans made during the company's financial year to a director of the company under s. 199 (1) CA 1948;The duty to disclose interests in contracts under S.200 CA 1948.

[729] See Mwaura, K. (2002), 'Regulation of Directors in Kenya: an empirical study', International Company and Commercial Law Review, Vol 13(12).

[730] See generally, Hofstede et al (2005), p.173.

[731] See generally, Scott, E. K. (1983), 'Corporation Law and the American Institute Corporate Governance Project', Stanford Law Review.

[732] Davies, P. (2002), Introduction to Company Law, p.170, (OUP).

[733] Mitchell, L. E. (1993),p.425

4.4.2.1 No conflicts approach

S. 175 (1) of England's CA 2006 provides that a director should:

> '... avoid a situation which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company.'[734]

Directors of companies in England are under a fiduciary duty to be loyal to their company[735]and, as such, not to put themselves in a position where their personal interests would conflict with the interests of the company.[736]However, it is possible to derogate from this strict rule where a director declares his interest in a transaction to other directors through s.177(1). S.177(1) states that a director must disclose any interest direct or indirect that he has in a proposed transaction including its nature and extent to the other directors.The duty to disclose can be used as a way to avoid liability where there is a potential conflict of interest or self-dealing.[737]On being alerted to the director's interest the company can affirm the contract or make it voidable. Shareholder approval is not required, simple disclosure to directors will be sufficient to free a director from the 'no conflict rule.'[738]Arguably this dilutes the duty of loyalty by lowering the threshold of a director's accountability to shareholders[739] and could potentially lower the levels of trust that minority shareholders have in Plcs. England's framework therefore places more power in a company to decide when conflicts of interest should be allowed in the performance of director' duties reflecting its high trust and uncertainty accepting culture which desires flexibility. These cultural attributes promote competition in markets and allow the law to be a facilitator of the company's interest; only coming in when necessary rather than circumventing entrepreneurship by totally preventing directors from taking risks.

Similar to directors in England, directors of Kenya's Plcs are under a fiduciary duty not to place themselves in a position in which there is a conflict between their duties to the company and their personal interests (*Aberdeen Railway v Blaikie*)[740] and to declare their interest in a transaction to other directors in s.200 CA 1948. This position is supported by

[734]CA 2006.
[735] S.170 (1) CA 2006
[736] S.175 (1) CA 2006; Aberdeen Railway v Blaikie (1854) 1 Macc. 461
[737] Lee, R. (2007), 'In Search of the Nature and Function of Fiduciary Loyalty: Some Observations on Conaglen's Analysis', 27(2) Oxford Journal of Legal Studies, p.329
[738] S.177 CA 2006
[739] However, the company may deviate from this rule and require more than simple disclosure in the Articles and arguably other directors duties such as the duty to promote the success of the company (S.172 CA 2006) must be complied with.
[740] (1854) 1 Macc. 461

Table A which states in Article 84 (2) that a director shall not vote in respect of any contract or arrangement in which he is interested, and if he does, his vote shall not be counted in the quorum present at the meeting subject to certain exceptions. Accordingly, directors in Kenya cannot exploit opportunities that would be of interest to the company as such exploitation would result in a conflict between personal and company interests. Where a director exploits such an opportunity, the company can require the director to account for any resulting profits.[741] Therefore, unlike the case of England, this is a strict rule which is solely concerned with the possibility of conflict rather than factual claims that mitigate the reality of the conflict. S. 200 CA 1948 compliments Kenya's medium uncertainty avoidance culture which requires certainty. Therefore, on the face of it therefore there appears to be no need to review Kenya's law on conflicts of interest as Kenya framework is reasonable in regard to this particular aspect.

The advantage of this strict position from a trust perspective is that minority shareholders can have confidence in investing in Plcs as directors to whom they have entrusted their monies are strictly prohibited from self-dealing. The main limitation of s. 200 CA 1948 in the Kenyan context is that as success in business depends on one's social capital and the networks one has already created, having a director with an affiliation with a prospective business partner[742] is likely to be seen as an advantage rather than a conflict regardless of the extent to which the director is likely to benefit from his interest in the transaction. From a transplantation view-point, for s. 200 CA 1948 to be effective, there is need to adapt it in a way that addresses this conflict between Kenya's culture and the 'no-conflicts-rule'.

4.4.2.1.1 Suggestion

As courts in Kenya generally maintain a 'hands-off' approach to company law cases and use company procedure to determine if a director was in breach of his duties – R v. Kirubi – a more effective way to deal with conflicts of interest would be to review Kenya's CMA Guidelines so that they state clearly what passes for a conflict of interest thereby complimenting Kenya's medium uncertainty avoidance culture and increasing trust in Kenya's Plcs. The advantage of this approach is that it allows for more certainty without damaging the core of common law. In determining whether a transaction with a

[741] Regal Hastings v. Gulliver (1942) 1 All E. R. 378
[742] The term partner is here is used literally to refer to the person transacting on the other side of the contract.

director is in the interests of the company, the CMA Guidelines could require boards to discuss:

> Whether corporation will receive full value by going ahead with the transaction;
>
> Whether the corporation needs the property;
>
> Whether the corporation is able to finance purchase;
>
> Whether the transaction was at market price or below, or constituted a better bargain than the corporation could have otherwise obtained in dealings with others;
>
> Whether there was a detriment to the corporation as a result of the transaction;
>
> Whether there was a possibility of corporate gain siphoned off by the directors directly or through corporations they controlled; and
>
> Whether there was a full disclosure – including disclosure of 'other' interests.

Such a checklist would enable boards of Kenya's Plcs to determine whether self-dealing transactions are fair. Additionally, it would increase investor confidence as self-dealing transactions such as those in AccessKenya and CMC as well as positional conflicts such as the irrational expansion of Uchumi can be detected and prevented culminating in great costs for shareholders. Because of the high fraud nature of the Kenyan context, the author recommends the maintaining of a strict approach to conflicts of interest.

4.4.2.2 The secret profit rule

The second element of the duty of loyalty is the secret profit rule which prohibits a director from making a secret profit from a directorship. The secret profits rule governs a situation where a director by virtue of his position discovers a business opportunity that the company could be involved in, but instead pursues this opportunity personally, without informing the company and for his own benefit. The secret profit rule prohibits a director as a fiduciary from profiting from his position as director unless that profit is disclosed in advance to shareholders and approved by them. S.176 England's CA 2006 codifies the '*secret profits rule*' in *Regal (Hastings) Limited v Gulliver*[743]by providing that a director must not accept a benefit from a third party conferred by reason of his being a director or his doing/not doing anything as a director. Consequently, s.176 can also be breached where a director accepts a bribe. This is because a bribe is usually

[743] [1942] 1 All ER 378.

given for reason of his being director or by reason of his doing or not doing anything as a director[744]and can reasonably be regarded as likely to give rise to a conflict of interest.[745]S.176 therefore preserves England's highly masculine culture which is task-oriented and provides an atmosphere where competition can thrive thereby promoting England's masculine culture. The aim of s.176 is to protect the company from a director's self interest even where this self-interest does not conflict with the interests of the company by encouraging disclosure which is the basis of England's high trust culture. Disclosure is fundamental to keeping order and maintaining a task-oriented approach to business.

While England has codified this rule in S. 176 CA 2006, despite England's uncertainty accepting culture thereby reflecting the importance of the no profit rule in corporate governance, the no-profit rule in Kenya which has a significant uncertainty avoidance culture is common-law based.[746] Directors in Kenya are therefore likely to struggle with complying with the secret-profit-rule as its common-law status is likely to heighten uncertainty and be deemed unimportant due to its lack of codification thereby resulting in the rule being ignored. Kenya can learn that the strength of England's framework in this particular respect is that it ensures accountability of directors through codification. For that reason, unless the 'secret profit rule' is codified, directors in Kenyan companies will have little or no initiative to disclose personal interests that may affect their loyalty to the company, especially due to Kenya's uncertainty avoidance culture and the current levels of low trust in Kenya.

4.4.2.2.1 Suggestion

From England's experience Kenya can take the lesson that an effective framework is therefore one that facilitates disclosure not just of the business of the company, but of the director's personal business interests. In the Kenyan collectivist context that would include the disclosure of the director's 'other' interests. Disclosure as a value that underlies the Anglo-Saxon framework is arguably compatible with ubuntu as a lack of transparency between parties creates a climate of distrust and suspicion thereby damaging the harmony that is at the core of ubuntu. Although 'secrecy' is an attribute of Kenya's inter-tribal relations,[747]within the tribe honesty was valued and information was freely shared. Therefore the author suggests keeping the no profit rule. However, there

[744] See generally s.176(1)(a) and (b).
[745] S.176(4) CA 2006
[746] Regal Hastings v. Gulliver (1942) 1 All E. R. 378
[747] See Chapter 2 of this thesis

is need to codify the no profit rule. Codification would not only make directors' duties clearer to directors and shareholders, but it would also increase the accountability of directors as shareholders would have a measure on which to gauge the performance of directors. Codification would also increase certainty and therefore trust, and ensure that this provision is not ignored as a result of Kenya's uncertainty avoiding culture.

4.4.3 Directors Duties: the duty of care

The other way that the law monitors director behaviour to solve the agency problem is through the duty of care and skill which requires directors to be careful in the performance of their duties. The duty of care acts as a mechanism for replacing inferior management.[748] England's CA 2006 sets the standard of care that is expected of directors in the performance of their duties in S. 174 (2) which provides that a director:

> 'must display the care, skill and diligence that would be exercised by a **reasonably diligent person** with both the **general knowledge, skill and experience** that may reasonably be expected of a person carrying out the same functions as the director in relation to that company and the general knowledge and skill that the director actually has.'[749]

At the outset, English law makes a clear statement that the director's role is not a passive one. Additionally, the drafting of this rule displays weak uncertainty avoidance; it is not too rigid, allowing for flexible interpretation.

S. 174 CA 2006 provides a dual test of director liability that incorporates both an objective and subjective standard to the performance of the director's duty of care and skill. On an objective level, a director is not expected to 'shirk' his duties to the company; he is expected to be hard working but also to apply his knowledge and experience to the business of the company as any reasonably diligent person would. However, on a subjective level, a director's performance will only be judged according to his knowledge and experience. The objective part of the test is reflective of England's masculine culture which is task-oriented rather than relationship-oriented. The subjective part of the test represents the sense of fair-play that is characteristic of English culture. Whilst the intention is to ensure that directors do not 'shirk' their duties, care is taken to maintain a sense of justice by stating that a director cannot be expected to perform beyond his ability. This sense of fair-play also maintains the flow of the labour market; the duty of care is not overtly harsh to the point that it discourages

[748] Scott, E. K. (1983), p.931.
[749] S.174(2) CA 2006

potential candidates from taking up directorships, but it is harsh enough to deter miscreant directors from taking up positions in companies.

The duty of care and skill in Kenya's corporate law is found in both common-law[750] and legislation.[751] Consequently, it presents a challenge for Kenya's medium uncertainty avoidance culture that prefers clear direction and rules. The present position on the duty of care in Kenya originates from the 1925 decision of *Romer J.* in *Re City Equitable Fire Insurance Co,*[752] where Romer J ruled that:

> '… [A] director need not exhibit in the performance of his duties a greater degree and skill than may reasonably be expected from a person of his knowledge and experience.'

The duty of care in Kenyan law is therefore subjective and negative. It does not say exactly what a director should do to be considered to have fulfilled his duty to the company. This is further reflected in S. 402(1) CA 1948 which sets the standard of care and skill expected of directors in Kenya:

> '… [I]f in any proceeding for negligence, default, breach of duty or breach of trust against an officer of a company … it appears to the court hearing the case that that officer … is or may be liable … but that he has acted **honestly** and reasonably … he ought fairly to be excused …' [emphasis added].

This suggests that it is possible for directors of companies in Kenya not to be held liable as a result of negligence arising from their ignorance or inexperience. The court's ruling in *Flagship Carriers Ltd v Imperial Bank*[753] confirms this. The court in that case held that directors are only required to exhibit a degree of skill and care that may reasonably be expected from a person of their knowledge or experience, but they are not liable for errors of business judgment. Whilst the subjective nature of this duty is compatible with Kenya's respect culture, it is not likely to encourage the accountability of directors in Plcs. Instead, it insulates directors from any questioning about their performance.

4.4.3.1 Suggestion

This thesis suggests that the standard of care expected of Kenya's directors should be reviewed in line with that of England to incorporate an objective standard and a subjective standard that is not passive- that is, only considering honesty – but active in

[750] City Equitable Fire Insurance Co, Re [1925] Ch. 407.
[751] S.402 CA 1948
[752] 1925] Ch. 407.
[753] Flagship Carriers (Civil Case No.1643 of 1999), unreported, High Court.

the sense that it takes into account a director's knowledge and experience. Codification of this duty would also improve its clarity therefore increasing accountability and trust in Kenya's medium uncertainty avoidance culture.

4.5 The regulation of nominee directors

Due to the prevalence of misappropriation of assets resulting from majority control in the Kenyan context, it is important to review the regulation of nominee directors in the CA 1948. A nominee director is a person appointed as a director of a company on the understanding that he will represent the interest of another person/group of persons.[754] Nominee shareholdings are common in Kenya and often used to build up voting control in companies.[755] The issue of nominee directors is closely linked to that of companies operating within a group where usually an employee is nominated to sit on the board of a subsidiary.[756] Interlocking shareholdings and directorships are also common within Kenya's Plcs.[757] Specific research on the extent and effect of director and shareholding interlocks on corporate governance in the Kenyan context is lacking. This section reviews the duties of a nominee director's role in Kenya in relation to the director's duty of loyalty.

Director interlocks raise the issue of whether a director should take into account the interests of other companies within a group when there is a conflict of interests between the company in which a nominee sits and the appointing company.[758] The general rule in common law as stated by Roskill LJ in *The Albazero* is that, 'each company in a group of companies... is a separate entity possessed of separate legal rights and liabilities'[759] thereby reaffirming the principle laid down in *Salomon v Salomon*.[760] As such, nominee

[754] Redmond, P. (1987), 'Nominee Directors, University of New South Wales Law Journal, p.194

[755] An example is the case of Centum Plc where a former Uchumi Plc Chairman is the second largest shareholder, owning a 17.52% stake in his name and an extra 9.34 percent through his proxy companies Kiruma International (5.15%) and International House Ltd (4.19%). Kirubi also sits on the board of Centum as NED director. See Centum, Introduction Memorandum: Listing by Introduction on the Uganda Securities Exchange 2010

[756] A significant number of Kenya's Plcs are foreign-controlled multinationals and therefore operate as part of a group. Examples include Barclays, Standard Chartered, A. Baumann Co. and East African Breweries.

[757] For example, Kenya Commercial Bank Nominees Ltd A/C 769G is the 8th largest shareholder at NIC Bank Ltd owning 1.43%, the 7th largest shareholder at Nation Media Group owning 0.54% and the 9th largest shareholder at Bamburi Cement owning 0.29%. See Kenya Commercial Bank 2010 Annual Report and Financial Statements.

[758] Lee, P. (2003), 'Serving Two Masters – the Dual Loyalties of the Nominee Director in Corporate Groups', Journal of Business Law, pp.449-469.

[759] [1977] AC 774, (CA) at 807

[760] [1897] AC 22. However, the ruling in DHN Food Distributors Ltd v Tower Hamlets LBC [1976] 1 WLR 852 (CA) at 860 where Lord Denning held that subsidiaries are 'bound hand and foot' and that '[t]he group is virtually the same as a partnership where all three companies are partners' brings uncertainty in this area.

directors in performing their duties as directors of company must act in the best interests of the company in which they sit as nominee directors. This is the traditional common-law approach to the regulation of nominee directors.

The traditional common law approach (requiring nominees to avoid situations of actual or possible conflict), the Australian approach (that the duties of nominees can be adjusted by shareholders) and the current English approach (that the duties of nominees can be adjusted by directors if allowed by shareholders) are the three main approaches to dealing with this issue.[761]

4.5.1 The traditional common law approach

The common law traditionally took a strict approach to the regulation of nominee directors linking their duties to the no-conflict rule.[762] Appointers were not liable for the acts of nominees as nominee directors were bound due to their fiduciary duties to the company to ignore the wishes of their employer.[763] This traditional approach is reflected in England's CA 2006 to the extent that nominee directors are regulated under the conflicts of interests rule.

4.5.2 England's approach

England's CA 2006 does not address the issue of nominee directors specifically. Instead, the regulation of nominee directors falls under the duty to avoid conflict of interests in s.175. Due to the flexible approach taken to the regulation of conflicts of interests in s.175, nominee directors in the UK may act in the interests of the nominator instead of the company if this has been authorised by the board of directors.[764]This is a departure from the traditional position which did not permit a nominee to act in the interests of his nominator at all. Now a nominee may do so if the board approves. The CA however, puts some safeguards in place to protect minority shareholders: First, the company's constitution must allow for such authorisation to be given by the board.[765]Secondly,

[761]The approaches of other common law jurisdictions such as Ghana, New Zealand and Singapore cannot be considered in this chapter for reasons of scope, however they broadly fall within these three approaches. See Boros, E. (1989), 'The Duties of Nominee and Multiple Directors: Part 1', Company Lawyer pp.211-219; Salim, M. R. and Teh, T. Y.(2008), 'Market Freedom of Shareholder's Protection? A Comparative Analysis of the Duties of Nominee Directors', International Journal of Law and Management, 50, at 3.2

[762] See Lord Denning's statement in Boulting v Association of Cinematograph Television and Allied Technicians [1963] 2 QB 606 at 626

[763] Kuwait Bank v National Mutual Life [1904 3 All ER 404, PC

[764] S.175(4)(b) CA 2006; Salim, M. R. and Teh, T. Y.(2008), at 6.3

[765] S.175(5)(b) CA 2006

interested directors are not counted for the purposes of quorum[766] and their voting will be excluded.[767]The general assumption is that the board will approve what is in the interests of the company as directors are already bound to act in a way that promotes the success of the company in s.172 CA 2006. Thus, a nominee director who may consider acting in the interests of his nominator without approval from the BoD is likely to be personally liable for any losses accruing to the company as a result of his actions. Australia takes a much more liberal approach to the regulation of nominees.

4.5.3 The Australian approach

While traditional common law acknowledges the commercial reality of nominee directors on boards and allows for them provided there is no conflict of interests,[768] Australian courts seem to be very supportive of the position of nominee director so much so that Jacobs J. in *Levin v Clark*[769] stated that:

> '**It may be in the interests of the company that there be upon its board of directors one who** will represent... other interests and who **will be acting solely in the interests of... a third party** and who may in that way be properly regarded as acting in the interests of the company as a whole.'

Jacobs J's position is in complete contrast to Lord Denning's approach in *Scottish Co-operative v Meyer*[770] and *Boulting* which does not allow for conflicts at all but closer to England's CA 2006 position in s.175 which presents a more flexible approach to conflicts arising from the nominee's position.

In *Levin v Clark*, the articles of the company in question had been amended so that the powers of the governing directors who acted primarily to protect the interests of the mortgagee (the defendant and another) were exercisable only if Levin defaulted under the mortgage agreement; which he did. Although neither the articles nor the shareholder agreement stated that the defendants were nominees of the mortgagee, Jacobs J found that they acted primarily to protect the interests of the nominee. In their defence Jacobs J stated that:

[766] S.175(6)(a) CA 2006
[767] S.175(6)(b) CA 2006
[768] Lord Denning in Scottish Co-operative v Meyer [1959] AC 324.
[769] [1962] NSWR 686
[770] [1959] AC 324

> 'To argue that a director particularly appointed for the purpose of representing the interests of a third party cannot lawfully act solely in the interests of that third party, is in my view to apply the broad principle governing the fiduciary duty of directors, **to a particular situation, where the breath of the fiduciary duty has been narrowed, by agreement amongst the body of shareholders.** The fiduciary duties of directors spring from the general principles developed, in courts of equity governing the duties of all fiduciaries... and it must be always borne in mind that in such situations **the extent and degree of the fiduciary duty depends not only on the particular relationships, but also on the particular circumstances.** Amongst the most important of these circumstances are the terms of the instrument governing the exercise by the fiduciary of his powers and duties and the wishes, expressed directly or indirectly, by direction, request, assent or waiver, of all those to whom the fiduciary duty is owed.'[771]

Jacobs J lends further support to the nominee director in the performance of his duties in *Re Broadcasting Stating 2 GB Pty Ltd*[772] where he states that:

> 'It is my view that conduct of the kind which I have related [where nominees acted in accordance with their appointer's interests] is not reprehensible unless it can also be inferred that **the directors, so nominated, would so act even if they were of the view that their acts were not in the best interests of the company**...'

Like England's CA 2006, Australia's Corporations Act 2001 has no provisions specifically dealing with the nominee director. The relevant law is S.187 Corporations Act 2001 dealing with directors in groups of companies. S.187 Corporations Act 2001 to a large extent codifies Australia's pragmatic approach to nominees by providing that a director of a corporation that is a wholly-owned subsidiary of a body corporate is taken to act in good faith in the best interests of the subsidiary if the constitution of the subsidiary expressly authorises the director to act in the best interests of the holding company; and if the director acts in good faith in the best interests of the holding company; and the subsidiary is not insolvent at the time the director acts and does not become insolvent because of the director's act. Australia and England's approach to the regulation of nominee directors is similar to the extent that a nominee director's actions must be allowed for in the company's constitution.

[771] Levin v Clark [1962] NSWR 686
[772] [1964-65] NSWRR 1648

4.5.4 Kenya's position on nominee directors

Although nominee[773] and multiple directors[774] are widely used in Kenya, like in the cases of England and Australia, there is no specific legislation dealing with nominee directors in the Kenyan context. Justice Khamoni in *Housing Finance Company of Kenya Ltd v Palm Homes Ltd & 2 Others*[775] states that:

> '…the Companies Act does not make provisions for the concept of nominee directors and… **the concept is not known to Kenyan jurisprudence**.'

Nominee director cases in Kenya often involve fraud in parastatals with the nominee director representing well-connected/powerful politicians. A case in point is *National Social Security Fund Board of Trustees v Ankhan Holding Limited & 2 others*[776] which involved the illegal sale of public land to the NSSF. The defendants were listed as the directors of the company. However, information arising from the case identifies the real owner of the company as a son of former president Moi. The defendants contended that they 'merely acted' for a disclosed principal in the transaction and were therefore not liable. In delivering his ruling, Justice Fred Ochieng held that individuals who incorporate companies to acquire benefits will not be allowed to allege later when liability arises that they cannot be sued because they are nominee directors. According to Justice Ochieng, once a person is named as a director of a company, his rights and obligations are defined in the memorandum and articles of association. A director cannot purpose to diminish his legal responsibilities by 'a side contract' between himself and the company especially when the said director is dealing with third parties.[777]

Kenya's approach as represented in Justice Ochieng's ruling in *NSSF v Ankhan* differs from that of Australia and England in a number of respects: First, the liability of nominee directors is linked to the benefits accrued from their positions in the company. Secondly, no distinction is made between a 'nominee director' and a director and as such nominee directors in Kenya are bound by the same duties that bind directors. Thirdly, the notion that companies can alter their articles to allow a different standard of loyalty for nominee directors is totally rejected on public interest grounds. In sum, Kenya takes the

[773] See Housing Finance Company of Kenya Ltd v Palm Homes Ltd & 2 Others, Civil Case No.918 of 1999
[774] S.2.1.6 CMA Guidelines 2002 allows for multi-directorships.
[775] Civil Case No.918 of 1999
[776] HCCC No. 268 of 2004. This ruling is no longer publicly accessible.
[777] NSSF v Ankhan Holding Limited & 2 others, HCCC No. 268 of 2004 as reported in Nyamboga, N. (2006), Nominee Directors Can't Run Away from Company Liability, The Standard, 16th May.

traditional common law approach to the concept of the nominee director which gives the nominee director freedom to be a nominee director but also personal responsibility where he blindly acts in the interests of his appointer ignoring the interests of the company as demonstrated in the English decisions of *Scottish Co-operative v Meyer*[778] and *Selangor United Rubber Co. Ltd v Cradock (No.3)*.[779] In *Scottish Cooperative v Meyer*, Lord Denning held that:

> ' the duty of the [nominee] directors to the company was to do their best to **promote its business** and to act in complete **good faith** towards it; and, in consequence, **not to... operate to the disadvantage of the company**... they did nothing to defend the interests of the company against the conduct of the [appointer]. They probably thought that, 'as nominees'... their first duty was to the [appointer]. In this they were wrong.'[780]

This strict approach is justifiable in a low trust society where fraud is common place and directors often act to the disadvantage of the company as demonstrated in the Uchumi, AccessKenya and CMC scandals. Similarly, the English decision in *Selangor* supports Justice Ochieng's decision in *NSSF v Ankhan* to hold the nominee directors liable for allowing themselves to be mere puppets of their appointer and doing nothing to protect the interests of NSSF. In Selangor, two nominee directors were involved in causing the company to provide funds to Cradock to enable him to purchase shares of the company contrary to s.151 CA 1985.[781] Ungoed-Thomas J held the nominee directors liable for the misapplication of company funds:

> 'It seems to me, however that both L and J were nominated as directors... **to do exactly what they were told by Cradock**, and that is in fact what they did. They exercised no discretion or volition of their own and **they behaved in utter disregard of their duties as directors**... They put themselves in [Cradock's] hands... as their controller.'[782]

The advantage of Kenya's strict approach to the regulation of nominee directors is that it holds nominee directors to a high threshold of accountability in a context where fraud is common place. Amongst the disadvantages of Kenya's approach to the regulation of nominees are: First, it is common-law based and largely inaccessible to directors,

[778] [1959] AC 324
[779] [1968] 1 WLR 1555
[780] [1959] AC 324
[781] This prohibition now only extends to Plcs.
[782] [1968] 1 WLR 1555 at 1613

shareholders and stakeholders and therefore sits uncomfortably with Kenya's uncertainty avoidance culture. Secondly, it does not reflect commercial reality. Not allowing nominees to put themselves in a position of conflict[783]and requiring them to exercise independent judgment[784] puts nominee directors in a very complicated position. As a nominee director is primarily appointed to represent the interests of another – other than the company – on the board, allowing them to sit on company boards to represent other interests as opposed to the interests of the company and possibly share confidential information on the company with the appointer seems contradictory in itself. Crutchfield points out that:

> 'It may have been thought that **strict fiduciary principles would disentitle the nominee from being appointed to his position at all**, since a director, being a fiduciary, should be required to approach all questions concerning the company without being distracted by an extraneous loyalty.'[785]

Thirdly, the strict common law position ignores Kenya's business culture where social capital plays a vital role and the role that power distance plays in Kenya's Plcs.[786] Due to Kenya's medium power distance culture, subordinates are significantly dependent on bosses, with a general preference for an autocratic or paternalistic boss.[787] A nominee director is therefore likely to blindly follow their appointer's instructions. In such a context, is it justifiable to hold a nominee director liable for doing what he is culturally 'programmed' to do?: that is, to obey his appointer without asking questions? Shouldn't the law deal with the appointer rather than the nominee? Or both?

4.5.4.4 Suggestion

To increase the levels of certainty on nominee directors in Kenya, the author suggests codification as is the case in Australia.[788] The Australian approach is suitable for a high fraud context such as Kenya as it expressly states that the acts of a nominee should not

[783] Aberdeen Railway Co. v Blaikie Bros (1854) 1 Macc. 461.
[784] Kregor v Hollins (1913) 109 LT 225
[785] Crutchfield, P. (1991), 'Nominee Directors: The Law and Commercial Reality', Company Lawyer,p.137
[786] Salim, M. R. and Teh, T. Y.(2008) make a similar argument in relation to Malaysia.
[787] Gustavson et al (2006), p.12.
[788] New Zealand has also codified the fiduciary duties of nominees in its Companies Act 1993 embracing a more liberal approach than that of Australia. Malaysia has also codified nominee duties but embraced the traditional position in Malaysia's s.132(1E) Companies Act 1965. In support of codification, see Koh, P. (2007), 'The Nominee Director's Tangled Lot', Singapore Journal of Legal Studies, 148,p.155

make the company insolvent.[789] Additionally, it acknowledges the commercial reality that it may sometimes be in the interest of the company for an appointer's interests to be represented on the board thereby allowing market freedom.[790] The current position in England also supports this approach to an extent by allowing shareholders to provide for nominees in the constitution and for the board to approve transactions in which there is a conflict. The Australian approach and makes room for Kenya's power distance culture and the importance of business relations in the Kenyan context whilst providing directors, shareholders and stakeholders in a high fraud context with certainty on the extent and nature of the duties of the nominee. Due to the high incidences of fraud in Kenya's concentrated ownership context, as well as its weak regulatory and enforcement capability, shareholders in Plcs should not be allowed to adjust the fiduciary duties of nominees on public interest grounds.[791] This provision should only be available for private companies. Disclosure of a company's information should also only be allowed on approval by the board.[792]

Under ubuntu, responsibility is collective in nature. This suggests that both the appointer and the nominee should be held jointly-liable where they act against the interests of the company, as ensuring the success of the company is in the interests of ubuntu. The reason for this is that under ubuntu the appointer would be expected to care about the interests of his appointee. Traditionally this was how the household operated: the patriarch owed a duty of care to his family to manage its wealth in their best interest whilst the family reciprocated with unquestioning loyalty.[793] An advantage of this system is that people naturally took care of their kin. Therefore the appointer will be expected to naturally take care of the interests of the appointee or at least be seen to do so. In the case of a group of companies, under ubuntu the parent company is expected to care and as such act in the best interests of the subsidiary. Such a position is in line with common-law decisions where a parent company controls a subsidiary.[794]

[789] S.187 Corporations Act 2001
[790] Salim, M. R. and Teh, T. Y.(2008); Lee, P. (2003)
[791] Justice Ochieng in NSSF v Ankhan Holding Limited & 2 others, HCCC No. 268 of 2004; Salim, M. R. and Teh, T. Y.(2008) at 7 take a similar position on Malaysia on grounds of concentrated ownership.
[792] This approach is taken by New Zealand in s.145(2)(a) Companies Act 1993 and acknowledges that nominees will often revert information on the company to their appointer. See the New Zealand court decision in Berlei Hestia (NZ) Ltd v Fernyhough [1980] 2 NZLR 150.
[793] See Chapter 2 of thesis
[794] DHN Food Distributors Ltd v Tower Hamlets LBC [1976] 1 WLR 852 (CA) at 860

4.6 The derivative claim

4.6.1 England's derivative claim

Directors' duties in England are owed to the company rather than to individual members.[795]As such only the company can bring a derivative claim. This was the ruling in *Foss v Harbottle* where Wigram V-C held that the conduct complained of was a wrong done to the company and that only the company could sue.[796]In *Edwards v Halliwell*,[797] the Court of Appeal identified four exceptions to the rule in Foss v Harbottle: a) where the act complained of was ultra vires; b) where there was fraud on the minority and the wrongdoers were in control; c) where the act complained of was a violation of a requirement in the articles for a special majority; and d) where the act complained of was an invasion of the members' personal rights as members. Jenkins LJ stated that: '... *the rule is relaxed in favour of the aggrieved minority... if they were denied that right, their grievance could never reach the court because the wrongdoers themselves, being in control, would not allow the company to sue.'*[798]An example of a successful action brought under the exceptions is *Cook v Deeks*[799]where a fraud on the minority by controlling wrongdoers allowed a derivative claim. However, these exceptions remained difficult to achieve necessitating further reform.

England has since reviewed its derivative action resulting in the current s.260 derivative claim. S.260(3) CA 2006 allows shareholders to bring a derivative claim against a director for any actual or proposed act or omission involving negligence, default, breach of duty or breach of trust. This is wider than the old common law derivative action where the claimant had to show that the breach or default amounted to 'fraud on the minority.'[800]As such a derivative action could not be brought for negligence.[801] Negligence benefitting a wrongdoer, however did qualify as fraud in the common law. S.260 does not replace the rule in *Foss v Harbottle*; it simply provides a statutory procedure for a derivative action.

[795] S.170(1) CA 2006. However, in special circumstances, directors may owe duties to individual shareholders – Peskin v Anderson [2001] 1 BCLC 372
[796] Foss v Harbottle (1843) 2 Hare 461
[797] [1950] 2 All ER 1064
[798] Edwards v Halliwell [1950] 2 All ER 1064
[799] [1916] 1 AC 554
[800]Estmanco (Kilner House) Ltd v Greater London Council [1982] 1 All ER 437
[801]Pavlides v Jensen [1956] Ch 565. However negligence benefitting a wrongdoer, however did qualify as fraud in the common law. In Daniels v Daniels[1978] Ch 406.

However, a shareholder will need to meet some mandatory requirements to bring a derivative action under CA 2006. Under Ss.261and 263 CA 2006 the claimant has to show a *prima facie case* in order to get the permission[802] of the court to proceed. The court will first consider the case based on the evidence filed by the applicant only. If the applicant cannot establish a *prima facie* case, the application will be dismissed. Where a *prima facie* case is established the court may then require evidence to be provided by the company before a substantive action begins. This new procedure was designed to overcome the problems caused by the old common law derivative action where the claimant had to show wrongdoer control which was not an easy task.[803]The court will dismiss the application where there is insufficient evidence to justify further investigation. The reason for this is to ensure that the shareholder has adequate grounds for pursuing the claim and to minimise the expense of the company if a claim has no merit. Permission must be refused if a person acting in accordance with s.172 to promote the success of the company would not continue with the claim or if the claim arises from an act or omission that the company has authorised to be carried out, or if the act or omission has already taken place and the company has ratified it.[804]

Under s.239, shareholders have the power to ratify director's conduct, which amounts to negligence, default, breach of duty or breach of trust by ordinary resolution. However, a director holding shares and involved in the breach of duty cannot vote on the resolution to ratify their act or omission. The possibility of ratification remains a problem for the minority shareholder as it is a complete bar to a derivative action unless the claimant can show fraud and wrongdoer control. However, the ruling in ***Franbar Holdings Ltd v Patel***[805]confirms that where ratification effects a fraud on the minority, the court will let the derivative action continue.[806] In Franbar it was held that s.239 preserves the exception identified by Sir Richard Baggallay in ***North West Transportation Co Ltd v Beatty*** that an act may be ratified provided it: *'… is not brought about by unfair or improper means, and is not illegal or fraudulent or oppressive towards those shareholders who oppose it.'*[807]

If none of the mandatory grounds requiring the court to refuse permission under s.263(2) CA 2006 applies, the court will take into account a number of issues in deciding if

[802] Part 19.9(3) Civil Procedure Rules
[803] Prudential Assurance v Newman (No.2) [1982] Ch 204
[804] S.263(2) CA 2006
[805][2008] EWHC 1534 (Ch)
[806]Editorial (2007), 'A Statutory Derivative Action', Company Lawyer, 225.
[807] (1887) 12 App Cas 589 at 593-594

permission should be granted to continue the claim. These include whether continuing the claim would promote the success of the company (s.172),[808] the views of other shareholders who have no personal interest in the matter,[809] whether the action could have been ratified and whether the shareholders seeking to continue with the claim are acting in good faith.[810]The 'good faith' requirement reflects the Court of Appeal's decision in *Barrett v Duckett*[811] where it was held that a derivative action would be permitted where it was being brought bona fide for the benefit of the company for wrongs to the company which no other remedy was available.[812] These further considerations reflect the value of objectivity in English culture.

The strengths of England's CA 2006 is that: First, Under s.260 the derivative claim can be brought against a director,[813] a former director,[814] or a shadow director,[815] even if the director has not personally gained from the breach. Secondly, wrongdoer control is not a definitive factor for the court to decide whether the derivative action should proceed. Thirdly, s.260 covers cases which were not fraud on the minority for instance negligence claims. Therefore the derivative action will be available for breach of the duty to exercise reasonable care, skill and diligence under s.174 even if a director has not personally benefitted from the breach; Fourth, the derivative action under S.260(3) provides for a cause of action against another person thereby enabling recovery from a third party that has benefitted from the breach by a director. An example is s.260 is the solicitor's negligence case of *British Racing Drivers' Club Ltd v Hextall Erskine & Co.*[816]In Hextall, H acted as solicitors to B, but failed to advise B about the requirement under s.320 CA 1985 for company members in a general meeting to approve a transaction where a director had a personal interest. The director in question owned shares in T in which B was to acquire half the shares. H denied that the loss was suffered as a result of deficient legal advice. The court held that the purpose of s.320 CA 1985 was to safeguard a company against the losses resulting from transactions in which the directors had an interest. H deprived the companies of this safeguard by failing to advise the companies of the need to comply with s.320. The directors' negligence could not be relied upon by H to reduce their liability to the companies because the transaction was

[808] S.263(3)(b) CA 2006
[809] S.263(4) CA 2006
[810] See generally s.263 CA 2006.
[811] [1995] 1 BCLC 243
[812] See also, Portfolios of Distinction Ltd v Laird [2004] EWHR 207 (Ch).
[813] S.260(3) CA 2006
[814] S.260(5)(a) CA 2006
[815] S.260(5)(b) CA 2006
[816] [1996] 3 All E.R. 667

well within s.320. H would therefore be liable for the entire amount because there had been no failure by the plaintiffs to mitigate their loss. Fifth, England's derivative action is statutory based, therefore clear and assessable to a company's directors, shareholders and stakeholders.

The disadvantage of bringing a derivation action under s.260 is that if the action continues and is successful, any compensation payable is awarded to the company and not to the shareholder personally. This is because the purpose of a derivative claim is concerned not with the individual shareholder rights and property but with the company's rights and property so that the complainant gets no personal benefit from the action.[817]Costs are therefore a significant impediment to a minority shareholder bringing a derivative action in England. Regarding costs, in ***Wallersteiner v Moir (No.2)***[818] Lord Denning held that a minority shareholder who brings a derivative suit may have a right to an indemnity from the company if the proceedings were brought in good faith and reasonably, and provided the authority of the court is obtained in advance. However, they will have to take risk of paying for counsel's opinion and the costs of persuading other shareholders that the court may require to be summoned. If the court does not approve the action, any costs will have to be paid by the minority shareholder.[819]

Alternatively,[820] a member[821] of a company may apply to the court for an order under s.994 CA 2006[822] on the ground that the company's affairs are being carried out in a manner that is unfairly prejudicial to its members generally or some of its members including, at least, himself.[823]Under s.994 the conduct complained of must be unfairly prejudicial to the interests of members in their capacity as members and as such a member cannot complain about prejudice to some other interest.[824] Whether the company's conduct or proposed conduct amounts to unfair prejudice is decided on a case by case basis taking into account factors such as the petitioner's conduct, prior knowledge of matters complained of,[825]any offer to buy out the petitioner, the motive of the oppressor and any delay in petitioning amongst other factors. The courts have found conduct to be unfairly prejudicial where: excessive salaries are paid to directors (***Re***

[817] Editorial (2007), 'A Statutory Derivative Action', Company Lawyer, 225.
[818] [1975] QB 373, Court of Appeal
[819] See Rule 19.9(7) Civil Procedure Rules 1998.
[820] These alternative remedies are not considered in further detail because of the scope of this thesis.
[821] S.994(1) CA 2006
[822] S.994 simply restates s.459 CA 1985 which replaced s.210 CA 1948 and therefore case law under s.459 CA 1985 and s.210 CA 1948 still applies to claims brought under s.994 CA 2006.
[823] S.994(1)(a) and (b) CA 2006
[824] Re Legal Costs Negotiators Ltd [1999] 2 BCLC 171.
[825] Bermuda Cablevision Ltd v Colica Trust Co. Ltd [1998] AC 198, PC. This decision is used persuasively.

Cumana[826]); misleading information is provided to a company's shareholders (*Re A Company No. 008699 of 1985*[827]); a meeting of the company is convened for a date unreasonably in the distant future (*McGuiness and Another, Petitioners*[828]); there has been failure to pay proper dividends over a long period without explanation (*Re Sam Weller & Sons Ltd*)[829]; business has been diverted away from the company (*Re London School of Electronics*[830]); a proposal is made to sell the company's business at a substantial undervaluation to connected persons (*Re Postgate and Denby (Agencies) Ltd*[831]); there is gross mismanagement such as when company's assets are used for the benefit of the company's controlling shareholders and family (*Re Elgindata (No.1)*[832]). In order to succeed in a s.994 claim the minority shareholder will have to show that the conduct complained of is unfair and prejudicial to the minority shareholders but it does not have to be illegal[833] and the directors do not have to have acted negligently or in bad faith. Amongst the advantages of a s.994 claim is that the shareholder may be awarded compensation on his own behalf, rather than for the company as is the case under the derivative action.

As a last resort, a shareholder may petition a court to have a company wound up on just and equitable grounds under s.122 Insolvency Act (IA) 1986.[834] The advantage of this remedy is that an aggrieved shareholder can get the company wound up. The disadvantage is that as soon as a petition for winding is made, it paralyses the operations of the company as business transactions entered into by the company would be void in the event that a winding up order was made. Therefore a court will generally not wind up a successful company if there is the possibility of an alternative remedy such as s.994 CA 2006 and where the court is of the opinion that the petitioners are acting unreasonably in seeking to have the company wound up.[835]

4.6.2 Kenya's derivative claim

Kenya's derivative action, on the other hand, is provided for in s.211 CA 1948 which is similar to England's s.210 CA 1948. England's s.210 was passed on the recommendation

[826] [1986] B.C.L.C. 430; CA
[827] (1986) 2 B.C.C. 99024
[828] [1988] 4 BCC 161
[829] [1990] B.C.L.C. 80
[830] [1986] Ch. 211
[831] [1987] B.C.L.C. 8
[832] [1991] B.C.L.C. 959
[833] See HMSO (1962), Report of the Company Law Committee (Jenkins Committee) (Cmnd 1749) at 203
[834] A case under this section is Ebrahimi v Westbourne Galleries Ltd [1973] AC 360 (HL)
[835] S.125(2) IA (1986)

of the Cohen Committee following difficulties faced by minority shareholders at common law under the rule in *Foss v Harbottle* and the unsatisfactory relief under the winding up remedy which is now s.122(1)(g of the Insolvency Act 1986. The Cohen Committee recommended the introduction of a new section under which, on a shareholder's petitition, the court, if satisfied that a minority of the shareholders is being oppressed and that a winding up order would not do justice to the minority, should be empowered, instead of making a winding up order, to make such other order, including an order for the purchase by the majority of the shares of the minority at a prices to be fixed by the court as to the court may seem just.'[836]England's s.210 was therefore expected to provide more flexible remedies free from the strictness of the rule *in Foss v Harbottle* and the harshness of a winding up order by enabling any member to complain that the affairs of the company were being run in an oppressive manner. However, there were only two successful cases brought under s.210 in the UK.[837]

Taking into account the success rate of England's s.210 CA 1948, it is not surprising that successful derivative actions under Kenya's s.211 have been nearly impossible (if not impossible). This low success rate can be attributed to a number of factors: First, the heavy reliance on the ruling in *Foss v Harbottle* in s.211 proceedings without consideration of its exceptions. Although the rule in Foss v Harbottle has some practical advantages such as the avoidance of multiplicity of actions by insisting that the company is the proper plaintiff and avoiding litigation where an irregularity complained of is one that can be ratified by the company in the general meeting, it has been taken too far in the Kenyan context thus encouraging managerial misbehaviour in Kenya's Plcs. Even in cases where minority shareholders have alleged fraud and wrong doing by the majority, their interests have been ignored with Judges preferring to focus on procedure. Cases in point are *Tricor Enterprises v. Mwok-Handa*[838]where Justice Mango held that majority shareholders, 'naturally guard the interests of other shareholders.' Recent scandals in Kenya's Plcs have not shown majority shareholders naturally guarding the interests of minority shareholders. In Uchumi, the directors engaged in positional conflicts in the form of irrational expansion at the expense of the company as a whole, which includes minority shareholders. In CMC, Muthoka, a majority shareholder who was also Chairman engaged in self-dealing transactions at the expense of the company. The same can be said for AccessKenya, where majority directors in a family-controlled Plc sidelined the

[836] HMSO (1945), Report of the Committee on Company Law Amendment (Cohen Committee) (Cmnd 6659)
[837] Re H. R. Harmer Ltd [1959] 1 WLR 62; Scottish Co-operative Wholesale Society v Meyer [1959] AC 324
[838] Civ. Suit 2836 of 1990

rest of the board and acted in the family's interests by inflating the price of procurements at the expense of the interests of the company.[839]Going by the way Kenyan courts have handles MSP cases in private companies, it is unlikely that the exceptions in Foss v Harbottle will be considered in these Plc cases should they go to court.

Besides, it is much more difficult for a minority shareholder in a Plc than one in a private company to prove fraud due to information asymmetry. The position in favour in majority shareholders in the Kenyan context is so entrenched that in *Joseph Njuguna v. Githunguri Ranching Company Limited* [840]where the petitioner's claim concerned the misappropriation of assets, Ransley (Commissioner of Assize) relying on Foss v Harbottle stated the petitioners '… do not demonstrate that they are a majority of the shareholders entitled to relief against the directors...'[841]This is clearly a standard that a minority shareholder can never meet.

A second weakness of Kenya's s.211 is that, an order under Kenya's s.211 is closely allied to the rules of winding up. An order can only be made if the facts can be the basis of a winding up order on just and equitable grounds.[842] Therefore, a single act is insufficient to justify a petition under s.211 CA 1948 as a course of conduct has to be shown. Thirdly, in addition to demonstrating a course of conduct, according to the ruling in *Scottish Co-operative Wholesale Society v Meyer*[843]a petitioner has to show that the conduct was oppressive: that is *'burdensome, harsh and wrongful.'*[844] Fourth, the need to establish whether a shareholder has the *locus standi* to bring a derivative action heightens the costs of bringing a derivative action as often the preliminary hearing is turned into a mini-trial with a focus on procedure.[845]Fifth, Kenya's derivative action is case-law based and therefore largely inaccessible to shareholders of the company in Kenya's medium uncertainty culture, arguably heightening distrust between majority and minority shareholders.

Other remedies[846] available to an aggrieved shareholder in Kenya include s.324 CA 1948 which allows recovery of misappropriated assets from directors in winding up. Its greatest limitation however is that it can only be used in the course of winding-up.

[839] See summary of these scandals in the earlier section of this chapter.
[840] HCCC 1555/2001
[841] Joseph Njuguna v. Githunguri Ranching Company Limited (HCCC 1555/2001)at 2
[842] See Re Bella Dor Sick Ltd (1965) 1 All E.R. 667; Re Five Minute Car Wash Ltd (1966) 1 W.L.R. 745
[843] [1959] AC 324
[844] Also see Re H. R. Harmer Ltd [1959] 1 WLR 62
[845]Prudential Assurance Co. Ltd v Newman Industries Ltd (No.2) [1982] Ch 204
[846] These remedies are not considered in detail because of the scope of this thesis.

Another remedy is s.219(f) CA 1948 where the court may order a company to be wound up if in its opinion it is 'just and equitable' to do so. The weakness of s.219(f) is that the courts are unlikely to apply this remedy when there are alternative remedies.

Amongst the differences between England and Kenya's minority shareholder remedies is that under the CA 2006 negligence can form a basis for a derivative claim and companies are required to produce evidence. Compared to Kenya, England has a stronger derivative action: First, it is statutory based and therefore more accessible to shareholders and stakeholders. Secondly, England's derivative action is not linked to winding up, a single act or an omission or threatened future conduct can be the basis for a petition and personal representatives can sue.[847] Thirdly, s.994 applies to cases of 'unfair prejudice' which is clearly a wider remedy than the oppression rule.

4.6.2.1 Suggestion

First, Kenya should continue to recognise the doctrine of separate corporate personality.[848]As such, the company should be the proper plaintiff and a member should be able to maintain proceedings about wrongs done to the company only in exceptional circumstances.[849] Secondly, Kenya should replace the rule in *Foss v Harbottle* with one that reflects Kenya's commercial reality: which is the prevalence of a concentrated ownership structure. Although majority shareholders in common law are entitled to regulate matters of internal management by ordinary resolution, this rule has resulted in high incidents of managerial misbehavior in the Kenyan context as demonstrated in Uchumi, AccessKenya and CMC as majority shareholders are often directors of the company. Eight provinces in Canada have since 1975 replaced the rule in Foss v Harbottle with a requirement that the shareholder obtain leave of the court.[850] England and Australia already have statutory criteria for bringing a derivative action. The author suggests that Kenya adopts statutory criteria of bringing a derivative action so that it is possible to assess the chances of success of a claim before bringing a court action. This statutory criterion should include a rule limiting the powers of the majority to ratify director's wrongs and a requirement that directors should abstain from voting in transactions in which they have an interest.[851]The introduction of clear rules on the derivative action in Kenya would follow the lead given in other jurisdictions and increase

[847] s.994 CA 2006
[848] On sanctity of contract see, Law Commission (1997), 1.9(iv)
[849] Law Commission (1997),1.9 (i)
[850] Law Commission (1997),6.8
[851] DTI (2001), Modern Company Law for a Competitive Economy: Final Report, 7.52-7.62

transparency in corporate governance.[852] Additionally, statutory criteria would complement Kenya's uncertainty avoidance culture and the need for inclusivity under ubuntu by making shareholder remedies more accessible to shareholders and stakeholders of the company.

Thirdly, Kenya should repeal the oppression rule in s.211 CA 1948 and the removal of the link between s.211 petitions and winding up. This would lower the burden of proof and acknowledge the problems of information asymmetry that a minority shareholder is likely to face in proving that a company should be wound up. Instead, the author suggests that Kenya adopts the fairness standard. Lord Hoffmann in ***O'Neill v Phillips*** pointed out that fairness was the criterion which Parliament had chosen to grant relief under s.459 CA1985. According to Hoffman:

> 'The concept of fairness must be applied judicially and the content which it is given by the courts must be based on rational principles. As Warner J said in Re J.E. Cade and Son Ltd, Re [1992] BCLR 213,227: 'The court… has a very wide discretion, but it does not sit under a palm tree.' Although fairness is a notion which can be applied to all kinds of activities, its content will depend upon the context in which it is being used. … a balance has to be struck between the breadth of the discretion given to the court and the principle of legal certainty. Petitions under s.459 are often lengthy and expensive. It is highly desirable that lawyers should be able to advise their clients whether or not a petition is likely to succeed.' [853]

Arguably Kenya's lawyers are not able to conclusively advise shareholders on their chances of success in bringing a petition. Whilst certainty is one of the aims of common law, a minority shareholder taking a derivative claim to a Kenyan court is wholly reliant on the judge's discretion as there is no effective system of recording precedent from which the principles can be traced. Often there is no way of knowing what other courts have decided on the same issue and therefore rationality is almost impossible to apply. Judges are largely reliant on counsel's submission and counsel, on the other hand, are under-resourced, lacking access the relevant 'institutions' that are required for the effective function of common law such as effective access to precedent. The content of fairness therefore needs to be adjusted in the Kenyan context to make it less reliant on case-law and more reliant on statute as statute is more readily accessible. This would

[852] Law Commission (1997), Shareholder Remedies (Law Com. No. 246) part1,6.9
[853] O'Neill v Phillips[1999] 1 WLR 1092

increase certainty and therefore trust in the system enabling Advocates to conclusively advise clients on the likelihood of success in a petition.

The codification of Kenya's derivative action does not have to be exactly the same as that of England. Lord Hoffman points out that the English way is not the only way to achieve fairness:

> ' … Nineteenth- century English law, with its division between law and equity, traditionally took the view that while literal meanings might prevail in a court of law, equity could give effect to what is considered to have been the true intentions of the parties by preventing or restraining the exercise of legal rights. …This way of looking at the matter is a product of English legal history… But another approach, in a different legal culture, might be simply to take a less literal view of 'legal' construction and interpret the articles themselves in accordance with…. 'the plain general meaning of the deed.' Or one might, as in Continental systems, achieve the same result by introducing a general requirement of good faith into contractual performance. These are all different ways of doing the same thing. I do not suggest there is any advantage in abandoning the traditional English theory, even though it is derived from arrangements for the administration of justice which were abandoned over a century ago. On the contrary, **a new and unfamiliar approach could cause uncertainty**.'

The English way of doing things is unfamiliar in the Kenyan context resulting in uncertainty and a focus on procedure. It is arguable that a simplified derivative action is needed in the Kenyan context. The author suggests that simplification can be achieved through codification of what amounts to 'unfairness'. Kenya's drafters should include a non-exhaustive list of conduct that is unfair and prejudicial referring to rulings in England's s.459 CA 1985 and s.994 CA 2006. For instance: excessive salaries to directors; providing misleading information; setting a company meeting unreasonably in the distant future; failure to pay proper dividends; diverting a company's business; selling the company's business at a substantial undervaluation to a connected person; and gross mismanagement amongst others. This will result in inclusivity, trust in the corporate framework and shareholder engagement. Additionally, codification will provide certainty in Kenya's uncertainty avoidance culture and overcome problems of institutional complementarity such as inaccessibility of reported cases to lawyers, directors, shareholders and stakeholders in the Kenyan context – even if this is just a short-term measure for the transition period. A statutory criterion for the derivative action is easy to review and keep up to date as new developments can be kept track of without requiring a lot of financial investment on the part of developing common law countries.

Fourthly, Kenya's courts should require that on the purchase of shares, shareholders and stakeholders are given simplified copies of the company's memorandum and articles, as well as a simplified list stating the object of the company, the directors' obligations, shareholder rights and remedies. This should include a 'self-help' list on the range of remedies available to the shareholder[854] within and outside the company prior to seeking court action. This will increase certainty, trust and ubuntu through inclusivity. Fifth, bringing a derivative claim should be made efficient and cost-effective in the circumstances. Civil procedure on minority shareholder litigation should be streamlined so that it is less costly and complicated.[855] In particular, the procedural hurdles that a minority shareholder needs to overcome before a matter can be considered should be reduced.

Sixth, Kenya's CA should be reviewed to expressly require that a shareholder seeks counsel's opinion on the probability of success of a petition before it is presented to the court. This would solve the current difficulty where the Judges spend a lot of court time on technicalities of procedure and educating Advocates on how to bring a claim, and allow Judges to spend more time rationalising the relevant company law issues. At this stage Advocates should also be required to advise on alternative remedies such as arbitration stating their advantages and disadvantages in relation to the proposed petition. Arbitration would offer companies and shareholders the means to resolve their disputes quickly and with minimum costs.[856] Additionally, arbitration is likely to gain acceptance as a shareholder remedy as it is in line with ubuntu which prizes harmony and consensus, and was the traditional way of resolving disputes in all tribes.[857]Arguably, only when arbitration fails, should the derivative action be taken up as a remedy.[858]Lastly, Advocates who do not follow procedure should be awarded costs for as proceedings often brings the company's business to a standstill and not only financial capital but also social capital thereby lowering trust in companies.

4.7 Part III: Creating Trust in Kenya's Corporate Governance Code

The need for trust in the boardroom is of paramount importance for corporate governance. The past twenty years have seen a global decline in public trust towards directors and management of Plcs. Scandals such as Enron and WorldCom in the US, and

[854] See Law Commission (1997), 1.11
[855]See Law Commission (1997),1.11.
[856] DTI (2001), Modern Company Law for a Competitive Economy: Final Report, 4.11
[857] See Chapter 2 of this thesis.
[858]See Re Rotadata Ltd [2000] 1BCLC 122

more recently the bank crises at HBOS, the Royal Bank of Scotland, Bradford & Bingley and Northern Rock in the UK have decreased public trust towards the management of Plcs and resulted in a focus on the prevention of fraud and abuse of corporate power. Whilst the US has taken a hard law approach to regulating corporate governance through the Sarbanes Oxley Act 2002 mandating tighter accountability practices, the UK has embraced a self-regulatory approach as reflected in the Combined Code 2010 (CC 2010).[859] The self-regulatory approach involves the drafting of guidelines by an organisation/body on a comply/explain basis[860] and the regulated are active participants in designing self-regulatory rules and regulatory functions.[861]Self-regulation is therefore the result of trust between the regulated and is popular in capitalist states as a means of restricting the role of the state in the regulation of business by empowering independent state agencies to draft rules for the conduct of business. Compliance with self-regulatory codes is voluntary and based on agreement between corporations and the regulatory body. As such, legal action cannot be brought for non-compliance.[862]The hard law approach to corporate governance regulation in the US Sarbanes Oxley Act 2002 is a recent departure from this trend. Activists, shareholder interest groups and a reduction of the influence of the CEO in board selection have also become popular as instruments in preventing fraud in corporations.[863] The aim of the Sarbanes Oxley Act 2002 and the CC 2010 has been to increase trust in corporations.[864]

The creation of trust is important in the Kenyan context as recent scandals have demonstrated a general lack of communication within Kenyan boards destroying the trust of investors. In AccessKenya, NEDs were sidelined in discussions of the company's financial position resulting in the board splitting into two factions. In the CMC case there was a breakdown of communication within the board, with some board members not being aware of major decisions and transactions, resulting in the formation of factions within the board. Trust facilitates healthy interrelational dynamics among board members as board members who do not trust each other cannot have meaningful

[859]Financial Reporting Council (2010), The UK Corporate Governance Code, June 2010. The Financial Reporting Council (FRC) is the UK's independent regulator responsible for promoting confidence in corporate governance, including through excellent corporate reporting.
[860] Black, J.(1996), 'Constitutionalising Self-Regulation', Modern Law Review,56,p.24
[861] Ogus, A.(1998), 'Self-Regulation', in Encyclopedia of Law and Economics, Cheltenham.
[862] Ogus, A.(1998)
[863] Lee, S.K. and Carlson, L.R.(2007), 'The Changing Board of Directors: Board Independence in S&P 500 Firms', Journal of Organisational Culture, Communication and Conflict, 11,pp.31-41
[864] On the use of codes to increase trust see Rossouw, D. (2008), 'Aristotle in the Modern Corporation: From Codes of Ethics to Ethical Culture', Phronimon, 9(1),p.77.

debate.[865]Similarly, when majority and minority shareholders do not trust each other, the company will not realise its full potential as minorities will not invest/invest as much as they are capable. Low trust results in low levels of accountability and low commitment to the success of the company.[866]O'Brien points out that trust is confident expectation about the positive actions of other people, without being able to influence or monitor the outcome.[867] The recent board wrangles at AccessKenya & CMC have fallen way short of the confident expectation of Kenya's investors and in particular the expectation that directors should act in their interests. A good corporate governance code can go some way in achieving this confident expectation.

Both England and Kenya's corporate governance code (the CMA Guidelines) reflect the 'comply/explain' approach. Amongst the mechanisms contained in both codes are splitting the roles of Chairman/CEO, the introduction of NEDs and INEDs and committees which essentially target the agency problem between directors and shareholders in general. The following section will evaluate the corporate objective and the appropriateness of these corporate governance mechanisms for Kenya's Plcs. For minority shareholders to trust in Kenya's Plcs, Kenya's corporate governance has to be seen to reflect ubuntu and to address the current problem in Kenya's Plcs which is essentially a lack of accountability of directors and majority shareholders.

4.7.1 The Corporate Objective

The first aspect of creating trust in the corporation is aligning the perceptions of the director's role between various parties to the agency problem that is majority and minority shareholders in the Kenyan context as divergent opinions on BoD roles and responsibilities are likely to create mistrust. Proponents of shareholder primacy see the board's functions as being to protect the interests of shareholders as owners of the corporation[868]while supporters of the stakeholder theory expect the board to protect/serve/consider the interests of groups other than shareholders.[869]The managerial hegemony theory, on the other hand, argues that shareholder interests are subjugated to those of management as the board owes its positions to management[870]with directors

[865] Lencioni, P.(2002), The Five Dysfunctions of a Team, Jossey-Bass, CA.
[866] Lencioni, P.(2002)
[867] O'Brien, R. C. (2001),p.21
[868] Berle, A. A. (1931), Corporate Powers as Powers in Trust', Harvard Law Review, 44, p.1049
[869] Dodd, E. M. (1932), 'For Whom are Managers Trustees?' Harvard Law Review, 45, p.1162.
[870] Galbraith, J. K. (1984), 'Galbraith and the theory of the Corporation', Journal of Post Keynesian Economics, 7(1),p.44

being rewarded for less monitoring.[871] These differing perceptions of the board may lower trust where there is no clear statement on the responsibilities of the board. Whilst England's CC 2010 compliments the corporate objective as expressed in the s.172 CA 2006 which is to promote the success of the company by stating that the purpose of corporate governance is to deliver the long-term success of the company[872] Kenya's law and CMA Guidelines provide different objectives. Kenya's law through the ruling in *Hutton v West Cork Rly*[873] states the role of directors is to serve the interests of shareholders whereas Kenya's corporate governance code states that directors should consider both shareholder and stakeholder interests.[874]Not surprisingly, Mwaura's 2002 study showed that directors in Kenya were uncertain about their duties.[875]The lack of consistency in stating the corporate objective in both the CA and the CMA Guidelines can only heighten the distrust between majority and minority shareholders and stakeholders.

4.7.1.1 Suggestion

The author recommends an alignment between the corporate objective as stated in Kenya's CA and the CMA Guidelines by adopting England's s.172 CA 2006 whose focus is to promote the success of the company while taking into consideration stakeholder interests. S.172(1)(f) CA 2006 which expressly states that directors should have regard to the need to act fairly between the members of the company in promoting success of the company would go some way in curtailing the current trend where Kenyan courts are skewed towards the interests of the majority. As the survival of the company and inclusivity is paramount under ubuntu prioritising shareholder interests while taking into account stakeholder interests under s.172 CA 2006 would make Kenya's legislation compatible with the CMA Guidelines and provide one goal for directors – to promote the success of the company. South Africa has taken a similar approach in King III where it states that, 'acting in the interests of the company [is] the overriding factor, subject always to proper consideration of the legitimate interests and expectations of all the

[871] Westphal, J.D. and Stern, I.(2007), 'Flattery will get you everywhere (especially if you are a male Caucasian): How Ingratiation, Boardroom Behaviour, and Demographic Minority Status affect Additional Boardroom Appointments at U.S. Companies', Academy of Management Journal,50,pp.267-288
[872] CC 2010,p.1
[873] Co(1883) 23 ChD 654.
[874] S.1.2. CMA Guidelines 2002
[875] Mwaura, K. (2002), 'Regulation of Directors in Kenya: an empirical study', International Company and Commercial Law Review, Vol 13(12).

company's stakeholders.'[876]Such an approach would reduce discord between majority and minority shareholders and directors and stakeholders such as the local community thereby sustaining the ubuntu philosophy of co-existence, consultation and consensus.[877]

4.7.2 Splitting Chairman / CEO Role

Much of the inability of boards to perform adequately in their role to control management has been attributed to the lack of independence in boards with CEO duality[878]resulting in proposals to split the Chairman/CEO roles. However, while some studies find that firms opting for independent leadership consistently outperform those relying upon CEO duality,[879] others show that splitting Chairman/CEO roles has not resulted in better firm performance or in better decision making by firms.[880]Nonetheless, splitting Chairman/CEO roles is widely advocated in corporate governance. England in S.A.2.1 CC 2010 recommends the splitting of Chairman/CEO roles and states that the division of responsibilities between the Chairman and the CEO is clearly established, set out in writing and agreed by the board. The requirement to have these respective roles set out in writing is a departure from England's uncertainty accepting culture which prefers to solve problems without the use of formal rules suggesting that England considers clear division of these roles to be of absolute necessity. England's CC gives guidance on the Chairman's role[881]but not that of the CEO. Research has shown that a CEO's presence on the board can result in misplaced loyalty with directors being loyal to a dynamic CEO above the duty to shareholders and obedience to the law resulting in a general preference to exclude the CEO from playing significant roles on boards.[882] Similarly, the requirement to split the positions of CEO and Chairman in Kenya's Plcs is found in S.2.2.1 of the CMA Guidelines. However, there is no specific guidance on the

[876] Institute of Directors (IoD) (2009), King Code of Corporate Governance for South Africa, p.6 (hereafter King III)
[877] South Africa's King II Code (2002)
[878]Dalton, D. R. and Kesner, I. F. (1987), 'Composition and CEO Duality in Boards of Directors: An International Perspective', Journal of International Business Studies, Vol. 18, No. 3, p.35; Donaldson, L. and Davies, J. H. (1994), 'Boards and Company Performance – Research Challenges the Conventional Wisdom', Corporate Governance: An International Review, 2(3) p.151.
[879] See generally, Baliga et al. (1996), pp.41–43; and Rechner, P. L. and D. R. Dalton (1991), 'CEO Duality and Organisational Performance: A Longitudinal Analysis', Strategic Management Journal 12(2), 155-160.
[880] Vafeas, N. and E. Theodorou (1998), 'The Association between Board Structure and Firm Performance in the UK,' British Accounting Review 30, pp.383-407; Baliga, B. R., Moyer, R.C. et al. (1996), 'CEO Duality and Firm Performance: What's the Fuss?', Strategic Management Journal, 17 pp.41-43.
[881]See S.A.3 CC 2010 Supporting Principle
[882] See Morck, R. K..(2008),'Behavioral Finance in Corporate Governance: Economics and Ethic's of the Devil\s Advocate', Journal of Management and Governance,12,p.180

Chairman/CEO roles[883] or a requirement to set out in writing the division of responsibilities between the CEO and the Chairman. This is likely to cause uncertainty in Kenya's medium uncertainty culture, thereby lowering trust between directors and management.

The Centre for Corporate Governance (CCG) points out that in some of Kenya's corporations, 'the board tends to go beyond its level of operation and therefore usurp the role of management... [whilst in others] managers have a lot of control at board level overshadowing other directors.'[884] The former observation reflects a lack of clarity in Chairman/CEO roles that is reinforced by significant power distance in Kenya's culture where subordinates prefer autocratic and paternalistic bosses,[885] and close supervision is believed to lead to greater task accomplishment.[886]The latter reflects weaknesses associated with Galbraith's managerial hegemony theory and Milgram's experiments.[887] Galbraith's argument that the board is ineffective in protecting shareholder interests[888] is seen in Kenya's boards where CEOs overshadow directors. Amongst the reasons for this is a lack of quality in the membership of the board[889]which results in the perception of the CEO as an authority worthy of unquestioning loyalty.[890] This propensity to obey authoritative figures is reinforced by Kenya's history and culture[891] where those who fell into line behind a tribal chief had significant survival advantages over isolated individuals, a point noted by Milgram that continues to be reflected in Kenya's relationship-based business culture and politics.[892]Such allegiance to CEO's is worrying as it lies at the heart of virtually every recent corporate governance scandal in the developed world.[893]

4.7.2.1 Suggestion

From a cultural viewpoint, due to Kenya's medium power distance culture which often results in autocratic management it is beneficial to retain separation of positions of

[883] The Chairman's role is dealt with broadly in s.3.1.1 CMA Guidelines which states that the BoD should assume primary responsibility of 'fostering the long-term business of the corporation.' The CEO role is described in s.3.2(vi) CMA Guidelines as that of, 'implementing the board corporate decision.'
[884] CCG, (2004) 'Governance and Management: Where is the Boundary?'
[885] Hofstede et al (2005), p.45.
[886] Kuada, J.E. (1994), p.131.
[887] Milgram, S. (1974), Obedience to Authority, Harper and Row (cited in Morck, R. K..(2008))
[888] Galbraith, J. K. (1984),p.44
[889] See Mwaura, K. (2002).
[890] See Morck, R. K..(2008),p.190
[891] See generally Morck, R. K..(2008),p.196
[892] Milgram, S. (1974), (cited in Morck, R. K..(2008)p.183)
[893] Morck, R. K..(2008),p.180

Chairman/CEO as a corporate governance mechanism as autocratic management reduces trust in the company as management are not fulfilled in their roles.[894]Additionally, separating the positions of Chairman/CEO is likely to improve accountability in Kenya's Plcs as it provides the CEO with an alternative authority figure in the form of the Chairman for those companies where management overshadow directors thus weakening subservience and evoking independent thought.[895] For separation to be effective, the Chairman position should continue to be held by an INED.[896]Splitting the Chairman/CEO role as a corporate governance mechanism could be improved in the Kenyan context, which is uncertainty avoiding, by requiring that the respective responsibilities of the Chairman and CEO be put down in writing. South Africa has taken this approach in its corporate governance code (King III) which requires that the roles of the Chairman and CEO are formalised and that the board define its own level of materiality and approve a delegation of authority framework with the performance of the CEO being evaluated against the criteria specified.[897]Specifying the Chairman/CEO roles facilitates co-existence, consultation and consensus under ubuntu. In Kenya's significant power distance culture, the author recommends that CEOs be excluded from the board as the presence of an authority figure is likely to result in unquestioning obedience.[898]The CEO should submit a written report and only be available for clarification of issues raised to avoid swaying the board and ensure prioritisation of company interests.

4.7.3 The Senior Independent Director

The second mechanism of comparative interest is the SID. Morck argues that to eliminate unquestioning obedience, in addition to having an independent director chair the board, another must coordinate the activities of other independent directors. Both will serve as a rivalry authority figure to the CEO thereby freeing the board from reflective obedience and stimulating rational debate to expose strategies before they become fatal.[899]This however does not appear to be the role of the SID in England's CC 2010. S.A.4.1 CC 2010 describes the role of the SID as that of providing a sounding board for the chairman, serving as an intermediary for other directors when necessary and being available to shareholders if they have concerns which contact through the normal channels has failed to resolve or for which such contact is inappropriate. Amongst the SID's roles is

[894] O'Brien, R. C. (2001),p.26
[895] Morck, R. K..(2008),p.187
[896] Provided for in S.3.2(iii) CMA Guidelines; Morck, R. K..(2008),p.188
[897] Principles 2.16-2.17 King III 2009
[898] Morck, R. K..(2008),pp.187,190
[899] Morck, R. K..(2008),pp.188,196

appraising the chairman's performance at least annually or as deemed appropriate[900] S.E.1.1 CC 2010 requires the SID to attend sufficient meetings with a range of major shareholders to listen to their views in order to help develop a balanced understanding of the issues and concerns of major shareholders. Kenya's CMA Guidelines do not require Plcs to have SIDs.

The concept of the SID in England appears to be based on creating a hierarchy – a channel higher than the Chairman where shareholders can air their grievances and through which the Chairman can be held accountable. Whilst hierarchy continues to provide the structural backbone of virtually all corporations, it can lower trust through the economic and social distinctions it creates.[901]The fundamental problem with hierarchy as it relates to the SID is its two-faced character: on the one hand the SID serves as an extra channel/intermediary for directors and shareholders and, on the other the SID creates an additional level of authority for shareholders and directors to deal with. Additionally the SID position is likely to add to the firm's costs as hierarchy difference is often used as the basis for widening differentials in reward. The prospects of huge rewards may lead the SID to act in ways that are detrimental to the company such as less monitoring and more ingratiation in order to keep his position. Therefore, paradoxically, the hierarchy created by the SID position divides people at the same time at it endeavours to unite them. Hierarchy also creates dependency[902] and arguably slows down decision-making as the Chairman is aware he has a sounding board; so are shareholders. Despite England's small power distance culture, shareholders experience has been that SIDs 'are often very pompous or don't even want to meet'[903] thereby suggesting that the SID position has created significant social distance. Given Kenya's medium power distance, this social distance is likely to be greater in the Kenyan context. It is unlikely that the SID will make any difference for minority shareholders in the majority-minority corporate governance problem as he represents the interests of shareholders as a whole.

4.7.3.1 Suggestion

Taking on board England's experience, the author sees no need to adopt the concept of the SID as it is expressed in England's CC 2010 in Kenya's corporate governance; it will

[900] Ss.A.4.2 and B.6.3 CC 2010
[901] Child, J. and Rodrigues, S.B.(2003), 'Repairing the Breach of Trust in Corporate Governance', Birmingham Business School,p.11
[902] Child, J. and Rodrigues, S.B.(2003),p.13
[903] JCA Group (2009), Corporate Governance and the Effectiveness of Shareholder Engagement, p.30.

only increase the number of authorities from which permission is required before directors can proceed with the company's business[904]and complicate the carrying on of business in the Kenyan context. In addition, it is unlikely that minority shareholders will adequately engage with the SID due to power distance. Kenya could adopt the SID as a mechanism to weaken subservience in Kenya's boards. The SID's role would be to coordinate the activities of other independent directors with the aim of providing official opposition[905] in the boardroom. Assigning the SID the role of critical evaluator will mitigate weaknesses of ubuntu such as 'group-think' as the SID will remain impartial while independent directors analyse issues independently. Independence and freely voiced dissent lets groups make superior decisions[906]thereby justifying the cost of the SID mechanism in Kenya's concentrated ownership context. This suggestion is in line with corporate governance practice in South Africa which based on ubuntu. South Africa's King III provides for the appointment of 'a lead independent director'(LID) where an executive chairman is appointed or where the chairman is not independent.[907]

4.7.4 Independent Non-Executive Directors/Non-Executive Directors

NEDs are the cornerstone of corporate governance under the Anglo-Saxon model.[908] In addition to providing additional expertise, INEDs monitor executives to ensure they are acting in the interests of shareholders.[909]Hendry argues that boards should be entirely composed of INEDs save for the CEO to minimise agency costs.[910]However, INEDs have limited access to detailed and relevant information in relation to executive directors and their appointment by executive directors rather than shareholders leads to 'collusive' relationships.[911]The fact that NEDs are typically directors and NEDs of other companies and therefore embedded within the culture of those they monitor, raises questions on their likely effectiveness.[912] Empirical research on the effectiveness of NEDs gives mixed results. Hermalin and Weisbach find higher proportions of outside directors to be

[904] See generally, Hofstede et al (2005), p.164.
[905] Morck, R. K..(2008),p.197
[906] Morck, R. K..(2008),p.197
[907] Principle 2.16.3 King III 2009
[908] Mehra, M., 'Corporate Governance: An Alternative Model' in Leong, H. K. (2005), p.7.
[909]Hendry, K., and Kiel, G.(2004), 'The Role of the Board in Firm Strategy: Integrating Agency and Organisational Control Perspectives', Corporate Governance: An International Review, 12(4),pp.500-520; Hendry, J.(2005), 'Beyond Self-Interest: Agency Theory and the Board in a Satisficing World', British Journal of Management, 16,s55-s63
[910] Hendry, J.(2005). Disagreeing, Morck contends that boards composed of only INEDs only strengthen the CEO's power and other corporate insiders should be included on the board to contain the power of the CEO. See Morck, R. K..(2008),p.190
[911] Bruce, A., and Buck, T. (1997), 'Executive Reward and Corporate Governance', in Keasey K., et al, Corporate Governance: Economic Management and Financial Issues, OUP,p.83
[912] Bruce, A., and Buck, T. (1997),p.83

associated with better decisions.[913]Brickley and James find that the presence of NEDs tends to reduce the managerial consumption of perquisites.[914]However, Agrawal and Knoeber's study highlights a negative relationship between NEDs and firm performance.[915]

Both England[916] and Kenya's[917] corporate governance code require that Boards of Plcs have NEDs to safeguard the interests of shareholders. S.B.1.2 England's CC 2010 requires half the board excluding the Chairman to consist of INEDs. Kenya's CMA Guidelines provide that INEDs should form at least a third of board.[918]South Africa's King III requires the majority of board members to be NEDs and the majority of NEDs to be independent.[919]The criteria of determining the independence of directors in Kenya is stated in S.2.1.4.1 CMA Guidelines and England sets out independence criteria in S.B.1.1 CC 2010. South Africa's King III does not provide criteria for independence. However, whilst England's code covers cross-directorships and representatives of significant shareholders Kenya's code does not mention these as criteria for independence despite its majority-minority agency problem and the fact that director interlocks are common in the Kenyan context. Arguably, this leaves room for minority shareholder expropriation as majority shareholders tend to be NEDs in some of Kenya's companies. In Centum, for example, the second largest shareholder is also a NED.[920]Despite England's weak uncertainty avoidance culture England's CC defines the role of the NED as that of providing constructive challenge and scrutinising management performance amongst other things[921]reflecting the importance that England attaches to the effective performance of the NED role. However, while assertive behaviour is seen as a sign of leadership in Anglo-American cultures[922]Such behaviour is seen as threatening in Kenya's inter-tribal relations context. As director interlocks are common in Kenya, a director's

[913]Hermalin, B. E. and M. S. Weisbach (2003), 'Boards of Directors as an Endogenously Determined Institution: A Survey of the Economic Literature', Economic Policy Review – Federal Reserve Bank of New York 9(1), 7 -26

[914] Brickley, J. A., & James, C. M. (1987), The Takeover Market, Corporate Board Composition, and Ownership Structure: The Case of Banking, Journal of Law and Economics, 10(1), pp.161-180.

[915] Agrawal, A. and C. R. Knoeber (1996), 'Firm Performance and Mechanisms to Control Agency Problems between Managers and Shareholders', The Journal of Financial and Quantitative Analysis 31(3), pp.377-397

[916] S.B.1.2 CC 2010 requires half the board excluding the Chairman to consist of INEDs.

[917] S.2.1.4 CMA Guidelines requires that the board should is composed of at least one-third of independent and NEDs.

[918] S.3.1.2 CMA Guidelines

[919]Principle 2.18 King III 2009

[920] Centum (2010), Introduction Memorandum. Listing by Introduction on the Uganda Securities Exchange.

[921] For other roles of the NED see S.A.4 CC 2010

[922] Anderson, C. and Kilduff, G.J.(2009), 'Why do Dominant Personalities Attain Influence in Face-to-Face Groups? The Competence-Signaling Effects of Trait Dominance', Journal of Personality and Social Psychology,96,pp.491-503

social capital may have more value for the company than his technical competence.[923]Open challenge by an NED could reduce trust between the NED and the board costing him social capital as well as split the board into factions along tribal lines as was the case in AccessKenya. At present, despite Kenya's medium uncertainty avoidance culture which prefers clear direction and rules, Kenya's CMA Guidelines define a NED as, *'… a director who is not involved in the administrative or managerial operations of the Company.'*[924]

4.7.4.1 Suggestion

The author recommends that an active definition of the NED role that reflects ubuntu be adopted in the Kenyan context. A clear definition of the NED role such as that in England's CC would be beneficial in Kenya's uncertainty avoiding culture particularly where it is adapted to reflect the ubuntu value of consensus. In contributing to board discussions, NEDs should aim at pursuing consensus rather than creating discord especially in the current climate of frequent board wrangles within Kenya's Plcs. Consensus was historically at the heart of social and political organisation and the ethos of the people of Africa. In any debate, the aim was to reach a consensus. The dedication to consensus seems to have been rooted in the firm epistemological belief that knowledge is dialogical or social as demonstrated in the following Baganda proverb, *'Magezi gomu, galesa Magambo ku kubo'* (Belief in his intellectual self-sufficiency resulted in Magambo's failure to reach home)[925]demonstrating the importance of consultation in ubuntu. The dialogical conception of knowledge did not exempt even technical experts from the epistemic help of others, as demonstrated in the following Baganda proverb: *'Omuwesi ekyamuzimbya kukubo kulagirirwa.'* (The reason a blacksmith locates his workshop by the roadside is to have access to the views of others)[926]Directors must therefore be willing to receive opinions from NEDs. The dialogical conception of knowledge was coupled with the equally important idea of collective social responsibility[927] as demonstrated in the Kiswahili proverb, *'Kidole kimoja hakivunji chawa'* (One finger cannot crush lice), demonstrating the centrality of political participation and social capital. Everyone was expected to contribute his part,

[923] Social capital has been shown to yield greater influence among board members, see Stevenson, W. and Radin, R.(2009), 'Social Capital and Social Influence on the Board of Directors', Journal of Management Studies,46,pp.16-44.
[924] S.2.1.4.2 CMA Guidelines
[925] Wamala, E. (2004), 'Government by Consensus: An Analysis of a Traditional Form of Democracy', in Wiredu, K. (2004), A Companion to African Philosophy, Blackwell Publishing, p.437.
[926] Wamala, E. (2004),p.438.
[927] Wamala, E. (2004),p.438.

working alongside others. Openness to input is certainly one of the hallmarks of a commitment to consensus.[928] Therefore for a board to reflect ubuntu, directors will have to be open to the input of NEDs. Consensus developed within the tribal setting where people were generally open to input. By adopting ubuntu into Kenya's corporate governance, consensus can be transferred to a generalised level leading to better decisions[929]and higher levels of trust between board members.

Additionally, the NED role in Kenya's concentrated ownership context should include the representation of minority shareholder interests to address Kenya's majority-minority agency problem. At present, Kenya's CMA Guidelines require INEDs to form at least a third of board.[930]Due to majority-minority shareholder problem and a propensity of courts to favour majority shareholders, the author recommends that Kenya adopt the South African approach which requires the majority of board members to be NEDs and the majority of NEDs to be independent.[931]This will better safeguard minority shareholder interests and encourage investment in the NSE. Cross-directorships and representatives of significant shareholders should also be included in criteria for determining independence in Kenya's concentrated ownership context. A clear definition of the NED role would empower NEDs in the performance of their duties and reduce uncertainty regarding their role given Kenya's medium uncertainty avoidance culture.

4.7.5 Remuneration Committees

Both England and Kenya are short-term time oriented cultures which are unlikely to focus solely on profit maximisation at the expense of returns or rewards.[932] As such, remuneration committees should be a major countervailing force to any short-term pressure from shareholders or the executive.[933] Only 6 out of 298 UK quote companies companies did not have a remuneration committee by 1995 and at present, all FTSE 100 companies have adopted remuneration committees.[934]Conyon's study on remuneration

[928] Wamala, E. (2004),pp.438-439
[929] Hermalin, B. E. and M. S. Weisbach (2003),7 -26
[930] S.3.1.2 CMA Guidelines
[931]Principle 2.18 King III 2009
[932] See generally, Hofstede et al (2005), p. 218.
[933] Walker, D. (2009), A Review of Corporate Governance in UK Banks and other Financial Industry Entities (16th July 2009), p.9; Also see Eisenberg, M.A. (1989), 'The Structure of Corporation Law,' Columbia Law Review,p.1489;Riley, C.A.(1995), 'The American Law Institute's Principle of Corporate Governance,' Company Lawyer, p.124; Pitiyasak, S. (2005), 'National Corporate Governance Committee: Three Disciplines for Good Corporate Governance in Thailand,' in Leong, H. K. (2005), Reforming Corporate Governance in Southeast Asia: Economics, Politics and Regulations, ISEAS Publications, p.233; Conyon, M. J. (1997), 'Institutional Arrangements for Setting Directors' Compensation in UK Companies in Keasey, K., Thompson, S. And Wright, M. (1997), Corporate Governance: Economic Management and Financial Issues, OUP, p.110
[934] Conyon, M. J. (1997), in Keasey et al, p.111.

committees in the UK found that in some circumstances, the adoption of remuneration committees lowers growth rates in top director compensation.[935]In another study, Conyon and Peck found that outside directors enhance the alignment of pay with performance.[936] Studies in the US however show different results. Anderson and Bisjak[937] and Vafeas[938] reported insignificant findings on the influence of remuneration committee independence on the level of CEO pay. Explaining these mixed findings, Sun and Cahan's study showed that the level of CEO compensation is related to the governance quality of the remuneration committee for US companies with fully independent remuneration committees.[939]Additionally, Conyon and He found that the presence of significant shareholders on remuneration committees is associated with lower CEO pay and higher CEO equity incentives.[940]Scholars argue that equity incentives align interests between management and shareholders.[941]Although the CMA Guidelines have been in place since 2002, the gap between the remuneration of employees and management in Kenya has continued to grow.[942] The remuneration of management in top companies in Kenya was reported to be approximately KES 2.5 million (US $33,400) a month, which is about 400 times higher than that of the lowest-paid employee.[943] Such a gap arguably reduces trust between directors, shareholders and stakeholders such as whose effectiveness is essential for achieving the firm's objectives.[944]

England's CC requires that the Board establish a remuneration committee of at least three INEDs.[945] The role of the remuneration committee is to set remuneration for all executive directors and the Chairman, as well as recommend and monitor the pay of

[935] Conyon, M.J.(1997),'Corporate Governance and Executive Compensation', International Journal of Industrial Organisation,15,pp.493-509
[936] Conyon, M.J. and Peck, S.I.(1998), 'Board Control, Remuneration Committees and Top Management Compensation', Academy of Management Journal,41,pp.146-157
[937] Anderson, R.C. and Bizjak, J.M.(2003), 'An Empirical Examination of the Role of the CEO and the Compensation Committee in Structuring Executive Pay', Journal of Banking and Finance,27,pp.1328-1348
[938] Vafeas, N.(2003), 'Further Evidence on Compensation Committee Composition as a Determinant of CEO Compensation', Financial Management,pp.53-70
[939] Sun, J. and Cahan, S.(2009), 'The Effect of Compensation Committee Quality on the Association between CEO Cash Compensation and Accounting Performance', Corporate Governance: An International Review,17(2),pp.193-207
[940] Conyon, M.J. and He, L.(2004), 'Compensation Committee and CEO Compensation Incentives in U.S. Entrepreneurial Firms', Journal of Management Accounting Research,16,pp.35-36
[941] Jensen, M. C. and Meckling, W. H. (1976), 'Theory of the Firm, Managerial Behaviour, Agency Costs and Ownership Structure', Journal of Financial Economics; Fama, E., & Jensen, M. C. (1983), 'Separation of Ownership and Control', Journal of Law and Economics,p.26.
[942] See Otieno, J. (2007), 'Kenya's Highest Paying Firms,' The Nation, October 19th 2007.
[943] Otieno, J. (2007).
[944] Child, J. and Rodrigues, S.B.(2003).
[945] S.D.2.1 CC 2010

senior management.[946]Similarly, Kenya's CMA Guidelines provide for a remuneration committee appointed by the board, consisting mainly of INEDs and NEDs to recommend the remuneration of executive directors.[947]In contrast however, England's CC allows the Chairman to be a member of the remuneration committee if he/she was considered independent on appointment but not chair the committee something which is not provided for in Kenya's CMA Guidelines. England's code surpasses Kenya's code by providing for the use of independent remuneration consultants[948] who bring independent knowledge on what competitors are paying their chairmen, executives and senior management. South Africa's King III requires companies to establish remuneration committees[949]and provides for the use of consultants by stating that committees should be free to take independent outside professional advice at the cost of the company subject to an approved process being followed.[950]On remuneration, King III requires that directors and executives be remunerated fairly and responsibly.[951]Remuneration policies should be aligned with the company's strategy and linked to individual performance.[952] They should also address base pay and bonuses, employee contracts, severance and retirement benefits and share-based and other long-term incentive schemes.[953]England also addresses severance in S.D.1.4 CC 2010 requiring remuneration committees to carefully consider what compensation commitments their director's terms would entail in the event of early termination with the aim of avoiding the reward of poor performance. Kenya's CMA Guidelines do not go into detail on the structure of directors' remuneration except that the remuneration of the executive director should include a share-option scheme to ensure maximisation of share-holder value.[954]The long-term interests of the company in the event of severance are not considered in the CMA Guidelines.

4.7.5.1 Suggestion

Remuneration committees are likely to provide a solution to Kenya's majority-minority agency problem as the divergence of interests in terms of remuneration occurs between management and shareholders; all shareholders will want executive remuneration linked to company performance. Therefore, this thesis recommends that Kenya keeps the

[946] S.D.2.2 CC 2010
[947] S.3.1.4 CMA Guidelines
[948] S.D.2.1 CC 2010
[949] Principle 2.23.6 King III 2009
[950] Principle 2.23.9 King III 2009
[951] Principle 2.25 King III 2009
[952] Principle 2.25.2 King III 2009
[953] Principle 2.25.2 King III 2009.
[954] S.3.1.4(iii) CMA Guidelines

remuneration committee as a corporate governance mechanism. The effectiveness of the remuneration committee could be improved in line Sun and Cahan's findings[955] by requiring that it is solely composed of INEDs and that efforts be made to ensure that its governance quality is improved, such as, training all directors on the importance of good corporate governance.[956]The role of the remuneration committee should also be extended to that of recommending and monitoring the pay of senior management as is the case in England.[957]The fair and responsible remuneration of directors and management considering the long-term interests of the company is something that Kenya can learn from South African corporate governance.[958] Incorporating fairness and responsibility into the awarding of executive remuneration would increase trust between directors, shareholders and stakeholders as fairness[959] and responsibility[960] are values of ubuntu. The pay of all directors and senior management should be aligned with company strategy and be linked to performance as is the case in South Africa.[961] Additionally, the remuneration committee should be required to carefully consider what compensation commitments their director's terms would entail in the event of early termination as is the case in England and South Africa, with an emphasis not solely on markets rates but also on fairness and responsibility. Kenyan medium power distance collective culture is not supportive of having a Chairman on the remuneration committee unless that Chairman is independent in accordance with S.3.2(iii) CMA Guidelines and prohibited from chairing the committee as is the case in England's CC so as to prevent reflexive loyalty.[962]Kenya would however benefit from England and South Africa's of allowing for the use of remuneration consultants. An independent remuneration consultant is likely to bring some objectivity to the awarding of remuneration in Kenya's Plcs, thereby aligning director, shareholder and stakeholder interests.

[955] Sun, J. and Cahan, S.(2009), 'The Effect of Compensation Committee Quality on the Association between CEO Cash Compensation and Accounting Performance', Corporate Governance: An International Review,17(2),pp.193-207
[956] At present, CCG Kenya trains directors on good corporate governance practice. www.ccg.or.ke
[957] S.D.2.2 CC 2010
[958] Principle 2.25 King III 2009
[959] See s.4.6.1 of this thesis
[960] King III,p.61
[961] Principle 2.25.2 King III 2009
[962] Morck, R. K..(2008),p.196

4.7.6 Nomination Committees

'If the board is to act as an effective monitor, then its composition is crucial, and the determination of that composition must be wrested from management.'[963] The purpose of the nomination committee is to make clear how director appointments are made.[964] Empirical evidence however shows UK companies have not embraced the nomination committee with the same vigour as they have the remuneration committee. In Main's 1993 study only 9 of the 24 companies in the UK studied had adopted a nomination committee[965]and in Plcs that had adopted the nomination committee, 'the nominations process [rested] firmly in the hands of the Chairman.'[966]The adoption of nomination committees improved in 1995 with more than 50% of Plcs having a nomination committee.[967] Although this number has since increased some Plcs still do not have a nominating committee.[968]These findings are in stark contrast with the US where by 1995, 95% of the Plcs had nomination committees.[969]Despite their increase, nomination committees have largely been overlooked in academic literature with existing studies showing that nomination committees can play a vital role in enhancing the independence of boards and reducing the influence of management.[970]

Both England[971] and Kenya's[972] corporate governance codes require that the boards of Plcs have nomination committees whose role is to appoint members of the board. The nomination committee is also a recommended practice in South Africa's King III.[973]England's CC 2010 provides that a majority of members of the nomination committee should be INEDs and the Chairman or an independent NED should chair the committee except when it is dealing with the appointment of a successor to

[963] Riley, C.A.(1995), 'The American Law Institute's Principle of Corporate Governance,' Company Lawyer,p.124.
[964] The Cadbury Code (1992), Report of the Committee on the Financial Aspects of Corporate Governance: The Code of Best Practice, Gee Professional Publishing, London, p.27.
[965] Main, B. (1993), 'Pay in the Boardroom: Practices and Procedures', Personnel Review, 22: 3-14 cited in Conyon, M. J. (1997), in Keasey et al, p.109.
[966] Main, B. (1993) in Keasey et al, p.109
[967] Conyon, M. J. (1997), in Keasey et al, p.119.
[968] Olswang point out that many AIM companies do not have a nomination committee. See Olswang (2006), Corporate Update, p.6. This document is available at http://www.olswang.com/pdfs/corp_jul06.pdf.
[969] Monk, R. and Nell, M. (1995), Corporate Governance, Blackwell cited in Conyon, M. J. (1997), in Keasey et al, p.112.
[970] Jensen, M.C.(1993), 'The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems', Journal of Finance,48(3),pp.830-879;Westphal,J.D. and Zajac,E.J. (1995), 'Who Shall Govern? CEO/Board Power, Demographic Similarity, and New Director Selection', Administrative Science Quarterly,40(1),pp.60-83;
[971] S.B.2.1 CC 2010
[972] See S.3.1.3 CMA Guidelines
[973] Principles 2.18.7&2.23.6 King III 2009

Chairmanship.[974] The role of the nomination committee is defined as that of evaluating the balance of skills, experience, independence and knowledge on the board and in the light of this evaluation preparing a description of the role and capabilities required for a particular appointment.[975]The requirement to describe the role and capabilities reflects uncertainty avoidance in this respect emphasising the importance of the right candidate being picked for the position. South Africa's King III requires the nomination committee to comprise a majority of NEDs of which the majority should be INEDs[976]and the role of the nomination committee as to assist with identifying suitable directors,[977]do background and reference checks of directors before nomination and appointment,[978] formalise appointments through a letter of appointment[979] and make full disclosure regarding individual directors to enable shareholders to make their own assessment of directors.[980]The requirement for disclosure to enable shareholders to make their assessment provides for inclusivity which is paramount under ubuntu. Transparency and participation of shareholders in the nomination process is likely to increase trust between majority and minority shareholders. Similarly, Kenya's CMA Guidelines S.3.1.3(i) states that nomination committees should consist mainly of INEDs and NEDs. In selecting directors, the nomination committee should only consider, '... persons of *calibre,* credibility and who have the necessary skills and expertise in exercising independent judgement on the issues that are necessary to promote the company's... business.'[981]

The use of the term 'calibre' in Kenya's medium power distance culture is of concern as it is often interpreted as meaning persons of high social standing reflecting the fact that appointment to boards in Africa are often political[982] and based on *'know who'* rather than *'know how'*. Eshiwani points out that a typical dysfunctional board in Kenya will denote a lack of corporate culture and given its broad regional composition, a lack of national values such as hard work and integrity in the doing of business.[983] According to Eshiwani, members of the board are typically elderly and the discussion that takes place

[974] S.B.2.1 CC 2010
[975] S.B.2.2 CC 2010
[976] Principle 2.23.7 Kings III 2009
[977] Principle 2.19.1 Kings III 2009
[978] Principle 2.19.2 Kings III 2009
[979] Principle 2.19.3 Kings III 2009
[980] Principle 2.19.4 Kings III 2009
[981] S.3.1.3(ii) CMA Guidelines
[982]G.J. Rossouw, 'Business Ethics and Corporate Governance in Africa' (2005), Business Society,44,p.94.
[983]Eshiwani, A. (2006) 'Director Liability in the Wake of Uchumi (Collapse)', Institute of Directors (Kenya), July 14, 2006

for the better part of the meeting has little to do with the objectives of the company.[984] This is in line with Gustavson et al's finding that some executives perceive taking up a board position as being a form of semi-retirement.[985] This perception is the result of the lack of a labour market for directors or the presence of an ill-functioning labour market. An ill-functioning labour market is the result of Kenya's feminine culture which manifests itself in the lack of competition within the market for directors. Consequently directors do not have the incentive to perform well in order to keep their position in the company. The absence of a requirement to describe roles and their capabilities is likely to increase uncertainty in Kenya's uncertainty avoidance culture and result in a tendency to fall back on relationship between the appointer and the appointee and historic loyalties such as tribe thereby lowering trust.

This is further reinforced by S.3.1.3(iii) CMA Guidelines which states that the nominee committee should also 'consider candidates for directorship proposed by the CEO and shareholders.' This provision is likely to cause problems of misplaced loyalty[986]as an examination of Kenya's Plcs shows that it is common for CEOs to sit in nomination committees: in Nation Media Group,[987] Cooperative Bank[988] and Transcentury,[989] the CEO sits in the nomination committee. Like England's CC 2010, S.3.1.3(iv) CMA Guidelines requires the nomination committee to review the boards mix of skills and expertise. Newly appointed directors should also be given an orientation on the company's business to enhance their effectiveness.[990]Additionally, the appointment process should be sensitive to, amongst other things, 'national outlook and should not be perceived to represent single or narrow community interests.'[991]The CMA Guidelines also provide that the nominating committee should recommend to the board 'candidates for directorships to be filled by shareholders as the responsibility for nominating rests on the full board, after considering the recommendations of the nominating committee'[992]reflecting the committee's subservience to the board and the common practice in Kenya's Plcs where directors also tend to top-ten shareholders.

[984] Eshiwani, A. (2006).
[985] Gustavson, R., Kimani, N. N. and Ouma, D. A. (2005), The Confluence of Corporate Governance and Business Ethics in Kenya: A Preliminary Investigation, 5th BEN - Africa Conference, Kasane, Botswana, p.8.
[986] See Morck, R. K..(2008), p.180
[987] Nation Media Group Annual Report 2010
[988] Coop Bank 2010 Annual Reports & Financial Statements
[989] Transcentury Annual Report & Financial Statements 2010
[990] S.3.1.3(iv) CMA Guidelines
[991] S.3.1.3(viii) CMA Guidelines
[992] S.3.1.3(vii) CMA Guidelines

4.7.6.1 Suggestion

The author suggests that for the nomination committee to be successful In Kenya's medium power distance culture it should be composed of INEDs and be free from the influence of management and majority shareholders. Provisions such as S.3.1.3(vii) CMA Guidelines which provide for 'directorships to be filled by shareholders' are not helpful if independence is to be maintained on the boards of Kenya's Plcs. Additionally, the CEO should not sit in the nomination committee or chair its proceedings as this is likely to lead to unquestioning obedience of his recommendations in Kenya's collective context.[993] Adopting England's approach of describing roles and the capabilities required for each role, rather than using terms such as 'caliber' would go a long way in introducing objectivity in appointments, increasing certainty and therefore trust between majority and minority shareholders. Additionally, the author recommends the retention of regional balancing as a consideration in selecting candidates for board positions. Although demographically similar boards can advance in-group cohesion thereby increasing trust within board members,[994] they can also lead to the phenomenon of 'group think' where individuals cede to consensus in order to be part of the group leading to business failure.[995] Whilst consensus is important in ubuntu, it should be informed and rationalised consensus for it to promote the interests of the company.

4.7.7 Audit Committees

Another mechanism that England[996] and Kenya's[997] corporate governance code have in common is the audit committee. Malin points out that the audit committee is arguably the most important of the board sub-committees.[998]The main role of the audit committee is to advise on the audit and to have free access to company financial information and its auditors.[999]In principle, having an audit committee comprising solely of NEDs could improve financial disclosure practices, communications with shareholders, and the independence of the firm's auditors by discouraging their dependence upon the

[993] See Morck, R. K..(2008),p.180
[994] Leigh, A. (2006);Westphal, J.D. and Zajac,E.J.(1995), 'Who Shall Govern? CEO/Board Power, Demographic Similarity, and New Director Selection', Administrative Science Quarterly,40(1),pp.60-83
[995] Ramirez, S.A. (2003), 'A Flaw in the Sarbanes-Oxley Reform: Can Diversity in the Boardroom Quell Corporate Corruption?' St John's Law Review, 77,pp.837-866; Janis, I.L.(1972), Victims of Groupthink A Psychological Study of Foreign-Policy Decisions and Fiascos, Houghton Mifflin, Boston.
[996] S.C.3.1 CC 2010
[997] S.3.5 CMA Guidelines
[998]Malin, C. A. (2010), Corporate Governance, OUP, p.169.
[999] Ezzamel, M. and Watson, R. (1997), 'Wearing Two Hats: The Conflicting Control and Management Roles of Non-executive directors,' in Keasey et al (1997), p.68.

executives who employ them and pay them.[1000]Beattie et al report that audit partners, finance directors and financial journalists believed that audit committees with independent directors strongly encourage auditor independence.[1001]However, the requirement in the US' Sarbanes Oxley Act 2002 (SOA) that the SEC to adopt rules mandating that audit committees of Plcs must comprise at least one member who is a financial expert – that is, with accounting education or experience-[1002]resulted in criticism that it was overly restrictive and severely limited the pool of qualified experts. Even Alan Greenspan and Warren Buffet would not have qualified as financial experts under the new rules.[1003] As a result the SEC adopted a more liberal definition of financial expertise, to include accounting expertise as well as any experience in supervising employees with financial responsibilities and overseeing the performance of companies. However, following the substitution of the SOA requirement a significant number of studies find no evidence that financial expertise positively influences audit committee effectiveness.[1004] Studies based on the narrower definition have found that there are advantages of having financial expertise on audit committees.[1005]Critics however argue that these studies have not examined the influence of accounting expertise separately.[1006]

While England's code requires that the audit committee consist of at least three INEDs,[1007]Kenya's CMA Guidelines require that the audit committee consist of at least three 'independent and NEDs' suggesting that all members of the audit committee do not have to be independent.[1008]England's CC also requires that at least one member of the audit committee has 'recent and relevant financial experience.'[1009]Additionally, the

[1000] Ezzamel, M. and Watson, R. (1997), in Keasey et al (1997), p.69.
[1001] Beattie et al (1999), 'Perceptions of Auditor Independence: UK Evidence', Journal of International Accounting & Taxation,8(1),pp.67-107
[1002] S.407 Sarbanes Oxley Act 2002
[1003] Bryan-Low,C.(2002), Defining Moment for the SEC: Who's a Financial Expert?, Wall Street Journal, December 9th.
[1004] Carcello, J.V. and Neal,T.L.(2003), 'Audit Committee Characteristics and Auditor Dismissals following 'New' Going-Concern Reports', The Accounting Review,78,pp.95-117;Lee,H.Y., Mande, V. and Ortman,R.(2004), 'The Effect of Audit Committee and Board of Director Independence on Auditor Resignation', Auditing: A Journal of Practice & Theory,23,pp.131-146; DeFond, M.L. et al (2005), 'Does the Market Value Financial Expertise on Audit Committees of Board Directors?', Journal of Accounting Research,43,pp.153-193
[1005] Krishnan, J.(2005), 'Audit Committee Quality and Internal Control: An Empirical Analysis', The Accounting Review,80,pp.649-675;Bedard,J. et al (2004), 'The Effect of Audit Committee Expertise, Independence, and Activity on Aggressive Earnings Management', Auditing: A Journal of Practice &Theory,23,pp.13-35
[1006] DeFond, M.L. et al (2005), pp.153-193;
[1007] S.C.3.1 CC 2010
[1008] S.3.5.1 CMA Guidelines
[1009] S.C.3.1 CC 2010; FSA Rule DTR 7.1.1 R

main role and responsibilities of the audit committee should be set out in writing[1010]and include to monitor the integrity of financial statements, to review the company's internal financial controls, to monitor and review the effectiveness of the company's internal audit function, to have primary responsibility[1011] for making recommendations to the board on the appointment and removal of the external auditor and its remuneration, to review and monitor the external auditor's independence, to provide an explanation to shareholders how if the auditor provides non-audit services auditor objectivity and independence is safeguarded,[1012] to develop and implement policy on the engagement of the external audit to supply non-audit services,[1013]to review arrangements by which staff can in confidence raise concerns improprieties in financial reporting[1014],to review the effectiveness of the internal audit.[1015] South Africa's King III requires the audit committee consist of at least three INEDs and that the chairman of the board should not be chairman or the audit committee.[1016]The audit committee can consult specialists/consultants subject to approval.[1017]The responsibilities of the audit committee are very similar to those of England except that integrated reporting that takes into account stakeholder interests such as sustainability is required.[1018]King III states that by issuing integrated reports, a company increases the trust and confidence of its stakeholders and the legitimacy of its operations. It can increase the company's business opportunities and improve its risk management. Additionally, integrated reports make a company evaluate its ethics, fundamental values and governance which improves the trust and confidence of stakeholders. The integrated report should have sufficient information on how the company has both positively and negatively impacted on the economic life of the community and how it plans to improve the positive aspects and ameliorate the negative aspects.[1019]This approach ensures inclusivity of stakeholders which is a value under ubuntu.

In terms of financial experience, Kenya's CMA Guidelines require 'familiarity with basic accounting principles.'[1020]Like England, Kenya requires that terms of reference which

[1010] S.C.3.2 CC 2010; FSA Rule DTR 7.1.3 R
[1011] S.C.3.6 CC 2010;
[1012] S.C.3.7 CC 2010;
[1013] S.C.3.2 CC 2010;
[1014] S.C.3.4 CC 2010;
[1015] S.C.3.5 CC 2010;
[1016] Principle 3.2 King III 2009
[1017] Principle 3.2.6 King III 2009
[1018] Principle 3.4 King III 2009
[1019] King III 2009,p.12
[1020] S.3.5.2 CMA Guidelines

deal clearly with the authority and duties of the audit committee be put in writing[1021] reflecting Kenya's uncertainty avoidance culture. The duties of the audit committee are set out in S.3.5.3 CMA Guidelines are more detailed that those in England's CC 2010. They include: being informed, vigilant and effective overseers of financial reporting, considering the appointment of the external auditor, its remuneration and independence, reviewing company's financial statements, discussing problems arising from audits with external auditor, reviewing communication between external auditor and management, considering related-party transactions, considering major findings of internal investigations and management response, having explicit authority to investigate any matter within its terms of reference, obtaining professional advice if necessary and[1022]determining the remit of the internal audit function.[1023]S.3.5.5 CMA Guidelines provides that the finance director should attend meetings of the audit committee.[1024]

Barako et al's study on compliance with Kenya's corporate governance code found that Kenya's Plcs willingly complied with the requirement to have audit committees.[1025]The success of the audit committee in the Kenyan context can be attributed to its ownership structure which is concentrated coupled with the fact that there is no divergence of interests between minority and majority shareholders: both want financial statements that reflect the true position of the company. Another factor that explains the success of the audit committee in the Kenyan context is that, Kenyan Plcs were already required by law to hire auditors.[1026] Therefore the requirement to have an audit committee in the CMA Guidelines did not contradict existing practice.

4.7.7.1 Suggestion

As the audit committee seems to be effective mechanism in the Kenyan context, the author suggests that the efficacy of the audit committee can be further improved in the Kenyan context by requiring that it is fully composed of INEDs in accordance with Beattie et al finding that committees with independent directors strongly encourage auditor independence.[1027] As studies have shown that there are advantages of having financial

[1021] S.3.5.1 CMA Guidelines
[1022] S.3.5.3 CMA Guidelines
[1023] S.3.5.4 CMA Guidelines
[1024] S.3.5.5 CMA Guidelines
[1025] Barako, D.C, et al (2006), 'Factors Influencing Voluntary Disclosure by Kenyan Companies', Corporate Governance: An International Review, Vol 12, 2, 107-125.
[1026] See eStandardsForum, Kenya: International Standards on Auditing at http://www.estandardsforum.org/kenya/standards/international-standards-on-auditing.
[1027] Beattie et al (1999), pp.67-107

expertise on audit committees,[1028]Kenya's code should require more than 'basic' accounting knowledge. The author recommends the adoption England's requirement that one of the members of the audit committee have recent and relevant financial experience. Due to Kenya's medium power distance culture, S.3.5.5 CMA Guidelines which provides that the finance director should attend meetings of the audit committee might be problematic in the Kenya context resulting in obedience to a legitimate authority[1029] especially in the current situation where only basic accounting knowledge is required. In the interests of the company, the author suggests that the audit committee should sole consist of INEDs with the financial director only attending on invitation to answer questions – not to chair a meeting.

Additionally, Kenya's CMA Guidelines should be improved to ensure accountability to stakeholders by adopting the South African approach of integrated reporting which requires the company as a member of the community within the ubuntu philosophy to be accountable on the positive and negative effects that its activities have had on the community and how it intends to improve. To further improve accountability to shareholders, the author recommends that annual reports be simplified to make the information in them accessible to both shareholders and stakeholders as required in ubuntu. In examining, the annual reports of Kenya's companies in 2010, the author has found the financial statements to be nearly impossible to decipher for those outside the accounting and finance professions. This is importance as through annual reports management can disseminate information that reduces uncertainty about the firm.[1030] Unintelligible reports introduce conflict and are arguably not based on ubuntu as they show little concern for their users and in so doing reduce trust between directors, shareholders and stakeholders. Sharing/inclusivity is an important value in ubuntu.

4.7.8 Shareholder Engagement

Passivity of shareholders is a problem for both England[1031] and Kenya's corporate governance. England deals with this problem in the CC 2010 by requiring that directors

[1028] Krishnan, J.(2005),pp.649-675
[1029] Morck, R. K..(2008),p.180
[1030] Baker, H. E., and Kare, D. D. (1992), 'Relationship between Annual Report Readability and Corporate Financial Performance', Management Research News, 15(1), pp.1-4.
[1031]Britain's shareholders have traditionally taken a 'hands off' approach towards corporate governance. See Cheffins, B.(2010), 'The Stewardship Code's Achilles Heel', Modern Law Review,p.1004;Keay points out

of FTSE 350 companies be subject to annual election by shareholders[1032] and through the introduction of a Stewardship Code 2010.[1033] The Stewardship Code, based on the comply/explain approach, describes the interventionist role of institutional investors in detail,[1034] its aim being 'to enhance the quality of engagement between institutional investors and companies to help improve long-term returns to shareholders.'[1035] England's effort to describe in detail the institutional investor's role as a corporate governance mechanism, in spite of England's uncertainty avoidance culture, is reflective of the importance of shareholder engagement for the effective functioning of corporate governance. The Stewardship Code is supported by the CA 2006 which provides that institutional shareholders disclose how they voted owned shares[1036]and the FRC's decision to post on its website those institutional investors that publish a statement on the extent of compliance.[1037]According to the FRC, greater clarity in the respective responsibilities of asset managers and owners as well as strengthened accountability of institutional shareholders to clients will strengthen trust in the financial system.[1038] Cheffins argues that primarily due to the sustained fragmentation of share-ownership in the UK over the past twenty years, the Stewardship Code is unlikely to foster substantially greater shareholder involvement in UK corporate governance.[1039]

Kenya, on the other hand provides for a Shareholders Association and for institutional investor intervention in the CMA Guidelines. S.3.3(xiii) CMA Guidelines states that the role of the Shareholders Association is to promote dialogue between the company and the shareholders by encouraging all shareholders to participate in the annual general meeting of the company or assign necessary voting proxy.The role of institutional

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that shareholder democracy in the UK is a 'myth.' See Keay, A. (2007), 'Company Directors Behaving Poorly: Disciplinary Options for Shareholders', Journal of Business Law,p.682;McConvill argues that due to the passivity of shareholder's in the UK the general meeting has been turned into little more than a 'rubber stamp'for approving directors decisions. See, McConvill, J. (2005),'The Separation of Ownership and Control Under a Happiness-Based Theory of the Corporation', 26 (2) Company Lawyer, pp.35, 39.

[1032] S.B.7.1 CC 2010.

[1033] FRC(2010), The UK Stewardship Code, July 2010

[1034] Stewardship Code, pp.5-12

[1035] Stewardship Code 2010, preface. England's approach to stewardship as expressed in the Stewardship Code 2010 is different to that of South Africa where management is required to formulate policies for the management of relationships with each stakeholder. See King III, Ch.8

[1036] Ss.1277-1278 CA 2006

[1037] Stewardship Code 2010, preface.

[1038] FRC(2010), Consultation on a Stewardship Code for Institutional Investors, January 2010.

[1039] Cheffins, B.(2010),p1004. There are also concerns that the Stewardship Code is not well targeted. Key investors therefore fall outside its mandate. Other concerns are that the flexibility granted by the comply/explain approach creates a risk that institutional investors will not treat compliance as a priority. See Reisberg, A. (2011), 'The notion of Stewardship from a Company Law Perspective', Journal of Financial Crime,pp.127,131; Masters, B., and Burgess, K.(2010), Investors Raise Fears on 'Stewardship Code', Financial Times, April 15th.

investors is described in s.3.3(x) CMA Guidelines as that of entering into a dialogue with the directors of the company and exercising their vote conscientiously. However, unlike England, Kenya does not provide guidance on how this intervention should take place. The effectiveness of the institutional investor as a corporate governance mechanism is based on the fact that they hold a significant stake in Plcs and therefore it is unlikely that a director will keep his position should an institutional investor disinvest because of poor management. However, in practice, the effectiveness of the institutional investor is limited as they may not be able to simply sell their stakes where they disagree with the direction of the company.[1040] This is particular so in Kenya's concentrated ownership context where the NSE is not as active as the LSE. Institutional intervention can also lower trust between majority shareholders and minority shareholders where directors seem to be acting in the interests of majority shareholders. England's approach to monitoring by the institutional investors may further lower trust between directors and majority shareholders in the Kenya context as distinction between monitoring the director and placing undue influence on the director in the running of the company is unclear in the Kenyan context.

4.7.8.1 Suggestion

Although England in its Stewardship Code states that UK institutions that apply the code should use their best efforts to apply its principles to overseas holdings,[1041] such an approach is not welcome in the Kenyan context as it is incompatible with ubuntu.The author suggests that Kenya should follow the South African approach to stewardship which considers not just the interests of shareholders but also those of stakeholders and therefore reflects ubuntu. The CMA Guidelines could be strengthened by describing how shareholders and stakeholders are to engage with the company. This description should include the fact that any intervention by institutional investors/majority shareholders in the affairs of the company should be in the interests of the company as a whole whose sustainability is in the interests of ubuntu. This would increase trust between majority and minority shareholders by minimising uncertainty on shareholder/stakeholder engagement in Kenya's medium power distance culture. In terms of engagement, the author proposes a face-to-face approach which is in line with the ubuntu values of co-existence, consultation and consensus and reflective of Kenya's relationship culture.[1042]

[1040]CalPERs has acknowledged this position. See Bernstein, A.(2007), 'Power to Shareholders', Directorship,33(5),p.18

[1041] Stewardship Code, preface.

[1042] Rushworth, J. and Schluter, M. (2010), 'The Relational Business Charter: A New Approach to the Purpose, Performance and Assessment of Companies', Draft Paper, Relationships Global, Cambridge.

Such an approach would promote inclusivity therefore ubuntu, promoting trust between the majority and minority shareholders and between the company and the local community.

4.7.9 The suitability of the comply/explain approach for the Kenyan context

Amongst the advantages of the comply/explain approach is that it avoids litigation. This makes it less costly and it can easily be internalised into the corporate operational structure.[1043] Self-regulation provides less procedural hurdles for minority shareholders and is therefore an easier remedy to use for minority shareholders in Africa than the law. Regulatory bodies in charge of compliance usually have a more practical sanctioning system than is available through litigation such as delisting companies from the stock exchange. As court cases in the Kenyan context take a couple of years to be resolved, self-regulation offer sanctions that are more in the long-term interest of the company than litigation. Additionally, self-regulatory codes can easily be adapted and reviewed compared to statutes, and may therefore provide a solution to corporate governance in developing countries.

However, despite the advantages of self-regulation, it has done little to improve corporate governance in Kenya. First, as Kenya's code operates on a 'comply/explain' basis it is possible for Kenya's Plcs not to comply with the CMA Guidelines and give an explanation instead. Few companies report their compliance with the CMA Guidelines making it difficult to assess compliance. The reason for low compliance may be that whilst in England companies were involved in the drafting of the Combined Code and therefore have an incentive to comply as these guidelines as they reflect their needs, in Kenya the CMA Guidelines were imposed on the companies listing on the NSE. As the CMA Guidelines are not legally binding, Plcs cannot be made to respect them or comply with them as no legal action will be taken against them except in extreme cases where there is fraud. Secondly, the CMA Guidelines have not been given enough publicity and there is hardly any pressure from shareholders and stakeholders – compared to that in England- to observe the CMA Guidelines[1044]as pressure groups are weak and not well organised.[1045]In the recent Uchumi case, despite the pressure from shareholder and stakeholders compliance with the CMA Guidelines was not considered in court as the

[1043] Dane, L.B. and Wood, N.(2007), Making Global Self-Regulation Effective in Developing Countries, OUP.
[1044] Shareholder and stakeholder pressure can influence the observance of self-regulatory codes. Graham, D. and Woods, N. (2006), 'Making Corporate Self-Regulation Effective in Developing Countries', World Development,34,p.868
[1045] The Centre for Corporate Governance is however training shareholders in this regard. www.ccg.or.ke

corporate governance code has no force in law. Thirdly, the CMA has also proved to be unable to effectively implement Kenya's self-regulatory corporate governance code. The presence of a functional market also makes non-compliance with the corporate governance code costly[1046] for England's Plcs as they need to build up a good reputation on their disclosure practices and social responsibility. Although the review of Kenya's corporate governance code is likely to improve corporate governance at board level, it is unlikely to make any difference to the minority shareholder where it is breached as it is not legally binding. There is therefore need to research on alternative models of regulating corporate governance in Kenya in particular whether Kenya should adopt a hard law approach to its corporate governance regulation such as that of the US in the Sarbanes Oxley Act of 2002 or a hybrid form of self-regulation whether the government has a role in enforcement[1047]as well as the effects of each approach in creating trust in Kenya's corporate governance context.

4.8 Conclusion

The aim of this chapter was to carry out a comparative study between England and Kenya's corporate framework taking into account the effects of culture and ethnic diversity on corporate governance. This chapter pointed out that ethnic heterogeneity is negatively correlated with trust. Trust was found to be a mechanism that reduces complexity thus enabling people to deal with high levels of uncertainty. This chapter found that for Kenya as a country in transition, trust is needed as a mediator between the contract and the kinship norm. In comparing England and Kenya's framework this chapter found a positive correlation between Hofstede's uncertainty avoidance dimension and trust. This chapter found that to create trust in Kenya's ethnically heterogeneous society it was necessary to neutralise tribalism and explored the creation of trust through ubuntu. On how far we should go in Africanising Kenya's framework, this chapter decided to limit the adaptation of the framework along the lines of ubuntu to the corporate governance level and preserve the core of common law. The comparative section of Part II examined directors' duties, the duties of nominee directors and the derivative action. This chapter found the main directors duties were common-law based, a contradiction to Kenya's uncertainty avoiding culture which values predictability. In this regard, this thesis recommended codification of directors' duties to increase certainty and therefore accountability in Kenya's Plcs. Another finding was that directors

[1046] Roirdan, C.M, Gatewood, R.D., Bill, J. (1997), 'Corporate Image: Employee Reactions and Implications for Managing Corporate Social Performance', Journal of Business Ethics, 16(4),p.401

[1047] Ayres, I. and Braithwaite, J. (1992), Responsive Regulation: Transcending the Deregulation Debate, OUP.

were held to a subjective standard in their duty of care, this chapter suggested that an objective standard be adopted to increase trust in corporations. Part III found Hofstede's dimensions of power-distance and uncertainty avoidance to significantly determine the efficacy of Kenya's corporate governance. Alternative authority figures were found to be necessary in Kenya's medium power distance culture as they would weaken subservience and group think. To neutralise the negative effects of ethnicity on Kenya's corporate governance, this thesis suggested that a clear definition of the NEDs role was important particularly where it is adapted to reflect the ubuntu value of consensus. Finally, this chapter recommended further research on how self-regulation can be strengthened in order to create trust in the Kenyan corporate governance context.

Chapter 5: Conclusion

5.1 Introduction

The aim of this chapter is to draw a close to the issues discussed in this thesis and in so doing highlight the contribution of this thesis. This chapter also considers the limitations of this thesis and directions for future research.

5.2 Findings of this thesis

The research question that was the subject of this thesis was:

> 'How can Kenya's legal framework for governing directors be adapted to reflect local conditions and ideologies so as to improve accountability in Plcs in Kenya?'

This thesis suggested that Kenya's framework be reviewed taking into account the ownership structure of Kenya's Plcs and the African philosophy of ubuntu. This suggestion was made on the basis of findings that a history of ethnically repressive policies have lowered trust and resulted in concentrated ownership in Kenya's Plcs. Kenya like many developing countries has adopted the Anglo-American model of corporate governance following its popularisation as a model of economic success by proponents of the 'law matters' thesis and its endorsement by international financial bodies. However, this thesis has found tensions between Kenya's culture and effective functioning of some of the mechanisms proposed in Kenya's Anglo- Saxon-based corporate governance model such as the NED. The fact that most of Kenya's directors have grown up under the kinship norm and therefore their thinking is not solely influenced by the social and economic structures of capitalism alone has interfered with its effective function of Kenya's framework. Trust is therefore needed as a mediator between the contract norm contained in Kenya's English-based corporate framework and the kinship norm. Welter points out that trust is particularly important in transition economies which are characterised by economic, political and societal changes as these changes render previously learned behaviour contradictory to what is required in a modern market-based society.[1048]

[1048] Welter, F. (2005), 'Culture versus Branch? Looking at Trust and Entrepreneurial Behaviour from a Cultural and Sectorial Perspective,' in Hohmann, H. H. and Welter, F.(2005), Trust and Entrepreneurship: A West – East Perspective, Edward Elgar,p.26

Secondly, this thesis found that ownership structure should be taken into account in coming up with an appropriate model of corporate governance. In Kenya where ownership is concentrated, this thesis found that the agency problem is primarily between majority and minority shareholders and suggested that the law be reviewed to address the majority-control problem which has lowered trust in Kenya's Plcs. On examining Kenya's legislation this thesis found that there is little in the way of innovation in amending and interpreting statutes that were originally adopted from England to solve Kenya's corporate governance problem. This has resulted in oppressive application of the law with legal practice being heavily skewed in favour of directors and majority shareholders who it is supposed to monitor.

Thirdly, this thesis found that Kenyan courts have struggled with the uncertainty acceptance nature of English common law. Due to the under-development of institutions such as Kenya's law reporting, this thesis found this has resulted in a lack of awareness of directors' duties amongst directors and a tendency to focus on the technicalities of procedure in derivative actions sidelining the legal issue at hand. To remedy this, this thesis suggested codification of the corporate objective and director's duties to make them more accessible to directors, shareholders and Kenya's judiciary. Additionally, this thesis suggested the repeal of the oppression standard in derivative claims and the adoption of a fairness standard in line with English law. In sum, thesis found that codification would reduce uncertainty and is likely to improve compliance with directors' duties in the Kenyan context. Codification coupled with the adoption of a fairness standard in common law would prevent creative compliance that is common in civil law countries where in tunneling cases transactions are structured in such a way as they do not consist theft or fraud in law. The adoption of a fairness standard in Kenya's derivative action covers situations that no one has foreseen or categorised.[1049]

Finally, while Hosftede's uncertainty avoidance was found to be the key influential cultural dimension in the functionality of Kenya's law, both power-distance and uncertainty avoidance were found to determine the effective functioning of Anglo-Saxon based corporate governance mechanisms at board level. This chapter found that in some of Kenya's firms the board tends to go beyond its level of operation usurping the role of management whilst in others management had a lot of control overshadowing directors. This was attributed to a lack of clarity in roles and this chapter recommended the detailed description of the roles of the board and its relation to management thus

[1049] Johnson, et al(2000), 'Tunneling', AEA Papers and Proceedings,p.24

increasing certainty and trust between management and the board. Alternative authority figures were found to be necessary in Kenya's medium power distance culture as they would weaken subservience and group think.

5.3 The contribution and broader implication of this thesis

The first contribution of this thesis is to comparative law. As little has been done in comparative law on Africa,[1050]by comparing the laws of England and Kenya this thesis contributes to existing knowledge by providing a description of Kenyan culture and an illumination of how this culture affects the effective function of corporate law.

The second contribution of this thesis is its attempt to fill the cultural gap in corporate governance.[1051] In this regard it finds that ethnicity, particularly through kinship plays a key role in the efficacy of the Anglo-American model of corporate governance when it is transplanted to the Kenyan context. This finding supports Ruskola's finding that, unlike Anglo-American countries where 'contract' is the basic norm of business association, in collective systems, kinship is the basic norm of business associations.[1052]

5.4 Limitations of this study

The main limitation of this study was the absence of sufficient empirical data on the ownership structure and directorship of Kenya's Plcs to make a complete evaluation of the nature and extent of kinship relations in Kenya's corporate governance particularly on deliberations on the board and on the protection of minority shareholder interests.

5.5 Directions for future research

It is the author's opinion that corporate governance research would benefit from an empirical study on the role of ethnicity in African corporate governance. Although ethnicity was found to affect relations on the board and result in factions in Kenya's Plcs, there is insufficient information to determine the channel through which ethnicity leads to the formation of factions in Kenya's corporate governance.

Secondly, corporate governance research would benefit from an analysis of the difference between Asian and African kinship. From the findings of this thesis, although both Kenyan Africans and Kenyan Asians subscribe to kinship there is a factor that

[1050] Giliker, P., (2006), p.243.
[1051] On the cultural gap, see Ching et al (2006), p.33.
[1052] Ruskola, T. (2000), 'Conceptualizing Corporations and Kinship: Comparative Law and Development Theory in a Chinese Perspective', Stanford Law Review, Vol. 52, No. 6, pp. 1599-1729.

distinguishes Asian kinship - in terms of its ability to develop large corporations - which to the author's knowledge is not yet researched.

Thirdly, there is need for further research on how self-regulation can be strengthened in order to create trust in the Kenyan corporate governance context.

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