Enhancing Kenya's Securities Markets through Corporate Governance: Challenges and Opportunities

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Abstract

The essential role played by corporate governance in the promotion of securities markets cannot be over-emphasized. Internal corporate governance structures of publicly held companies must inescapably imbue trust and enhance investor confidence in the organization. Similarly, the external corporate governance architecture must be facilitative and effective in safeguarding the securities markets in general. This paper argues that the current internal and external corporate governance structures for listed companies in Kenya are largely dysfunctional in safeguarding investor interest and promoting investor confidence as exemplified by incessant corporate scandals. The operative principles of corporate governance for listed companies, which are based on the dispersed ownership structure and whose enforcement matrix is "comply or explain" have not been particularly effective. More importantly, the obligations of directors, role of external auditors, shareholders and the ownership architecture have not facilitated the institutionalization of a responsive culture of corporate governance. There is need for a paradigmatic shift.

Although the phrase "corporate governance" has been in existence for over several decades,[1] its prominence in the recent past is attributable to developments in the corporate sector which have catapulted it to the forefront in the market confidence and investor protection matrix.[2] Corporate scandals are reshaping the way that corporations are directed and controlled. Although the contours of corporate governance are yet to be clearly delineated, it has become a topical and fashionable subject. Analogous to other fashionable concepts, the phrase corporate governance has no universally accepted definition and has not infrequently been misconstrued as the *panacea* for all corporate ills.[3]

Commentators acknowledged that corporate governance is concerned with rights and responsibilities of company's management, its board of directors, shareholders and other stakeholders.[4] The phrase corporate governance is narrowly used to designate the "system by which companies are directed and controlled"[5] or the institutions that influence how business corporations allocate resources and returns.[6] Put differently, corporate governance is concerned about the governance of corporations[7]or simply how corporations are run.

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[1] John H. Farrar. The Corporate Governance of SMEs and Unlisted Companies, 14 NZBLQ 213, 213 (2008).
[2] Jeswald W. Salacuse, Corporate Governance in the new Century, 25(3) Comp L. 69, 69 (2004); THOMAS .J. DOUGHERTY, THE POLITICAL ECONOMY OF CORPORATIONS: VARYING APPROACHES TO CORPORATE GOVERNANCE AROUND THE WORLD, SL085 ALI-ABA 253, 256-57 (2006); Henry Bosch, The Changing Face of Corporate Governance, 25U.N. S. W. L.J. 270 (2002).
[3] See Angus Young, Frameworks in Regulating Company Directors: Rethinking the Philosophical Foundations to Enhance Accountability, 30(12) COMP. LAW. 355, 355 (2009).
[4] OECD: Organization for Economic Co-operation and Development, Corporate Governance: Frequently Asked Questions about the OECD Principles of Corporate Governance, available at http://ww.oecd.org.faq/02583, en_2649_37439_31717413_1_1_1_3473900html (visited on July 24, 2010).
[5] Report of the Committee on the Financial Aspects of Corporate Governance (Cadbury Report), para.2.5 available at www.ecgn.org (visited on July 24, 2010).
[6] Mary O'Sullivan, "Corporate Governance and Globalization" (2000) 570 ANNALS, American Academy of Political Science 153-154.
[7] Bashar H. Malkawi, Building a Corporate Governance System in Jordan: A critique of the Current framework, 6 J.B.L. 488, 489 (2008).

A broader exposition of the phrase would be that it is a system of checks and balances to ensure that decisions makers are accountable to stakeholders.[8] Monks and Nell perceive it as "the structure that is intended to make sure that the right questions get asked and that checks and balances are in place to make sure that the answers reflect what is best for the creation of long term sustainable value."[9] It is the process of regulating and overseeing corporate conduct and of balancing the interests of internal and other parties who can be affected by the corporations' conduct.[10] The object is to promote responsible behavior by corporations for the attainment of the maximum possible level of efficiency and profitability. According to Parkinson, corporate governance is the system through which those involved in the company's management are held accountable for their performance with the aim of ensuring that they adhere to the company's proper objectives.[11] This explanation is based on the United Kingdom's Cadbury Report.

In a nutshell, corporate governance comprehends a framework of rules, principles, systems and processes within and by which corporate authority is exercised and controlled for the benefit of all stakeholders. Most common law jurisdictions adopted the definition in Hampel's Report[12] whose thrust is optimization of shareholder value through business prosperity and corporate accountability while taking into account the interests of other stakeholders. The underlying principle is that affairs of corporations should be managed in a participatory, transparent, and effective manner for the benefit of internal and other stakeholders. Although the roots of corporate governance are traceable to the separation of corporate ownership and control, the concept has now expanded in some jurisdictions to encompass other stakeholders.

Why corporate governance?

There are legitimate reasons to nurture and promote corporate governance particularly in developing countries whose main goal is to promote economic growth to raise the standards of living of the people.[13] Because securities markets are an integral part of the development template, corporate governance plays an important role.[14] Good corporate governance practices ensure integrity, transparency, accountability and enforceability in the market place.[15] They facilitate efficient allocation of resources and guarantee investors substantial returns on their investment.[16] Corporate governance enhances investor protection and encourages investment.[17]

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[8] Jill Solomon & Anis Solomon, Corporate Governance and Accountability, 12-15 2004); FARRAR, COMPANY LAW (3 rd Ed., Butterworth 301 1998); Guobadia D.A. The Rules of Good Corporate Governance and the Methods of Efficient Implementation: A Nigeria Perspective, 22(4) COMP. L. 119 (2001).

[9] ROBERT A.G. MONKS & NELL MINOW, CORPORATE GOVERNANCE, 3 (4th ed. 2008).

[10] See Rose A. Zukin, We talk, you listen: Should shareholders' voices be heard or stifled when nominating Directors? How the Propose Shareholder Director Nominating Rule will contribute to restoring proper Corporate Governance, 33 PEPP L. REV. 937, 949 (2006).

[11] See generally PARKINSON J., COMPANY LAW AND STAKEHOLDER GOVERNANCE (1997).

[12]Final Report of the Committee on Corporate Governance, available at http:// www.ecgi.org/codes/documents/hampel.pdf (visited on July 20, 2010).

[13] See Lucian Bebchuk et al., What Matters in Corporate Governance, 22 REV. FIN. STUD. 783, 786 (2009); Vikramaditya Khanna, Corporate Governance Ratings: One Score, two scores or more, 158 U.PA. L. REV. PENNUMBRA 39 (2009).

[14]See generally Peter A. Gourevitch, The Politics of Corporate Governance Regulation, 112 YALE L. J. 1828 (2003).

[15]Don Tapscott & David Ticoli, The Naked Corporation: How the Age of Transparency Will Revolutionalize Business, 22 J.B.L. (2003); Janine Pascoe & Shanthy Rachagan, Key Developments in Corporate Law Reform in Malaysia, SING. J. LEGAL STUD. 93, 97 (2005); Kumar B. V., Abuse Versus Speculation-The Role of the Regulatory Authority: Some case Studies of the Bombay Stock Exchange, 9(1) J.F.C. 30 (2001) (discussing how lack of good corporate governance principles could adversely impact on investors. The writer uses the so called "vanishing companies" of India to exemplify his discussion. Fraudulent people would form dubious companies, have them issue securities and listed on the Bombay Stock Exchange and then vanish leaving investors with no recourse).

[16]See Victor C.S. Yeo, Corporate Governance in the Information age: The Impact of Information Technology and Emerging Legal Issues, 29 HONG KONG L. J. 194, 184 (1999); Rajesh Chakrabarti, Corporate Governance in India-Evolution and Challenges, available at http://ssrn.com/abstract=649857.

[17] Cheryl W. Gray & William W. Jarosz, Law and the Regulation of Foreign Direct Investment: The Experience from Central and Eastern Europe, 33COLUM. J. TRANSNAT'L L. 1, 4-9 (1995); Alan Dignam & Michael Galanis, Australia Inside-out: The Corporate Governance System of the Australia Listed Market, 28 MELB. U. L. REV. 623 (2004); Gordon Walker, Corporate Governance in East Asia: The Policy Rationale for Reform, 19(8) J.I.B.L.R. 273 (2004).

It is associated with more efficient corporate management and higher valuation.[18] Globally, jurisdictions with good corporate governance structures perform better than those with poor structures.[19] By ensuring that investor wealth is secure and well managed, good corporate governance systems attract foreign direct investment. Admittedly, corporations with good corporate governance structures are more likely to attract investors. The contribution of corporate governance to capital formation, maximization of shareholder value and protection of investor rights is widely acknowledged and documented.[20]

Incontrovertibly, corporate governance promotes market integrity, investor confidence and economic growth.[21] It has become one of the indispensable institutions in the development of deep and vibrant securities markets.[22] Strong corporate governance is essential for deep and vibrant securities markets.[23] Consequently, many common law jurisdictions have adopted non-binding codes and guidelines to promote principles of good corporate governance. This has culminated in the development of a self regulatory system of corporate governance.
In sum, although corporate governance "may not be the engine of economic growth, it is essential for the proper functioning of the engine."[24]Concededly, corporate governance "is not just one of those imported western luxuries, it is a vital imperative."[25]

Corporate Governance in Kenya

Historically, corporate governance emerged in developed jurisdictions as a mechanism to address the incongruence between the interests of investors and management. It was intended to ameliorate the problem of agency costs.[26] It was contemplated that precepts of corporate governance would facilitate the alignment of interests of agents and their principals. Codes of corporate governance first emerged in countries with dispersed share ownership and were intended to make corporate boards of directors more professional, effective and accountable in the discharge of their responsibilities. Evidence from developed jurisdictions suggests that the effectiveness of these codes is largely dependent on the underlying legal and regulatory framework. Noteworthy, their success in these jurisdictions is circumstantial evidence to corroborate their chances of success in jurisdictions with different corporate ownership structures and cultures.

In developing jurisdictions, share ownership is typically concentrated and the principal challenges are expropriation of the minority by the majority and the extraction of benefits of private control. The jury is still out whether principles designed to ameliorate the agency problem between shareholders and the management in jurisdictions with dispersed ownership and large institutional shareholders could be equally effective in jurisdictions with different ownership structures and culture where the principal challenge is expropriation of the minority by the majority.[27]

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[18] Christopher John Gulinello, The Revision of Taiwan's Company Law: The Struggle Towards a Shareholder- Oriented Model in one Corner of East Asia, 23 DEL. J. CORP. L. 75 (2003).

[19] Low Chee Keong, The Corporate Governance Debate, in CORPORATE GOVERNANCE: AN ASIAN-PACIFIC CRITIQUE,1,22 (2002);Bernard Black, Does Corporate Governance Matter? A Crude test using Russian Data, 149 U. PA. L. REV. 2131 (2001).

[20] See Kala Anandarajah, The new Corporate Governance Code in Singapore, 3(6) J.I.F.M. 261, 266 (2001); Gordon Walker, supra note 17

[21] Anna Grandori, CORPORATE GOVERNANCE AND FIRM ORGANIZATION: MICRO FOUNDATIONS AND STRUCTURAL FORMS, 318 (2004). See also JOSE A OCAMPO & JOSEPH E. STIGLITZ, CAPITAL MARKET, LIBERALIZATION AND DEVELOPMENT 23 (2008).

[22] Neelakshi Nayak, Corporate Governance: Inevitability in the New Millennium, 12(7/8) I.C.C.L.R. 212, 212 (2001).

[23]Jeswald W. Salacuse, Corporate Governance in the new Century, 25(3) Comp L. 69, 69 (2004).

[24] See Martin Lipton & Paul K. Rowe, The Inconvenient Truth about Corporate Governance: Some Thoughts on Vice-Chancellor Strine's Essay 33 J.CORP. L. 63 (2007); Varun Bhat, Corporate Governance in India: Past, Present and Suggestions for the Future, 92 IOWA L.REV.1429, 1456 (2007).

[25] See Arthur R. Pinto, Globalization and the Study of Comparative Corporate Governance, 23 WIS. INT'L L. J. 477 (2005); Odhiambo Ochola, Corporate Governance is Key to success of companies, THE STANDARD, Mar. 8, 2011 at 18.

[26] See generally Alex Lau, The new Corporate Governance Code for Hong Kong Listed Companies-Part 2: Application of Corporate Governance Theories, 26(11) COMP L. 345 (2005).

[27] Jeswald W. Salacuse, supra note 23; Lucian A. Bebchuk & Assaf Hamdani, The Elusive Quest for Global Governance Standards, 157 U.PA.L. L.REV. 1263 (2009). (Arguing that governance problems in controlling and non-controlling shareholders differ significantly); Terry Reid & Gordon Walker, Upgrading Corporate Governance in East Asia, 17(4) J.I.B.L.

Before liberalization of Kenya's economy in the 1990s which institutionalized privatization of government corporations, accountability in the public sector was largely anathematic.[28] The culture of nepotism, clientelism and corruption was pervasive. Lack of accountability in the public sector was replicated in the private sector.[29]Furthermore, inefficiency had been institutionalized. This was further compounded by the absence of a corporate governance framework. With senior government officials owning shares in the few publicly held companies, the government was not fervent on enforcing securities laws. The boards of directors of many listed company consisted of friends, relations and political associates of government officials. The situation was excercabated by the fact that the Nairobi Securities Exchange (NSE) was under the control of family owned and managed stock brokers whose driving force was business not regulation. Consequently, the NSE had a cordial relationship with listed companies and seldom invoked regulatory sanctions for non-compliance with Listing or Membership Rules. Privatization of government enterprises introduced new dynamics into the market place, for instance, new companies floated securities and the public subscribed for them with enthusiasm. These companies were subsequently listed on the Nairobi Securities Exchange. The establishment and subsequent inauguration of the Capital Markets Authority (CMA) in 1990 did not fundamentally alter the corporate governance landscape in the country.

The mission to institutionalize principles of corporate governance in Kenya culminated in the promulgation of the Guidelines on Principles of Corporate Governance for Public Listed Companies in 2002.[30]Interestingly, adoption of these Guidelines was not motivated by any corporate scandal. The Guidelines are a carbon copy of the Hong Kong, Singapore and Malaysian Codes of Corporate Governance[31] which are replications of the United Kingdom's Combined Code.[32]Analogous to these jurisdictions, Kenya adopted non-statutory Guidelines and implemented the "explain or comply" enforcement paradigm. No attempt was made to align them with local circumstances and institutions.[33] It is important to underscore the fact that a corporate governance system is a complex mix of institutions, including the legal framework which militates against wholesale transplantation.[34]

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96 (2002) (arguing that although functional convergence could play a significant role in protecting of outside investors, legal convergence is an imperative since investor protection entails radical changes to the law and its enforcement); Victor Brudney, The Independent Director—Heavenly City or Potemkin Village? 95 HARV. L. REV. 598 (1982); Barry D. Baysinger & Henry n. Butler, Revolution Versus Evolution in Corporate Law: The ALI's Project and the Independent Director, 52 Geo WASH. L. REV. 557 (1984); Douglas M. Branson, The very Uncertain Prospect of "Global" Convergence in Corporate Governance, 34 CORNELL L. J. 321 (2001); Stephen M. Bainbridge, Independent Directors and the ALI Corporate Governance Project, 61 Geo. WASH. L. REV. 1034 (1993) (arguing that because no single shareholder owns enough stock to affect corporate decision making, the corporation is effectively controlled by managers and that unchecked management may abuse its control by benefiting at the expense of shareholders); Donald C. Clarke, The Independent Director in Chinese Corporate Governance, 31 DEL J. CORP L. 125 (2006) (arguing that the Chinese insider trading laws are United States transplants).

[28] See Alan Dignam, Exporting Corporate Governance: UK Regulatory System in a Global Economy, 21(3) Comp.L. 70, 70-2 (2000).

[29] See Christian C. Day, Partner to Plutocrat: The Separation of Ownership from Management in Emerging Capital Markets – 19th Century Industrial America, 58 U. MIAMI L. REV 525, 563 (2004).

[30] See DU PLESSIS et al, PRINCIPLES OF CONTEMPORARY CORPORATE GOVERNANCE, 6-7 (2005).

[31] See Aiman Nariman Mohd-Sulaiman, Strengthening the Independence Criteria: A Comparison of the UK, Malaysia, Hong Kong and Singapore, 21(7) I.C.C.L.R. 239(2010); Elisabeth Wong, Singapore: Company Law- Corporate Governance, 21(1) J.I.B.L. 5 (2006).

[32] See Ben Pettet, The Combined Code: A Firm Place for Self-regulation in Corporate Governance, 13(12) J.I.B.L. 394 (1998). The Combined Code is an aggregation of the Cadbury, Greenbury and Hampel Reports of 1992, 1995 and 1998 respectively.

[33] See Lilian Miles, The Cultural Aspects of Corporate Governance Reform in South Korea, J.B.L. 851 (2007) (on the challenges of cultural practices on principles of corporate governance in Korea). See also Ali Adnan Ibrahim, supra note 379 at 112-116; John Nowland & Angus Young, In Search of Good Governance for Asian Family Listed Companies: A Case Study on Hong Kong, 28(10) COMP. L. 306 (2007).(On the importance of accommodating culture and other local factors in the corporate governance framework)

[34] See generally Troy A. Paredes, A Systems Approach to Corporate Governance: Why Importing U.S. Corporate Law is not the Answer, 45 WM. & MARY L. REV. 1055, (2004).; Jonas V. Anderson, Regulating Corporations the American way: Why Exhaustive Rules and Just Deserts are the Mainstay of U.S. Corporate Governance, 57 DUKE L.J. 1081 (2008) (comparing the U.S. and U.K approaches to corporate Governance and the challenges of adopting either approach in the other jurisdiction); Rachael Ntongho, Self-regulation of Corporate Governance in Africa: Following the Bandwagon? 20(12) I.C.C.L.R. 427 (2009).

The Guidelines encourage listed companies to embrace a positive corporate culture of accountability and responsiveness to the interests of investors. The fact that non-compliance with the Guidelines is largely inconsequential was intended to engender them to listed companies. The Guidelines provide an array of mechanisms to enhance corporate governance.[35] To reduce the overconcentration of power in the hands of one person, the Guidelines provide for the segregation of the office of the chairman of the board from that of the chief executive of the company.[36] Viewed panoramically, the Guidelines were a positive addition to the country's corporate governance architecture.

Among the acclaimed innovations of the Guidelines was the establishment of the office of independent non-executive directors. Independent directors have long been perceived as the *panacea* for many corporate governance challenges.[37] Their envisioned role was that of oversight and monitoring of executive directors as opposed to whistle blowing. The theory behind the creation of an independent corporate constituent was to enhance corporate governance by monitoring the excesses of executive directors and safeguarding minority interest.[38] It was contemplated that their "independence" would strengthen the corporate governance structure.[39] Their interpersonal skills, sound knowledge, advice, comments and counsel would widen the issues considered by the board and avoid conflict of interest.[40] More specifically, they were expected to bring to bear an independent judgment on questions of strategy, performance of the company, resources, key appointments and standards of conduct.[41]This was the foundation of their monitoring role. The rough logic is that "[t]hey should question intelligently, debate constructively, challenge vigorously and decide dispassionately."[42]

[35] See Janet Dine, The Governance of Governance, 15(3) COMP. L. 73 (1994).The Guidelines require companies to provide for the qualification and appointment of directors, structure and composition of boards of directors, approval of major decisions by members, accountability and audit, rights of shareholders and participation in general meetings, establishment of the audit remuneration and nominating committees, limit on the number of directorships a person may hold, institutionalization of independent non-executive directors and internal controls, improvement of communication between management and shareholders, involvement of shareholders in company affairs and establishment of shareholder associations, and ensuring that the offices of the chief finance officer, corporation secretary and internal auditor are held by professionally qualified persons.

[36] See Borokhovich A. K. et al., Outside Directors and CEO Selection, 31(3) J. FIN. & QUANTITATIVE ANALYSIS, 337 (1996); Fama E. &Jensen M.C., Separation of Ownership and Control, 26 J. L. & ECON. 301, 315 (1983); Brickley J. et al., Leadership Structure: Separating the CEO and the Chairman of the Board, 3 J. CORP FIN. 189(1997).

[37] Donald C. Clarke, Three Concepts of the Independent Director, 32 DEL. J. CORP. L. 73, 73 (2007); Jill E. Fisch, The Overstated Promise of Corporate Governance, 77 U. CHI. L. REV. 923 (2010).

[38] See generally Saleem Sheikh, Non-executive Directors: Self-regulation or Codification? 23(10) COMP. L. 296 (2002); Jeffrey N. Gordon, The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Prices, 59 STAN. L. REV. 1465 (2006); Daniele Marchesani, The Concept of Autonomy and Independence Director of Public Corporation, 2 BERKELEY BUS. L. J. 315 (2005).

[39] Philip Wickham & Peter Townsend, The Non-executive director: A Management Perspective, 15(7) COMP L. 211 (1994); Stephen Bainbridge, Why a Board? Group Decision making in Corporate Governance, 55 VAND. L. REV. 1 (2002); Donald J. Langevoort, The Human nature of Corporate Boards: Law, Norms and the Unintended Consequences of Independence and Accountability, 89 GEO. L. J. 797 (2001); Lynne L. Dallas, The Multiple Roles of Corporate Boards of Directors, 40 SAN DIEGO L. REV. 781 (2003).

[40] Margarita Sweeney-Baird, The Role of Non-executive Director in Modern Corporate Governance, 27(3) COMP. L. 67, 69 (2006); Jacobs E.J. Non-executive Directors, J.B.L. 269, 270 (1987); Melvin A. Eisenberg, The Architecture of American Corporate Law: Facilitation and Regulation, 2 BERKELEY BUS L. J. 169 (2005); Adolph A. Berle, Corporate Powers and Powers in Trust, 444 HARV. L. REV. 1049 (1931) (arguing that directors serve shareholders interest); Merrick E. Dodd, For whom are Corporate Managers Trustees? 45 HARV. L. REV. 1145 (1932) (arguing that directors should serve other groups including employees, managers and society in general); Scott J. Gorsline, Statutory Independent Directors: A Solution to the Interested Director Problem, 66 U. DET. L. REV. 655 (1989); Cyril Moscow et al., Michigan's Independent Director, 46 BUS. LAW 57 (1990).

[41] See Financial Reporting Council, Committee on the Financial Aspects of Corporate Governance, Report, p 4.11 (1992) (Cadbury Report); available at http://www.ecgi.org/codes/documents/Cadbury.pdf (visited on July 7, 2010); John Holland, Self Regulation and the Financial Aspects of Corporate Governance, J. B. L. 127, 131 (1996). See also Kala Anandarajah, The new Corporate Governance Code in Singapore, 3(6) J.I.F.M. 261, 266 (2001).

[42] Derek Higgs, Review of the Role and Effectiveness of Non-executive Directors (London: DTI 28 2003).

The envisioned role and effectiveness of independent non-executive directors was anchored on the concept of independence.[43] However, as Victor Brudney asserts:

> "[n]o definition of independence yet offered precludes an independent director from being a social friend of, or a member of the same clubs, associations or charitable efforts as, the persons whose performance he is asked to assess."[44]

The upshot of these words is that it is doubtful whether independent non-executive directors could be as independent as envisaged by the Guidelines.[45]

Traditionally, company directorships in Kenya were a preserve for the rich, influential politicians and business persons. Board membership is perceived as an honour as opposed to a responsibility. But more importantly, directors are well remunerated for attending board and committee meetings which make the positions irresistible. A local newspaper once reported that a 74-year old man enjoying multiple directorships of publicly held companies earned about $400,000 a year in allowances.[46] Unfortunately, institutionalization of independent non-executive directors by listed companies is for the most part cosmetic and has changed neither the traditional conception of directorship nor the corporate governance architecture in Kenya. The situation is excercabated by the fact that the Companies Act does not recognize their position on the board of directors and envisages no role for them. Regarding liability, it is important to emphasize that because of the unitary structure of boards of directors in common law jurisdictions, independent non-executive directors are subject to the general common law and equitable obligations owed directly to the company. Their position is therefore not dissimilar to that of executive directors.[47]

Commentators on corporate law are almost unanimous that the system of independent non-executive directors is systemically dysfunctional.[48] Neither their position nor obligations or constituency is clearly defined. Whether they are accountable to the company or the minority shareholders is unclear. What appears unassailable is that their effect on corporate governance is largely unnoticeable. Few executive directors would welcome let alone tolerate individuals who are too keen on monitoring their activities. The requirement to appoint "strangers" to the board places listed companies in unfamiliar territory.[49]

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[43] Hans-Christoph Hirt, The Review of the Role and Effectiveness of Non-executive Directors: A Critical Assessment with Particular Reference to the German two-tier Board System, 14(7) I.C.C.L.R. 245 (2003).

[44] Victor Brudney, The Independent Director—Heavenly City or Potemkin village? 95 HARV. L. REV. 597, 613 (1982).

[45] See Aiman Nariman Mohd-Sulaiman, Strengthening the Independence Criteria: A Comparison of the UK, Malaysia, Hong Kong and Singapore, 21(7) I.C.C.L.R. 239, 245(2010);

[46] See, Emmanuel Were, A top-notch executive who is jiggling five board seats, DAILY NATION, July 25, 2010, at 18. (according to the report, Mr. Richard Kemoli aged seventy four was the chairman of the board of directors of Bamburi Cement Co Ltd and Unga Ltd. In addition, he was a member of the boards of directors of East Africa Breweries, Kakuzi Ltd and Cooper Motors Corporation Ltd).

[47] See Peter Burbidge, How can you be sure of Shell? Is Corporate Governance better served by Unitary or two-tier boards? 16(7) I.C.C.L.R. 291 (2005); Nyakundi Nyamboga, Nominee Directors can't run away from Company Liability, THE STANDARD, May 16, 2006, at 17; Anne Kiunuhe, Why Directors must take their role seriously, BUSINESS DAILY, Oct. 26, 2010, at 27 (explaining the extent to which directors may be held responsible for breach of their common law and fiduciary obligations).

[48] Sanjai Bhagat & Bernard Black, The Non-Correlation between Board Independence and Long-term Firm Performance, 27 J. Corp L. 231, 265 (2002; Sarah Kiarie, Non-executive Directors in the UK Listed Companies: Are they Effective? 18(1) I.C.C.L.R. 17 (2007); Hans Christoph Hirt, Id.; Margarita Sweeney-Baird, supra note 1118; Laura lin, The Effectiveness of Outside Directors as a Corporate Governance Mechanism: Theories and Evidence, 90 NW. U. L. REV. 898 (1996); Donald C. Clarke, The Independent Director in Chinese Corporate Governance, 31 DEL. J. CORP. L. 125(2006).Ronald J. Gilson, Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy, 199 HARV. L. REV. 1641(2006) (arguing that cultural factors could also account for the maintenance of control by insiders); Tan Cheng Han, Corporate Governance and Independent Directors, 15 SING. ACAD. L. J. 355 (2003); Brian Cheffins, Current Trends in Corporate Governance: Going from London, Milan to Toronto, 10 DUKE J. COMP & INT'L L. 5 (2000); Afra Afsharipour, Corporate Governance: Lessons from Indian Experience, 29 NW. .J. INT'L L. & BUS 355 (2009); Tamar Frankel, Corporate Boards of Directors: Advisors or Supervisors? 77 U. CIN L. REV. 501 (2008)(arguing that the effectiveness of the board of directors largely depends on how well they understand their role).

[49] See generally Deborah A. Demott, Guests at the Table: Independent Directors in Family Influenced Public Companies, 33 J. CORP. L. 819 (2008); Mohammed B. Hemraj, Corporate Governance: Directors, Shareholders and the Audit Committee, 11(2) J.F.C. 150 (2003).

The temptation to appoint professional colleagues and associates is overwhelming. Appointees are head-hunted by executive directors and 'elected' by the shareholders in general meeting.[50] Most appointees are either friends of executive directors or persons they associate with. The parameter of appointment is invariably "know who rather than know how."Debatably, it is difficult to locate their allegiance elsewhere.

The entire infrastructure on independent non-executive directors undermines their independence.[51] These directors rely on the executive directors for information which is crucial to the discharge of their obligations. The probability of being denied unpalatable company information or inability to access adequate data cannot be underestimated. Since their selection, remuneration, tenure and toolkit are largely dependent on executive directors, these directors are unlikely to be overly enthusiastic in their supervisory and monitoring role.[52]The soft relationship between executive and independent directors undermines the independence of the latter. The fact that their monitoring role could precipitate conflict of interest is to some extent antithetical to a unitary board.[53] There is need to enhance their independence.[54]The role of independent non-executive directors is further undermined by the fact that the Companies Act does not define the term "director" with specificity. Section 2(1) provides that director "includes any person occupying the position of director by whatever name called."Legally, all employees serving the company in managerial capacities are directors.

Relatedly, the impact of board committees on corporate governance has been unremarkable.[55] The Audit Committee is by far the most important. Its establishment was first provided for by the more rigorous and enforceable Capital Markets (Securities) (Public Offers, Listings and Disclosures) Regulations, 2002. The Committee plays a critical role appraising the financial and operational controls which give meaning to corporate governance. It is instrumental to the establishment of effective internal controls as well as appointment and remuneration of external auditors. Competence in finance and accounting in the audit committee is critical. It is likened to an internal ombudsman. Members of the committee are predominantly independent non-executive directors. Importantly, it should operate independently. The reasoning is that the more independent the Audit Committee is, the more reliable the financial information released by the company.[56] Intriguingly, the role of the internal audit department is yet to be fully appreciated. The department facilitates corporate governance by enabling the management indentify and strengthen internal controls. The Audit Committee could play an important role in strengthening the internal and external audit function. Statutory recognition of the Audit Committee would undoubtedly enhance its profile and role in corporate governance.

One of the major short comings of the Guidelines is the failure to institutionalize compulsory and continuous training and education of directors of listed companies.[57]

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[50]The case of Sameer Africa Ltd exemplifies this position. The chairman of the board who was the majority shareholder (57.3%) resigned in July 2010, head-hunted a director and appointed him chairman of the board. See Michael Omondi, Merali now steps down as Sameer Chairman, BUSINESS DAILY, July 26, 2010, at 10; Nation Correspondent, Old boys' Networks dominate Listed firm's boards, DAILY NATION, Feb. 8, 2011, at 6 (reporting that the composition of boards of directors of at least 45 corporations listed on the NSE is determined exclusively by controlling shareholders, business associations and personal contacts, an attribute which does not augur well with the enhancement of principles of good corporate governance).

[51] See generally Ronald J. Gilson & Reiner Kraakman, Reinventing the outside Director: an Agenda for Institutional Investors, 43 STAN. L. REV. 863 (1991); Norman E. Veasey, The Defining tension in Corporate Governance in America, 52 BUS. LAW. 393 (1997);

[52] See Ian G.C. Stratton, Non-executive Directors: Are they Superfluous? 17(6) COMP. L. 162, 164 (1996).

[53] Gerard M.D. Bean, Corporate Governance and Corporate Opportunities, 15(9) COMP. L. 266, 270 (1994).

[54] See John Paterson, Corporate Governance in India in the Context of the Companies Bill 2009: Part 3: Proposals, 21(4) I.C.C.L.R. 131, 136-38 (2010).

[55] April Klein, Firm Performance and Board Committee Structure, 41 J. L. & ECON. 275 (1989); See Angus Young, Frameworks in Regulating Company Directors: Rethinking the Philosophical Foundations to Enhance Accountability, 30(12) COMP. LAW. 355, 356 (2009)..

[56] See generally Jody K. Upham, Audit Committees: The Policemen of Corporate Responsibility, 39 TEX. J. BUS. L. 537 (2004); Vasudev P.M., Credit Derivatives and Risk Management: Corporate Governance in the Sarbanes-Oxley World, 4 J.B.L. 331 (2009).

[57] Janine Pascoe & Shanthy Rachagan, Key Developments in Corporate Law Reform in Malaysia, SING. J. LEGAL STUD. 93, 102 (2005); Kala Anandarajah, The new Corporate Governance Code in Singapore, 3 (6) J.I.F.M. 262 (2001).

The need to enhance knowledge and skills of directors cannot be overemphasized. If companies are to prosper, directors must be well versed with their role.[58]They must understand the business and legal environment in which their companies operate.[59] The Guidelines merely provide that newly appointed directors should be provided with the necessary orientation in the area of the company's business in order to enhance their effectiveness on the board.[60] Although some directors of listed companies are professionals in specific fields, training would enable them appreciate their responsibilities as corporate directors and optimize their contribution in the running of company affairs. A second and more grievous omission was the failure to align the Guidelines with the underlying legal framework.

Implementation of Guidelines on corporate governance

Publicly held companies are required to make annual reports to the CMA on their compliance and non-compliance with the Guidelines on corporate governance. Since 2004, the CMA has been posting compliance statistics in its annual reports. *Prima facie*, statistics on compliance paint an exceedingly reassuring picture in certain respects. For instance, in its 2009 Annual Report, the CMA reported that average compliance stood at eighty four percent. The average in previous years was much lower. Eighty two per cent of all listed companies had established the requisite board committees (presumably the audit, nominating and remuneration) and ninety percent had sufficient board composition (executive and independent non-executive). Additionally, over ninety percent released their annual financial reports as prescribed and had submitted interim reports to the CMA within the prescribed duration.

The Table below is a synthesized record of implementation of Guidelines on corporate governance by listed companies for 2008/9.

Corporate governance Guidelines	2008 Compliance	Listed Companies	Percentage	2009 Compliance	Listed Companies	Percentage
Establishment of board committees	43	60	72	49	60	82
Sufficient board composition	49	60	82	54	60	90
Disclosure of statement on CSR in the Annual Report	36	60	60	48	60	80
Ownership details of the top ten shareholders	47	60	78	53	60	80
Timely release and submission of 2007 audited accounts	51	60	85	56	60	93
Timely submission of interim reports 2007/08	50	60	83	55	60	92
Chief Finance Officer in good standing	38	60	63	31	60	52
Company Secretary in good standing	56	60	95	56	60	93

[58] See Datuk Simon Shim, Governance in the Markets: Malaysian Perspective, 13(3) J.F.C. 300, 305 (2006); Geoffrey Irungu, Directors are yet to understand boardroom business, BUSINESS DAILY, Nov. 12, 2010, 22.

[59] See Geoffrey Irungu, Revealed: The Waning value of Directors in Corporate Kenya, BUSINESS DAILY, Oct. 11 2010, at 20(criticizing the poor performance of directors on the basis of a report prepared by audit firm KPMG after a thorough research involving directors of publicly held companies. According to the report, "most companies are full of ineffective and less knowledgeable directors who are either unwilling or unable to evaluate management decisions. The article isolates the old boy networks which have led to interlocking directorships as a major challenge. But more importantly, the writer identifies lack of enforcement of the principles of corporate governance as the major challenge); Jaindi Kisero, Fury at National Bank of Kenya Management plot to strip Preference Shareholders of equal Rights, DAILY NATION, Apr. 20, 2010, at 24.

[60] Guideline 3.1.3(viii)

Interestingly, over ninety percent of the listed companies had qualified persons as corporation secretary. An extensive examination of the statistics reveals that fundamental principles of corporate governance are routinely ignored and not a single company had facilitated the formation of shareholder associations or implemented Guidelines on members' rights to participate in company affairs. The most unconcealed violation related to the position of the chief finance officer. The CMA Regulations ordain that the holder of the office must be a qualified Certified Public Accountant and a member of the Institute of Certified Public Accountants of Kenya (ICPAK).[61] Surprisingly, only fifty percent of the listed companies were compliant.[62] Although the Guidelines are soft law, the CMA Regulations are enforceable. However, the CMA does not appear passionate about enforcing this specific requirement. Although the CMA regulations recognize the centrality of the position of chief finance officer, many companies remained non-compliant. The holder of the office sets the standard and pace for the finance and internal audit departments which play a critical role in financial reporting, internal controls and corporate governance. Intriguingly, the CMA appears lackadaisical about enforcing this specific requirement.
What is perplexing is that a similar requirement with regard to the corporation secretary has been implemented by virtually all listed companies. The corporation secretary plays an instrumental role in the implementation of principles of corporate governance. With regard to the chief finance officer, one plausible explanation is that in many companies the position is currently held by persons who may have been promoted on the basis of experience as opposed to qualification. Another possibility is that engaging a fully qualified and experienced accountant would be exceedingly expensive for the company. Finally, fear that the position is too sensitive to be held by persons unfamiliar with the company's culture may be another reason. In such circumstances, companies headhunt persons they can trust whether they are qualified or not.

The foregoing statistics demonstrate that implementation of the Guidelines on corporate governance has not been without challenges. Evidently, the level of compliance appears to be in consonance with the legal requirements except for the position of the chief finance officer where the CMA Regulations have been ignored. It is not implausible to surmise that compliance with the Guidelines has been generally out of necessity as opposed to choice. As the succeeding parts of this paper illustrate, the Guidelines on corporate governance have had minimal impact on how publicly held companies are managed or relate to their members. Notwithstanding the fact that the Guidelines meet certain key requirements, such as encouraging companies to institutionalize a clear succession plan for the chairman of the board and the chief executive officer, professionalize the offices of internal auditor, chief finance officer and corporation secretary and institutionalize board committees, certain fundamental short comings undermine their efficacy. For instance, the Guidelines are reticent on the actual role and rights of independent non-executive directors, related party transactions, minority representation on the board, cumulative voting, rendering of non-audit services by external auditors and protection of whistleblowers.[63] The fact that the Guidelines apply exclusively to publicly held companies further reduces their utility and impact in the corporate sector.[64]

Several unfortunate instances illuminate the fact that the enabling or voluntary corporate governance regime is suboptimal. The Uchumi Supermarkets Co. Limited conundrum mentioned earlier exemplifies this argument.[65] Cessation of carrying on business by the company in on May 31st 2006 implicated the role of independent non-executive directors, audit committee and the external auditor. More recent corporate scandals involved the boards of directors of Access Kenya Limited,[66]

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[61], Reg. F. 05.
[62] See James Makau, Most top finance bosses fall short of ICPAK Standards, BUSINESS DAILY, July 6, 2010, at 27.
[63] Bernard Black & Reinier Kraakman, A Self-Enforcing Model of Corporate Law, 109 HARV. L. REV. 1911, 1946-47 (1996) (making a strong case for the adoption of cumulative voting in emerging markets with weak regulatory bodies).
[64] John H. Farrar. The Corporate Governance of SMEs and Unlisted Companies, 14 NZBLQ 213, 213 (2008).
[65]Criminal Cases No. 1337 & 1338 of 2008;.Judy Ogutu, Nalo: I was kept in the dark on Uchumi closure, THE STANDARD, Mar. 11, 2011, at 10.
[66]See Johnstone Ole Turana, Tackle Boardroom Queries on Corporate Governance, BUSINESS DAILY, Apr. 12, 2010, at 14; Michael Omondi, Why Access Kenya's AGM was Suspended, BUSINESS DAILY, May 14, 2010, at 20; Michael Omondi, Access Kenya under CMA scrutiny, BUSINESS DAILY, May 20, 2010, at 11; Ephantus Bukusi, Access Kenya holds Annual General Meeting after two-month delay, BUSINESS DAILY, Sept. 1, 2010, at 21. After the company went public in 2007, the former owners (Somen Family) who were a father and his two sons retained 26% of the company's shares and remained the chairman of the board of directors, managing director and executive director respectively. To consolidate the family's control

Housing Finance Company of Kenya (HFCK),[67] Kenya Re-insurance Corporation,[68] East Africa Portland Cement Company Limited (EAPCC) [69]and CMC Holdings Ltd.[70] Cumulatively, these debacles implicated the effectiveness of the principles of corporate governance and the regulatory conundrum.

Although the overall contribution of the Guidelines on the corporate governance landscape remains uncertain, their adoption has induced certain changes in publicly held companies.[71] The functional separation of the chief executive officer and the chairman of the board which all listed companies have implemented of directors is commendable. The attempt to professionalize the offices corporation secretary, chief finance officer and the internal auditor is undoubtedly positive.

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of the board, the family appointed a fourth director who was a partner in a law firm where the chairman of the board was a senior partner for over thirty years. The company had three other directors who in early 2010 are reported to have questioned how two tenders were awarded without involving all members of the board. The three were forced to resign. Investigations by Deloitte and Runji Partners (auditors and engineers) commissioned by the company vindicated the three directors that the tenders had been awarded irregularly and the company lost over Kshs. 300 million ($ 3.75 million). Fearing that shareholders would demand answers on the tender and loss to the company, the board of directors postponed the company's annual general meeting scheduled for May 31st to August 31st 2010. Some shareholders petitioned the CMA on the domination of the Somen family of the board. This scandal exemplifies the typical challenge where the majority dominates the board of directors and is inclined on gleaning private benefits of control. See also Kevin Mwanza, Michael Somen leaves AccessKenya Co. Ltd. Board after 10 years in chair, BUSINESS DAILY, July 9, 2010, at 11; Jevans Nyabiage, Access Kenya: What went wrong? DAILY NATION, Mar.16, 2011, at 16 Jevans Nyabiage, Access Kenya profit plunges in 2010, DAILY NATION, Mar. 24, 2011, at 19.

[67] See Joseph Bonyo, Equity: We want more of Housing Finance, BUSINESS DAILY, Apr. 4, 2010, at 9. In 2007 Equity Bank Co Ltd acquired 24.9% of HFCK whose principal business is mortgage financing. Both companies are listed on the NSE. As a consequence, Equity Bank and British American Co Ltd own 42% of HFCK. In a move calculated to exert their influence on the board of HFCK, the two companies forced the chairman of and two other members of the board to resign. The managing director of Equity Bank Co Ltd was subsequently quoted contending that it was the banks intention to have directors who championed its cause on the board of HFCK. Apparently HFCK had no independent non-executive directors. This case is a classical illustration of how controlling shareholders dominate board of directors and therefore shape company policies.

[68] Ten months before her contract with the company was due to expire, the managing director of the company intimated to the board her desire to have the contract renewed. The board of directors communicated its decision not to renew the contract one month before the contract expired and subsequently appointed one of the company's managers as acting managing director. The former managing director sought and obtained a court order for reinstatement but the company refused to honour the order. The case is pending determination. This case demonstrates that some companies are yet to internalize elementary principles of corporate governance such as succession plans for the chief executive officer which is fairly central in dynamic markets. See Nicholas Waitathu, Truth Behind State Corporations' CEOs exit, THE FINANCIAL POST, July 26, 2010, at 3; Steve Mbogo, Kenya Re eyes high returns in plan to triple mortgage lending, BUSINESS DAILY, Dec. 21, 2010, at 12; Paul Muhoho, Kenya Re sued over dismissal, THE PEOPLE, Jan. 22, 2011, at 29.

[69] See Michael Odhiambo, Portland Cement boss quits amid board row, BUSINESS DAILY, July 23, 2010, at 12; Allan Odhiambo, CEO explains how Strategy row forced his exit, BUSINESS DAILY, July 26, 2010, at 12; The chief executive officer of the company resigned in July 2010 citing disagreements with the board of directors. The board on the other hand argued that the CEO pursued an expansionist strategy while the board preferred a cautious approach. The board was also unequivocal that the CEO had failed to meet company targets. Whereas the resignation was not unprecedented, it was shocking to learn that the company has had six CEOs in the last seven years and had no independent non-executive directors. This is not uncommon for companies in which the Government of Kenya is the controlling shareholder. John Njiraini, East Africa Portland Cement Company Ltd too hot for chief executive, THE STANDARD, Sept. 21, 2010, at 8. But see also Kui Kinyanjui, Joseph bows out after a 10 year stint at Safaricom, BUSINESS DAILY July 22, 2010, at 15.

[70] See Benson Wambugu, Ousted CMC board members to know fate next month, BUSINESS DAILY, Oct 25, 2012 at 19; Benson Wambugu, CMC Holdings loses exclusive dealership of Man trucks, BUSINESS DAILY, Oct. 26, 2012 at 8; Victor Juma, Owners oust CMC Motors board chairman, DAILY NATION, Mar. 30, 2011, at 21(reporting how majority shareholders of a publicly held company had ganged up and forced a long serving chairman of the board of directors of the company out of office).

[71] See Richard Lough, Safaricom's Michael Joseph eyes retirement in 2010, THE STANDARD, Mar. 19, 2010 at 35. (reporting that the CEO of Safaricom Ltd had intimated to the board of directors of the company his intention to retire at the end of the year thus giving the company sufficient time to recruit and orientate a successor. Although this is not sufficient evidence that the company has internalized the principle of corporate governance, it is invariably a positive sign. After retirement in late 2010, the former chief executive was retained as a director of the company).

In sum, there has been no meaningful attempt to make the Guidelines part of a comprehensive and sustainable corporate culture. Consequently, listed companies are yet to internalize them. Extending the Guidelines to all companies would have assisted in institutionalizing and standardizing a culture of transparency and accountability which is generally lacking in the corporate sector.

Enforcement of Guidelines on corporate governance

Undoubtedly, the credibility of any corporate governance framework rests on its enforceability since it determines its success or failure.[72] As adverted to elsewhere, the CMA replicated the Combined Code of the United Kingdom which is based on a dispersed ownership structure without any serious attempt to domesticate the principles. No research was carried out to ascertain their appropriateness in Kenya or the need for modification. The "comply or explain" paradigm does not appear to have endeared the Guidelines to listed companies. Since most of the Guidelines are not based on any binding principles, their implementation has been unenthusiastic. As mentioned earlier, listed companies have implemented some of the Guidelines out of necessity not choice.

Undoubtedly, the legal framework plays an important role in corporate governance. The efficacy of guidelines, codes or principles is generally attributable to the underlying legal framework.[73] Admittedly, the principles of corporate governance would be more efficacious if the legal system was facilitative.[74]

Analysis

Broadly, the sources of law on corporate governance in Kenya are corporate law, securities law, statutes dealing with qualifications of Accountants, Public Secretaries, Lawyers and CMA Regulations. Since corporate law is concerned with the basic structure and primary rules of operation of the company and defines the basic rights of shareholders, it is one of the major sources of corporate governance.[75] Its quality is therefore imperative in assessing the extent to which principles of corporate governance are entrenched.[76] Unfortunately, flaws in the legal framework continue to impact negatively on corporate governance. As this paper exemplifies, Kenya's corporate law undermines good corporate governance in multifarious ways.

The Companies Act and corporate governance

The board of directors is one of the central pillars of corporate governance. Kenya maintains the single tier board. Although the Companies Act establishes the position of director and prescribes the minimum number of directors which a public or private company must have, it is reticent on the explicit role of the board.[77] As one of the traditional and principal organs of the company, the board of directors is an important component of corporate governance.[78] It is the *nexus* between shareholders and senior management. The Guidelines on corporate governance exhort publicly held companies to have an "effective board." This is hortatory because the substantive law on appointment, qualification, disqualification and removal of directors is governed by substantive provisions of the Companies Act.

The Act champions shareholder primacy but without sufficient safeguards for the minority. For instance, directors are elected by an ordinary resolution of members in general meeting. Similarly, the general meeting is empowered to remove directors from office.[79]

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[72] See generally Bernard Black & Reinier Kraakman, A Self-enforcing Model of Corporate Law, 109 HARV. L. REV. 1911 (1996). See also Mundia Geteria, In the best interest of Stakeholders, PROFESSIONAL MANAGEMENT, Feb. 2006, at 20-22.
[73] See Pascoe & Rachagan, supra note 57 at 103.
[74] See R. La Porta, F. Lopez-de-Silanes & A. Shleifer, What Works in Securities Laws, 61(1) J.FIN.27 (2006). See also A. Shleifer & R. Vishny, A Survey of Corporate Governance, 52(2) J. FIN. 774 (1997).
[75] See generally Jean J. Du Plessis, Corporate Law and Corporate Governance Lessons from the Past: Ebbs and flows, but far from the "end of History," 30(2) COMP. LAW. 43 (2009); Loise M. Musikali, The Law Affecting Corporate Governance in Kenya: A need for Review, 19(7) I.C.C.L.R.312 (2008).
[76] See generally John M. Holcomb, Corporate Governance: Sox Related Issues and Global Comparisons, 32 DENV. J. INT'L L. & POL'Y 175 (2004).
[77] § 177
[78] See Background Paper11 (HIH Royal Commission), Directors' Duties and Other Obligations under the Corporations Act, (Nov. 2001) available at http://www.hihroyalcom.gov.au. (visited on May 8, 2010).
[79] § 185

The Act does not prescribe the method of voting but directors are voted into office individually.[80] Any person who has attained the age of twenty one and has not attained the age of seventy qualifies for appointment as a director.[81] A director need not be a member of the company unless the constitutive documents of the company make it a condition precedent.[82] The underlying theory was to give companies sufficient flexibility in the recruitment of directors. In practical terms, few companies appear to have taken advantage of the flexibility to recruit high caliber directors.[83] Where shareholding is a prerequisite for directorship, the share qualification must be acquired within two months of appointment or such shorter time as the constitutive documents of the company may provide.[84] There are no academic or professional qualifications for directorship. However, undischarged bankrupts and insolvent persons are not eligible for appointment.[85] Relatedly, section 189 of the Companies Act empowers the High Court to disqualify any person from being directly or indirectly involved in company management on certain grounds for a duration not exceeding five years.[86] A disqualified person can only take part in company management with leave of the court. Disconcertingly, section 189 is generally invoked in the course of winding up and thus cannot ensure that fraudulent and undeserving persons are not appointed directors.
The Companies Act contains other provisions on directorships which impact on corporate governance.[87]

An interesting feature of these provisions is that they either embody exceptions or vest the power of approval on the general meeting thus entrenching the position of the majority. First, payment of tax free benefits to directors is unlawful.[88] The Act makes no direct reference on remuneration of directors. The Guidelines on corporate governance require listed companies to disclosure the aggregate amount paid to directors as opposed to individual emoluments.[89] Second, it is unlawful for a company to make a loan to its director or a director of its holding company or guarantee or provide security in connection with a loan made to such a person.[90] However, the Act recognizes various instances in which a company may lend money to directors. Third, the Act makes it unlawful for a company to compensate a director for loss of office or as consideration for his retirement unless the particulars of the proposed payment including the amount has been disclosed to and approved by members in general meeting.[91] Similar provisions apply in relation to the transfer of the whole or any part of the undertaking of the company by way of compensating a director for loss of office or as consideration for his retirement.[92]
These provisions accord the majority shareholders unrivalled advantage in exercising control over the company. However, shareholder power to approve fundamental transactions of the company is merely a veto power because they have no mandate to originate such decisions otherwise than by exception. Although shareholders face legal restraints in their attempt to control managers, the power to hire and fire is an effective weapon.

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[80] § 184
[81] §§ 186 &187
[82] §§ 182 &183
[83] See Geoffrey Irungu, Revealed: The Waning value of Directors in Corporate Kenya, BUSINESS DAILY, Oct. 11 2010, at 20(criticizing the poor performance of directors on the basis of a report prepared by audit firm KPMG after a thorough research involving directors of publicly held companies. According to the report, "most companies are full of ineffective and less knowledgeable directors who are either unwilling or unable to evaluate management decisions. The article isolates the old boy networks which have led to interlocking directorships as a major challenge. But more importantly, the writer identifies lack of enforcement of the principles of corporate governance as the major challenge); Geoffrey Irungu, Directors are yet to understand boardroom business, BUSINESS DAILY, Nov. 12, 2010, 22.
[84] §183
[85] § 188
[86] (1) If a person has been convicted of any offence in connection with the promotion, formation or management of a company, (2) In the course of winding up, it appears that the person has been guilty of any offense for which he is liable under section 323 whether convicted or not and (3) the person has been guilty, while an office of the company, of any fraud in relation to the company or breach of duty to the company.
[87] See generally Janine Pascoe, Regulation and Disclosure of Financial Benefits to Directors and Related Parties: A comparative Analysis of the Malaysian and Australian Approaches, 3 SING. J. INT'L & COMP. L. 108 (1999); Julianne Doe, Corporate Governance in Hong Kong, 9(10) I.C.C.L.R. 281 (1998).
[88] § 190
[89] See Geoffrey Irungu, CMA Plans to lift the veil on executive pay, BUSINESS DAILY, Oct. 13, 2010, at 18.
[90] § 191
[91] § 192
[92] § 193

For instance, requisitioning of an annual or extra ordinary general meeting is subject to significant but surmountable legal hurdles.[93]More importantly, company general meetings are annual rituals and typically, proposals made by directors acting in concert with the majority receive endorsement.

In jurisdictions with concentrated ownership, the question of independence of the board from the controlling shareholders is pertinent. Since directors are elected by majority vote, controlling shareholders exercise unfettered discretion in determining the composition of the board.[94] This plenary power of the general meeting is also manifested in the appointment and removal of auditors, approval of accounts, remuneration of directors, winding up and approval of fundamental changes to the constitutive documents of the company. These shareholders influence the management strategy and operational affairs of the company. It is doubtful whether company directors enjoy any meaningful independence from controlling members. This challenge implicates the nomination and election process. Serious corporate governance challenges arise when the controlling shareholder focuses exclusively on gleaning private benefits from exercising control. Controlling shareholder(s) can take advantage of their position to further their interests at the expense of minority shareholders. The danger of excessive remuneration, expropriation of minority and diversion of business opportunities from the company cannot be underestimated. Unquestionably, these activities undermine the of precepts corporate governance.[95]
Equally inadequate in safeguarding investor's interests are the various provisions of the Companies Act on related party transactions. A director who is directly or indirectly interested in a contract or proposed contract with the company is required to declare the nature of his interest at the earliest meeting of the directors.[96] The director is obligated to give a general notice of the nature of his interest. This is intended to enable the board of directors make an informed decision whether or not to approve the contract.

The disclosure formula prescribed by the relevant provisions has several major drawbacks. First, it does not require the director to declare the extent of his interest which is material. Second, it does not require disclosure to members of the company who are major stakeholders. Third, the provision is unclear on the consequences of disclosure by the director. It does not bar an interested director from participating in the deliberations on the contract or voting on the matter.[97] Finally, it is restricted to contracts between the company and directors notwithstanding the fact that a director may be interested in a contract between the company and other persons. This disclosure formula is susceptible to abuse by directors who may be inclined on extracting private benefits of control. Significantly, the provision constitutes non-disclosure a criminal offense for which the director is liable to a fine not exceeding Kshs 2,000 ($25). In addition, equity renders the contract is voidable at the option of the company. Needless to emphasize, the criminal sanction is too accommodating to discourage non-disclosure.

The drawbacks of Kenya's corporate law in enhancing corporate governance are also manifest in section 402 (1) which provides *inter alia:*

> "If in any proceedings for negligence, default, breach of duty or breach of trust against an officer of a company or a person employed by accompany as an auditor, it appears to the court hearing the case that that officer or person may be liable…but that he has acted honestly and reasonably,… and he ought fairly to be excused… that court may relieve him either wholly or partly from his liability…"

The upshot of this provision is that directors who are in fact guilty of egregious conduct may escape responsibility at the instance of the court.

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[93] §§ 131, 132 & 135.

[94] See Johnstone Ole Turana, Tackle Boardroom Queries on Corporate Governance, BUSINESS DAILY, Apr. 12, 2010, at 14; Michael Omondi, Why Access Kenya's AGM was Suspended, BUSINESS DAILY, May 14, 2010, at 20; Michael Joseph Bonyo, Equity: We want more of Housing Finance, BUSINESS DAILY, See also Kevin Mwanza, Michael Somen leaves AccessKenya Co. Ltd. Board after 10 years in chair, BUSINESS DAILY, July 9, 2010, at 11Apr. 4, 2010, at 9;

[95] La Porta et al., Corporate Ownership, 54(2) J.F. 471, 474 (1999); Barca F. & Becht M., THE CONTROL OF CORPORATE EUROPE, 2001; Victor Juma, Owners oust CMC Motors board chairman, DAILY NATION, Mar. 30, 2011, at 21(reporting how majority shareholders of a publicly held company had ganged up and forced a long serving chairman of the board of directors of the company out of office).

[96] § 200

[97] Under Article 84 of Table A, an interested director is allowed to participate in the deliberations involving the contract but cannot vote on the issue. Additionally, he is not counted in the determination of quorum for the meeting. However, companies are free to adopt, modify or exclude this provision.

With regard to takeovers, the Companies Act provide for the compulsory acquisition of minority shareholders shares if the offeror is a company where holders of at least 90% of the shares of the target company or class of shares have accepted the offer within four months. The offeror company may within two months notify dissentient shareholders its intention to acquire their shares. The dissentient shareholders may apply to the court within one month of the notice for the acquisition to be disallowed.[98] In determining the application, the court considers whether the proposed acquisition is reasonable to the dissenting members. If there is evidence of *mala fides*, the court may disallow the takeover bid. The applicant is bound to establish want of good faith in the transaction absent which the acquisition is allowed. In re Bugle Press Ltd,[99] the court was satisfied that the proposed takeover was motivated by bad faith and disallowed it.

Finally, the Companies Act does not recognize insider trading and other forms of market abuse as market improprieties. Thus, before the promulgation of the Capital Markets Authority Act in December 1989, no tangible efforts had been expended in enhancing market integrity. Even after the Act came into operation and the Capital Markets Authority was inaugurated, allegations of market abuse elicited no concrete action from the Authority[100]except in one reported case.[101]

Penal Act

Section 327 of the Penal Act[102] imposes harsh criminal sanctions on trustees who fraudulently dispose of trust property but excludes corporate directors from the definition of the term "trustee." In equity, directors are regarded as trustees in certain respects.[103] Other provisions of the Penal Act which impose criminal liability on directors for fraudulent accounting or appropriation[104] or giving false information to deceive or defraud the company[105] are seldom activated.

In sum, the current statutory mechanisms for holding directors and the majority shareholders accountable are exceedingly inadequate. As demonstrated above, controlling shareholders have liberty to authorize loans and other payments to directors, compensate them for loss of office or remove them from office.

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[98] See § 210

[99] [1961] Ch. 270

[100] See Samuel Nduati, Posers for Stocks Body, KENYA TIMES, May 26, 1990, at 11; Peter Warutere, Timsales Takeover: NSE Adamant, DAILY NATION, Apr. 5, 1990, at 10; Samuel Nduati, Stock Markets and Politics, KENYA TIMES, May 19, 1990, at 11; Peter Warutere, Kenya Commercial Bank Comes Under Scrutiny, DAILY NATION, June 24, 1991, at 11; Kauli Mwembe, University don Answers Kenya Commercial Bank Chief, DAILY NATION, June 18, 1991, at 11; Francis Makokha, Nairobi Stock Exchange under Scrutiny, DAILY NATION, July 10, 1993, at 4; Samuel Nduati, Cooper Motors Corporation cries foul over 2,500 shares deal, DAILY NATION, Feb. 5, 1994, at 12; Samuel Nduati, What Holds Kenya Commercial Bank Shares? DAILY NATION, June 23, 1992, at 11; Samuel Nduati, Car firm Gripped by Takeover fears, DAILY NATION, Feb. 8, 1994, at 13; Daniel Kamanga & Maurice Otieno, Kenya Commercial Bank Shares at NSE Crash in Panicky Session, DAILY NATION, Feb. 11, 1994, at 12., Maurice Otieno, Analysts Baffled as Stock Market Heats up, DAILY NATION, Feb. 15, 1994, at 2; Alex Chege, Mbaru Explains rise in Trading, DAILY NATION, Feb. 17, 1994, at 11,

[101] See Alex Chege, British American Tobacco's Billion Profit hits Stock market, DAILY NATION, Feb. 22 1994, at 2; See also James Makau, Capital Markets Authority opens probe into Kenol share price jump, BUSINESS DAILY, Nov. 13, 2008, at 10.

[102] Cap 63, Laws of Kenya.

[103] First, directors are considered trustees of any company assets which come into their hands or under their control. See Re Forest of Dean Coal Mining Co. Ltd (1878) 10 Ch.D. 450. Second, money in a company bank account which directors are authorized to operate is held in trust for the company. See Selangor United Rubber Estates v. Craddock [1968] 1 W.L.R.1555. However, directors are not trustees' *stricto sensu* because unlike ordinary trustees whose primary obligation is to preserve trust property, directors on the other hand are bound to invest for the benefit of the company. Second, while ordinary trustees have legal title in the property of the beneficiary, directors do not since it is vested in the company.

[104] § 328

[105] § 329. But see Benson Wambugu, Uchumi Supermarkets: Kirubi Accused of Irregular Asset Sale, BUSINESS DAILY, Oct. 13, 2010, at 25. (The accused was a major shareholder and former chairman of the board of directors of Uchumi Supermarkets, Co. Ltd. He disposed of his entire shareholding in the company and resigned as is chairman. He was charge with the offense of conspiracy to defraud the company. The prosecution alleges that the accused and other members of the board disposed of the company's property at Kshs. 147 million ($ 1, 837,500) to a company in which the chairman had an interest which subsequently leased the property to the Uchumi Supermarket Co. Ltd at Kshs. 1.7 million ($ 21,250) per month); Benson Wambugu, Valuer testifies in Uchumi fraud Case, BUSINESS DAILY, Dec. 15. 2010, at 15.

Although the Companies Act empower the High Court to disqualify persons convicted of fraud and other offences connected with the formation or management of companies from taking part in company management, these provisions have not been invoked.[106]

Obligations of directors

As one of the principal organs of company management, the board of directors exercises both power and influence over business and other affairs of the company. The board is arguably a focal point of corporate governance.[107] However, precepts of corporate governance are further undermined by the extraordinarily lax and subjective standards of director's common law duty of care, skill and diligence.[108] The principles governing director's duty of care, skill and diligence were formulated by Romer J in Re City Equitable Fire Insurance Company Ltd.[109]Succinctly put, directors need not exhibit, in the performance of their duties, any greater degree of care and skill than may reasonably be expected from persons of their knowledge and experience. They are not bound to give the affairs of the company continuous attention. Their duties are intermittently performed at periodical board meetings and meetings of committees of the board. They are bound to attend these meetings when it is reasonably practicable. Furthermore, they are at liberty having regard to exigencies of business and the article of association to assume that trusted servants of the company perform their duties honestly.[110] Directors are neither bound to bring any special qualifications to office[111]nor verify information provided by tried servants of the company.[112] Although this articulation of law is not binding on Kenyan courts, the High Court of Kenya has relied on this case as binding authority and adopted the foregoing principles as Kenyan standards.[113] These standards are exceptionally low particularly for publicly held companies and could impact negatively on corporate governance. There is need statutory intervention to objectivise them. Debatably, it is feasible to objectivise these standards while retaining flexibility.

The same basic argument applies with regard to fiduciary obligations[114] or duties of loyalty and good faith. As fiduciaries, directors are bound to exercise their discretion *bona fide* in what they consider, not what the court may consider, to be in the interest of the company.[115]Thus, the interests of the company provide the outer limit of the fiduciary's discretion.[116]Judicial authority demonstrates that it has not been uncomplicated for courts to decipher what constitutes interests of the company.[117] The challenge for corporate governance is aggravated by the fact that courts in many common law jurisdictions are reluctant to review company management decisions. They appear to uphold the business judgment rule.

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[106] § 189. See also Andrew Hicks, Director Disqualification: Can it deliver, J.B.L. 433 (2001.

[107] See Abdul Majid, Low Chee Koeng & Krishnan Arjunan, Company Directors' Perceptions of their Responsibilities and Duties: A Hong Kong Survey, 28 HONG KONG L. J. 60, 62 (1998).

[108] See Chee Keong Low, A Road map for Corporate Governance in East Asia, 25 NW. J. INT'L L. & BUS. 165 (2004).See also, Vinch Vanessa, Company Directors: Who cares about skill and Care? 55 M.L.R. 179 (1992).

[109] [1925] 1 Ch. 407. According to Romer J., "a director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience. Second, a director is not bound to give continuous attention to the affairs of the company. His duties are of an intermittent nature to be performed at periodical board meetings, and at meetings of any committees of the board upon which he happens to be placed. He is not, however bound to attend all such meetings, though he ought to attend whenever, in the circumstance he is reasonably able to do so. Third, in respect of all duties that and having regard to the exigencies of business, and the articles of association, may properly be left to some other official, a director is in the absence of grounds for suspicion justified in trusting that official to perform such duties honestly."

[110] Re Denham & Co. (1883) 25 Ch. D. 752.

[111] Re Brazilian Rubber Plantations & Estates Co. Ltd. [1911] 1 Ch. D. 425.

[112] Dovey v. Cory [1901] A. C. 477, 17 T.L.R. 732.

[113] See Justice Hewett P.J.S. in Flagship Carriers Ltd v. Imperial Bank Ltd HCC No. 1643 0f 1999 (Unreported).

[114] See Vinter, A TREATISE ON THE HISTORY AND LAW OF FIDUCIARY RELATIONSHIP AND RESULTING TRUSTS (3 rd ed., 1955). See also SHEPERD, THE LAW OF FIDUCIARIES, (1981).

[115] Carlen v. Drury (1812) 1 Ves & B. 154 at 158. See also, Re Smith and Fawcett Ltd. [1942] Ch. 304 at 306, Teck Corporation v. Millar [1972] 33 D. L. R. 288; Marc T. Moore, Why UK Company Law must face up to the Political Realities of today's Economic World, 17(11) I.C.C.L.R. 297, 298 (2006).

[116] See Ross Grantham, The Content of Directors duty of Loyalty, J.B.L 149, 151(1993).

[117] See Hutton v. West Cork Railway Co. (1883) 23 Ch.D. 654, Parke v. Daily News [1962] Ch.D. 927, Re Olympia &York Enterprises & Hiram Water (1986) 59 O. R. (2d) 254.

Evidently, directors are likely to be punished for gross negligence only as opposed to misjudgment. An objective standard for instance, would require directors to exhibit a standard of conduct consistent with that of reasonable business persons in similar circumstances. There is need for statutory intervention in the formulation of an appropriate standard. In addition, the statutory framework on criminal liability of directors for breach of duty should be revamped in order to make it more efficacious. These proposals are consistent with developments in more progressive jurisdictions.[118]

In the United States for instance, the operative principle is the business judgment rule. The essence of the rule is that a director who makes a business judgment in good faith discharges his duty of care if he:

- had no personal interest in the subject matter,
- was well informed of the subject to the extent he reasonably believed to be appropriate and
- rationally believed that the business judgment was in the best interest of the company.[119]

Although the standard has been criticized by scholars, it is objective and protects directors from liability for commercial decisions taken in good faith.[120] Importantly, the standard is comparable to the statutory standards adopted in several common law jurisdictions such as United Kingdom, Singapore, Australia and New Zealand. Adopting a standard analogous to the business judgment rule in Kenya would objectivise the director's duty of care, skill and diligence and enhance corporate governance.

Role of Auditors

An equally important element of corporate governance is the audit function. This is a mechanism whose purpose is to enhance corporate integrity and accountability. Unlike directors who are part of the corporate structure, auditors comprise an external mechanism of corporate governance. Underpinning the foundation of good securities markets are the external mechanisms of corporate governance. As part of the external enforcers of corporate governance, auditors play a significant role in sustaining corporate governance. They ensure the veracity of corporate financial disclosure. They play a gate keeping role and are generally regarded as "watch-dogs" and are thus an indispensable component of corporate governance. Inevitably, "the annual audit is one of the cornerstones of corporate governance."[121]

Companies are statutorily required to have external auditors typically appointed by the annual general meeting on recommendations of the board of directors.[122] Although auditors are not regarded as officers of the company, for purposes of misfeasances and other malpractices committed or omitted in the course of discharging their obligations, they are regarded as such.[123] The auditing profession in Kenya is regulated by the Accountants[124]and the Companies Acts. The objective of regulating auditors is to promote competence, integrity, independence, objectivity and reliability of the audit function.

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[118] United Kingdom, Australia, New Zealand and Singapore have adopted objective standards on director's duties of care, skill and diligence as well as the fiduciary duty of good faith.

[119] See Principles of Corporate Governance: Analysis and Recommendations (The American Law Institute, 1994) in Paul Spink & Stephen Chan, The Hong Kong Company Director's Duty of Skill and Care: A Standard for the 21st Century, 33 HONG KONG L. J. 139, 156 (2003).

[120] See Stabb M., The Business Judgment Rule in Kansas: From Black and White to Gray, 41(3) WASHBURN L. J. 231 (2001); Manning B., Current Issues in Corporate Governance: The Business Judgment Rule in Overview, 45 OHIO ST. L. J. 615 (1984); Sergent R. S., The Corporate Directors Duty of Care in Maryland: Section 2-405.1 and the Business Judgment Rule, 44 HOW. L. J. 191 (2001); Gordon S. D., A Proposal to Eliminate Standards from the Model Business Corporations Act 67 U. CIN. L. REV. 1201 (1999); Emily Cassell, Applying the Business Judgment Rule Fairly: A Clarification from Kansas Court, 52 U. KAN. L. REV. 1119 (2004). See also, Letsou P. Theory Informs Practice: Implications of Shareholder Diversification on Corporate Law and Organization: The Case of the Business Judgment Rule, 77 CHI-KENT L.REV. 179 92001).

[121] See Andrew H. & S. H. Goo, Cases and Materials on Company Law, 564 (3rd ed. 1999).

[122] § 159

[123] See Re London & General Bank [1895] 2Ch. 16

[124] Cap 15, Laws of Kenya (Act No. 15 of 2008). The Act came into operation on December 30th, 2008. It repealed the Accountants Act, Cap 531.

Auditing plays an essential role in investor protection by *inter alia*, unearthing malpractices and vouching on the integrity of internal systems and reliability of financial statements and reports provided by management.[125] The audit provides an external and objective check on the way in which financial reports have been prepared and presented. It is an elemental part of the requisite system of checks and balances.

Although the training, qualifications and practice by Certified Public Accountants is highly regulated to ensure that only qualified and registered persons practice auditing and other specializations of the accountancy profession,[126] the standards expected of them in relation to company accounts and financial records are not commensurate with the rigorous and respectability of the qualification. The traditional role of the auditor is to examine the company accounts, books and consider other information availed during the audit in order to report whether the financial statements are in the proper form and give "a true and fair view" of the state of affairs of the company.[127] The audit is intended to provide a reasonable assurance that the financial reporting of the company is free from material misstatements. However, it is not an absolute guarantee that the figures are correct. Disconcertingly, auditors perform this function of as a matter of routine and prepare reports for submission to members in general meeting.[128]Their opinion is seldom qualified.[129]But more importantly, auditors are only accountable to the corporation with whom they have a contractual relationship. Unsurprisingly, the law imposes no obligation on the auditor to other consumers of audited financial statements.

Regarding the standard of care and skill, judicial authority is emphatic that auditors are only bound to bring to bear on their assignment the skill, care and caution of a reasonably competent, careful and cautious auditor. They are obligated to approach the assignment with an inquiring mind as opposed to a foregone conclusion of wrongdoing.[130] They are neither investigators nor fraud examiners. Their sphere of responsibility does not include the discovery and reporting of fraud or mismanagement. The primary responsibility for the prevention and detection of fraud is that of the board of directors. This argument is aptly encapsulated by the Lopes L.J. He opines that:

> "Auditors must not be made liable for not tracking out ingenious and carefully laid schemes of fraud when there is nothing to arouse their suspicion and when those frauds are perpetrated by tried servants of the company and are undetected by the directors. So to hold would make the position of an auditor intolerable."[131]

These somewhat relaxed standards of care and skill of auditors are not reflective of modern commercial trends and have not engendered corporate governance. The Uchumi Supermarkets Company Ltd debacle exemplifies the quagmire.[132]It is exceedingly difficult to establish professional negligence against auditors. Individual auditors are reluctant to testify against professional colleagues.[133] In Re Kingston Cotton Mills (No. 2), Kay L. J. observed:

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[125] See Lynn R.S., The Role of the Auditor in Corporate Governance, 6 AUST. ACCT. REV. 16 (1996); Robert A. Prentice, The Case of the Irrational Auditor: A Behavioral Insight into Securities Fraud Litigation, 95 NW. U. L. REV. 133 (2000); Rodger Buffington, A Proposed Standard of Common law Liability for the Public Accounting Profession, 5 S. CAL. INTERDISCIPLINARY L. J. 485 (1997).

[126] §§ 18-33

[127] Re Thomas Gerrald & Sons Ltd [1968] Ch. 455. See also contents of the Auditors Report, Seventh Schedule to the Companies Act. § 162.

[128] § 161

[129]For instance, in 1996, the Central Bank of Kenya placed the Kenya Finance Bank Co. Ltd under statutory management. The company was subsequently delisted from the Nairobi Stock Exchange and wound up. Intriguingly, the auditor had given the bank an unqualified audit report. The Uchumi Supermarkets Co. Ltd debacle relied upon elsewhere is a good illustration of the routine character of making the audit report.

[130] Fomento (Sterling Area) Ltd v. Selsdon Fountain Pen Co Ltd [1958] 1 W.L.R. 45

[131] Re Kingston Cotton Mills (No. 2) (1896)2 Ch. 279 at 288.

[132] The board of directors of the company resolved to discontinue the company's operations in early June 2006 on the ground of insolvency. The company had borrowed heavily from banks for what appeared to be an unplanned expansion program but failed to meet its obligations to lenders and suppliers. The auditors of the company who were privy to these developments and the company's performance were absolved from responsibility by the Capital Markets Authority and their professional body (Institute of Certified Public Accountants of Kenya) yet their reports to members of the company were never qualified.

[133]See ICPAK: Statement on Uchumi Supermarkets Co.Ltd, Dec.3, 2008, available at http://www.icpak.index.php=articles=75p-s-o-u.html. (exonerating Pricewaterhouse Coopers (PWC) from wrongdoing

"But if they (auditors) conducted their work with the amount of skill and care which can reasonably be expected from men of business in their position, is there any rule of law by which they can be made liable?"[134]

The traditional approach of requiring auditors to give an opinion whether the company's books and financial reports are proper and give a "true and fair view" of the state of affairs of the company is resoundingly inadequate.[135]Indubitably, certification of financial statements transcends a simple contractual relationship. Auditors perform a gate-keeping role with regard to financial statements of corporations. Because audited financial statements are increasingly being relied upon by an increasing constituency, it is imperative to incrementally extend the obligations of auditors. The fact that auditors perform a public function makes their role in corporate governance enhancement elemental.

The role of auditors in the enhancement of good corporate governance is further undermined by the reality that the Guidelines on corporate governance do not provide for rotation of auditors or audit partners after a specified duration of service. Second, company shareholders are not mandated to nominate auditors for appointment by the general meeting. Most importantly, the Guidelines do not prohibit auditors from rendering any non audit services to companies while simultaneously providing audit services. This has the potential to undermine their objectivity and independence in the audit function.[136]Noteworthy, in the United States, provisions of the Sarbanes-Oxley Act, 2002 address some of these concerns. For instance, the audit committees must pre-approve any services provided by the corporation's auditors[137] and more significantly, corporation auditors are barred from providing certain non audit services.[138]

Another pertinent issue regarding auditors and their role in corporate governance involves liability. The law and practice concerning the liability of auditors to the company and third parties and how partners may protect themselves against catastrophic liability is currently in a flux.[139] Courts in the United Kingdom on which Kenyan courts generally rely for guidance on various aspects of law have been reluctant to extend the liability of auditors to third parties who rely on audited financial statements and subsequently suffer loss. This was the pith and substance in Caparo Industries Plc v. Dickman.[140] The House of Lords held that an auditor had no general duty of care to third parties who purchased securities on the basis of audited financial reports. The court was categorical that auditors owed a legal duty of care to the company and its shareholders collectively but not to the shareholders as individuals or third parties. In his authoritative exposition, Lord Bridge of Harwich was emphatic that:

> "These considerations amply justify the conclusion that auditors of public companies owe no duty of care to members of the public at large who rely upon the accounts in deciding to buy shares in the company. If a duty of care were owed so widely, it is difficult to see any reason why it should not equally extend to all who rely on the accounts in relation to other dealings with the company as lenders or merchants extending credit o the company."[141]

The effect of Caparo was to limit the scope of liability of auditors. The House of Lords restricted the classes of persons to whom auditors owed a legal duty of care and the extent to which the audit report could be relied upon.

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following the collapse of Uchumi Supermarkets Co. Ltd. According to the Audit firm, the 2004 and 2005 financial statements were prepared in accordance with the International Accounting Standards (IAS).

[134] Id. at 294

[135] See Lynn R.S., The Role of the Auditor in Corporate Governance, 6 AUST. ACCT. REV. 16 (1996); Yeo, supra note 1156 at 200; Robert A. Prentice, The Case of the Irrational Auditor: A Behavioral Insight into Securities Fraud Litigation, 95 NW. U. L. REV. 133 (2000); Rodger Buffington, A Proposed Standard of Common law Liability for the Public Accounting Profession, 5 S. CAL. INTERDISCIPLINARY L. J. 485 (1997).

[136] Malkawi, supra note 7 at 498-501.

[137] §202

[138] §201(a)

[139] See ANDREW HICKS & S.H. GOO, CASES AND MATERIALS ON COMPANY LAW, 570 (3rd ed. 1999).

[140] [1990] 2 W. L. R. 358

[141] Id. at 361; Leon E. Trakman & Jason Trainor, The Rights and Responsibilities of Auditors to Third Parties: A Call for a Principled Approach, 31 QUEENS L. J. 148 (2005); Lloyd Alan Levitin, Accountants Scope of Liability for defective Financial Reports, 15 HASTINGS L. J. 436 91964); Warren A. Seavey, Notes and Legislation: The Accountants Liability- For what and to whom?" 36 IOWA L. REV. 319 (1951); Brian Cheffins, Auditor's Liability in the House of Lords: A Signal Canadian Courts Should Follow, 18 CAN. BUS. L.J. 118 (1991).

Put differently, the court shied away from extending the liability of auditors to all persons who forseably rely on the audited accounts of the company. Faced with a similar challenge, Kenyan courts would almost invariably replicate the U.K approach. Whereas auditors should not be exposed to catastrophic liability, the current approach is too restrictive and does not augur well with the enhancement of corporate governance.

The regulatory framework should be strengthened to make the external audit function a more effective component of corporate governance. In addition to their opinion, auditors should be required to report whether the company accounts are consistent with the director's report. Similarly, they should be required to report to the Capital Markets Authority any activities or conduct which in their professional opinion constitute an impropriety or non compliance with the laws or regulations for the time being in force.[142]However, they should be shielded from liability for such reports if made in good faith. Relatedly, they should be legally obligated to report fraud, dishonesty and other serious breaches to the relevant authorities for appropriate action. However, they should be protected from civil liability for anything done in good faith. To promote corporate governance, auditors should be responsible to persons who forseably rely on the audited financial statements of listed companies.

In sum, although the external audit function is potentially an important tool in the enhancement and enforcement of corporate governance in Kenya, it has not played a significant role. Admittedly, corporate governance envisages an enhanced role for the auditor.

Role of shareholders

Because ownership of shares confers primary and secondary rights, shareholders can play an important role in the institutionalizing corporate governance.[143] Disconcertingly, the Guidelines on corporate governance provide no effective mechanisms for shareholder participation in company affairs and decision making. Notwithstanding its short comings, the annual general meeting is retained as the only mechanism through which small individual shareholders are apprised of company activities and have the opportunity to consider, criticize and question the management on operation and governance issues. Although the Companies Act guarantees voting rights,[144] shareholder access to information is extremely weak and disempowering.[145] Apart from general statements on promoting communication between the company and its members[146] and ensuring "equitable terms"[147] or participation in major decisions,[148] which is exceedingly rhetorical, the Guidelines break no new ground in minority shareholder empowerment. Although companies are encouraged to facilitate the establishment of shareholder associations, no publicly held company has been enthusiastic in implementing the relevant guideline. Interestingly, although shareholders are entitled to attend and vote at general meetings of the company,[149] for multiplicity of reasons, including timing and venue, many seldom attend. Astonishingly, majority of the small individual shareholders who attend tend to agree with the recommendations of the board.[150]

Undoubtedly, shareholders can influence company management by ventilating their concerns in general meeting.[151] However, this is hardly the case as most retail investors lack awareness, incentive and resources to comprehend complex corporate governance issues and are thus incapable of exercising direct monitoring. The position of controlling shareholders is bolstered by the dispersed character of other shareholders of the company.

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[142] See § 33B, Cap. 485A.

[143] Cathy Mputhia, Shareholders are Watchdogs of their Companies, BUSINESS DAILY, July 19, 2010, at 16; See Yeo, supra note 16 at 202

[144] See Brenda Hannigan, Limitations on a shareholders' Right to vote- Effective Ratification Revisited, J.B.L. 493 (2000). (On the effect of ratification on voting rights).

[145] Nolan R.C., The Continuing Evolution of Shareholder Governance, 65(1) C.L.J. 92 (2006); Sarah Worthington, Shares and Shareholders: Property. Power and Entitlement, 22(10) COMP. L. 307, 312-14 (2001).

[146] Guideline 2.3.2

[147] Guideline 3.3

[148] Guideline2.3.1

[149] §§133 & 138 of the Companies Act

[150] See Mohammed B. Hemraj, Corporate Governance: Directors, Shareholders and the Audit Committee, 11(2) J.F.C. 152 (2003).

[151] See Lucian A. Bebchuk, Letting Shareholders set the Rules, 119 HARV. L. REV. 1784 (2006); Iman Anabtawi, Some Skepticism About Increasing Shareholder Power, 53 U.C.L.A. L. REV. 561 (2006). See also Lynn A. Stout, The Mythical Benefits of Shareholder Control, 93 VA. L. REV. 789 (2007).

Challenges of collective action make it logistically difficult for these shareholders to participate in company affairs effectively. Moreover, shareholder apathy is ubiquitous. This shortcoming can be remedied if institutional investors played their critical role. Unquestionably, "institutional investors are in a much more favourable position to play an activist role in corporate governance than dispersed individual investors."[152] This is because they are sophisticated, have the acumen, financial wherewithal and leverage in decision making. It is arguably their responsibility to monitor and ensure that the company complies with the Guidelines or principles of corporate governance. Because they have the requisite sophistication and resources to undertake greater oversight role at a lower transaction cost, they can ensure that concerns of minority shareholders are ventilated.[153] Additionally, they can use their power and influence to exert pressure on the management for desired policy changes. By exercising their role, institutional investors provide a critical layer of scrutiny over management behavior. Although their interests are not necessarily homogeneous, they are essential "constellations of control."[154] Company management is more likely to respond to institutional as opposed to individual pressure.[155] The Guidelines on corporate governance exhort institutional investors to make direct contact with the company's senior management to discuss performance and corporate governance. This is intended to facilitate the role of institutional investors as a corporate governance control mechanism.

The table below shows the number of institutional investors relative to the total number of investors in ten companies randomly selected from those listed on the Nairobi Securities Exchange.

Company	Number of Investors	Institutional Investors	Percentage shareholding
Kenya Re-insurance Corporation	126,713	9,989	8
Scangroup Ltd	34,253	1,719	5.3
Kenya Airways Co Ltd	76,703	3, 704	0.6
TPS Eastern Africa Ltd	9367	708	7.7
BOC Gases Kenya Ltd	721	518	9.48
Limuru Tea Co Ltd	93	5	6.26
Williamson Tea Kenya Ltd	1,296	154	19.09
Co-operative Bank of Kenya Ltd	116,068	3,201	73.8
Bamburi Cement Co Ltd	2,999	646	20
Total Kenya Ltd	5,410	600	12

Evidently, institutional investors are for the most part a minority and constitute a minute fraction of the total number of investors. It is important to underscore the fact that virtually all publicly held companies in Kenya have both local and foreign institutional investors whose interests lack homogeneity. They include insurance companies, bank nominee shareholders, pension funds, and trusts. Unfortunately, there is no evidence that these shareholders have been active participants in facilitating the entrenchment of principles of corporate governance.

[152] See Iman Anabtawi & Lynn Stout, Fiduciary Duties for Activist Shareholders, 60 STAN. L. REV. 1255, 1276 (2008); Bernard S. Black, Agents Watching Agents: The Promise of Institutional Investor voice, 39 U.C.L.A. L. REV. 811, 814-20 (1992); KEASEY K. & WRIGHT M., CORPORATE GOVERNANCE RESPONSIBILITIES, RISKS AND REMUNERATION, (1997); John Haberstroh, Activist Institutional Investors Shareholder Primacy and the HP-Compaq Merger, 24 HAMLINE J. PUB. L. & POL'Y 65 (2002) (arguing that institutional investors are the leading edge of activism because of the character of their shareholding).

[153] David P. Porter, Institutional Investors and their Role in Corporate Governance: Reflections by a "Recovering" Corporate Governance Lawyer, 59 CASE W. RES L. REV. 627 (2009).

[154] See SCOTT J., CORPORATE BUSINESS AND CAPITALISTIC CLASSES, 48-52 (1977); Grant Hayden & Mathew T. Bodie, Shareholder Democracy and the Curious turn Toward Board Primacy, 51 WM. & MARY L. REV. 2071 (2010); Robert C. Illig, The Promise of Hedge Fund Governance: How incentive Compensation can enhance Institutional Investor Monitoring, 60 ALA L. REV. 1 (2008); Robert C. Illig, What Hedge Funds can teach corporate America: A Roadmap for achieving Institutional Investor Oversight, 57 AM U. L. REV. 225 (2007).

[155] See Jason M. Loring & Keith Taylor, Shareholder Activism: Directorial Responses to Investors' attempts to change the Corporate Governance Landscape, 41 WAKE FOREST L. REV. 321 (2006) (Arguing that directors will more likely to respond to institutional investor pressure than individual shareholders); Michelle M. Harner, Corporate Control and the need for meaningful Board Accountability, 99 MINN L. REV. 541(2010); Randall S. Thomas, The Evolving Role of Institutional Investor in Corporate Governance and Corporate Litigation, 61 VAND L. REV. 299 (2008); Jayanti Sarkar & Subrata Sarkar, Large Shareholder Activism in Corporate Governance in Developing Countries: Evidence from India, 3 INT'L REV. FIN. 161 (2000);

They have shown little enthusiasm for engaging company management and comparable to many jurisdictions, they are characterized by passivity.[156] They appear to focus more on performance as opposed to governance and generally prefer taking the "Wall Street Walk" in case of disenchantment with the company. This challenge is compounded by the absence of shareholder activism in East Africa. Shareholder activism may be described as the exercise and enforcement of rights by minority shareholders with the objective of enhancing shareholder value in the long term.[157] It is a self-help measure undertaken by shareholders to safeguard their investment. Shareholder activism has the potential to promote good corporate governance because shareholder activists "fill the void in managerial monitoring."[158]By making demands on the management, shareholder activism influences the manner in which company powers are exercised and ensure proper behavior by directors.[159] This is particularly the case where institutional investors spearhead activism but as adverted to elsewhere, institutional investors have not been forthcoming in this respect and may be characterized as "reluctant activists."[160] Dissimilar ownership interests in companies constrain shareholder activism in Kenya. Individual shareholders who own small portions of companies are neither sufficiently empowered nor motivated to spearhead activism. Most importantly, there are no shareholder associations to institutionalize shareholder activism. The need for structured interaction between institutional and other investors in order to monitor the conduct of company management cannot be gainsaid. Institutional investors should exhibit their power by following up at general meetings pertinent issues discovered from their research and analysis of available information[161] Noteworthy and worrisome, shareholder activism can be employed counter-productively. Institutional investors may engage in activism for short term portfolio gains as opposed to the long term interests of the company.[162] In the United States for instance, there is evidence that hedge funds have engaged in shareholder activism exclusively for short term gains.[163] Irrefutably, neither institutional nor the minority shareholders have been instrumental in institutionalizing the principles of corporate governance. This is partly attributable to discordant interests, indifference, disempowerment and challenges of collective action.

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[156] See generally John C. Coffee Jr., Liquidity versus Control: The Institutional Investors as a corporate Monitor, 91 COLUM L. REV. 1277 (1991); Bernard S. Black & John C. Coffee JR., Hail Britannia? Institutional Investor Behaviour under limited Regulation, 92 MICH L. REV. 1997 (1994); Lucian A. Bebchuk, supra note 151 at 1798 (on shareholder democracy); JOHN LOWRY & ALLAN DIGNAM, COMPANY LAW 362 (2nd ed. 2003); Helen Short, Hao Zhang & Kevin Keasey, The Link between Dividend and Institutional Ownership, 8 J. CORP. FIN. 105 (2002); Bernard Black, The Value of Institutional Monitoring and Corporate Governance, 89 U.C.L.A. L.REV. 895 (1992); Karl Lins, Equity Ownership and Firm Value in Emerging Markets, 38 J. FIN. & QUANTITATIVE ANALYSIS 159 (2003); Geof Stapledon, Institutional Shareholders and Corporate Governance, (199); Goef Stapledon, The Structure of Share Ownership and Control: The Potential for Institutional Investor Activism, 18 U. N. S. W. L. J.250, 254 (1995); Olin Kramer, Pay Without Performance: The Institutional Shareholder Perspective, 30 J. CORP. L. 773, 774-775 (2005); Leo E. Strine Jr., Toward a true Corporate Republic: A Traditionalist Response to Bebchuk Solution for Improving Corporate America, 119 HARV. L. REV. 1759, 1765 (2006).

[157] Richard H. Koppes et al., Corporate Governance out of Focus: The Debate over Classified Boards, 54 BUS LAW. 1023, 1049-40 (1999); Paula J. Dalley, Shareholder (and Director) Fiduciary Duties and Shareholder Activism, 8 HOUS. BUS. & TAX L. J. 301 (2008).

[158] Roberta Romano, Less is More: Making Institutional Investor Activism a Valuable Mechanism of Corporate Governance, 18 YALE J. ON REG. 174, 176 (2001).

[159] Iris H-Y Chiu, The Meaning of Share Ownership and the Governance of Shareholder Activism in the United Kingdom, 8 RICH. J. GLOBAL L. & BUS. 117, 146 (2008).

[160] See Pozen R.C., Institutional Investors: The Reluctant Activists, HARV. BUS REV. Jan-Feb., 1994 at 140-149.

[161] See generally Mohammed B. Hemraj, How Shareholders' Activism can Refrain Directors from Hijacking the Company, 24(11) COMP L. 345 (2003).

[162] See ADRIAN CADBURY, CORPORATE GOVERNANCE AND CHAIRMANSHIP: A PERSONAL VIEW, 205 (2002); Gerald F. Davis & E. Han Kim, Business ties and proxy voting by Mutual Funds, 85 J. FIN. ECON. 552, 568 (2007); Camara K.A.D., Classifying Institutional Investors, 30 J. CORP. L. 253,242-50 (2005); Roberta S. Karmel, Should a Duty to the Corporation be Imposed on Institutional Shareholders? 60 BUS LAW. 1, 7-8 (2004).

[163] Thomas W. Briggs, Corporate Governance and the New Hedge Fund Activism: An Empirical Analysis, 32 J. CORP. L. 681 (2007); Marcel Kahan & Edward B. Block, Hedge Funds in Corporate Governance and Corporate Control, 155 U. PA. L. REV. 1021 (2007)(arguing that activism by hedge funds differ from activism from traditional institutional investors in that it involves significant changes in the company, entail higher cost and is strategic. Their reasoning is that unlike hedge funds, traditional institutional investors are subject to regulatory and political barriers and conflict of interest). But see George W. Dent, The Essential Unity of Shareholder and the myth of Investor Short termism, 35 DEL. J. CORP L. 97 (2010); Kuang Wei Chueh, Is Hedge Fund Activism new hope for the market? 2008 COLUM BUS. L.REV. 724 (2008); William W. Bratton, Hedge Funds and Governance Targets, 95 GEO L. J. 1375 (2007) (explaining the idea of hedge fund activism, its uniqueness and problems).

The question of empowering the board of directors has generated vigorous debate among commentators. The board primacy theory is anchored on the premise that companies are controlled by boards of directors not shareholders or managers with a caveat that shareholders are the ultimate beneficiaries. Directors' accountability is therefore to maximize shareholder value.[164] Director primacy theory constitutes directors the center-piece of corporate governance. One of the most steadfast proponents of the board primacy theory is Professor Bainbridge. Although establishing a strong board is a cardinal shareholder obligation, it is not the cure-all for challenges of corporate governance. It is submitted that while the director primacy theory may be suitable in jurisdictions with dispersed ownership such as the United States and the United Kingdom, its effectiveness in jurisdictions with concentrated ownership is doubtful because directors owe allegiance to shareholders. They are beholden to the controlling shareholder(s). Perhaps one way to make the board of directors an important tool for minority protection is for the Companies Act to provide for the position and mandate of independent non-executive directors. They are perceived as impartial.[165]

In sum, it is not implausible to hypothesize that the introduction of market based corporate governance has not resulted in significant improvement in corporate governance practices in Kenya. Several factors account for the lack of enthusiasm in domesticating the Guidelines. Principal among them is the underlying legal framework which is neither supportive nor facilitative. Whereas there is nothing overly challenging in the appointment of independent non-executive directors and establishment of board committees, institutionalizing their role and rendering them effective in executing their mandate is. The emphasis of empowering independent non-executive directors and board committees has failed for want of a supportive infrastructure.[166] There is a public interest argument for statutory intervention. The weak legal system,[167] poor property rights protection and weak enforcement of existing laws have resulted in the concentration of ownership in most publicly held companies. The majority shareholders are reluctant to relinquish control for fear of expropriation and ineffective management.[168] Because these shareholders control the management and the general meeting, they are capable of exercising company powers in a manner favourable to themselves. Foreign owned companies emblematize this phenomenon.

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[164] Stephen M. Bainbridge, Director Primacy: The Means and Ends of Corporate Governance, 97 NW. U. L. REV. 547, 550 (2003); Stephen M. Bainbridge, Director Primacy and Shareholder Disempowerment, 119 HARV. L. REV. 1735 (2006) (arguing that substantial benefits accrue from limiting shareholder voting power); Stephen M. Bainbridge, The Case for Limited Shareholder Voting Rights, 53 U.C.L.A. L. REV. 601 (2006); Lynn A. Stout, Bad and Not-so-bad Arguments for Shareholder Primacy, 75 S. CA. L. REV. 1189 (2002) (explaining that corporations exist to make money for its shareholders); Ian B. Lee, Efficiency and Ethics in the Debate about Shareholder Primacy, 31 DEL J. CORP L. 533 (2006). But see also Grant Hayden, Shareholder Democracy and the Curious turn towards Board Primacy, 51WM & MARY L. REV. 2071 (2010); Lucian A. Bebchuk, The Case of Increasing Shareholder Power 118 HARV. L. REV. 833 (2005) (making a strong case for shareholder to initiate and vote to adopt changes in the corporate charter and by-laws); Lucian A. Bebchuk, The myth of shareholder voting power, 93 VA. L. REV. 675 (2007); Jill E. Fisch, The Overstated promise of Corporate Governance, 77 U. CHI L. REV. 923 (2010) (arguing that corporate governance should promote efficiency in the securities markets and increase accountability for misinformation); Melvin A. Eisenberg, Legal Models of Management Structure in the Modern Corporation: Officers, Directors, and Accountants, 63 CAL. L. REV. 375 (1975).

[165] Mark Fox & Gordon Walker, Sharemarket Ownership and Securities Regulation in New Zealand, 17 NZULR 404, 416 (1997); Hans C. Hirt, The Company Decision to Litigate Against its Directors: Legal Strategies to deal with the Directors Conflict of Interest, J.B.L. 159, 267 (2005) (arguing that effective corporate governance requires independent non-executive directors with strong links to the shareholders); Yuan Zhao, Competing Mechanisms in Corporate Governance: Independent Directors, Institutional Investors and Market Forces, 21(10) I.C.C.L.R. 338 (2010) (arguing that if corporate governance is to be enhanced, independent non-executive directors, institutional shareholder activism and market forces should be viewed as complementary as opposed to competing).

[166] See Iris H-Y Chiu, The Role of a Company's Constitution in Corporate Governance, 7 J.B.L. 697 (20090. Loise Musikali, Why Criminal Sanctions Still Matter in Corporate Governance, 20(4) I.C.C.L.R. 133,134 (2009) James Anyanzwa, Improve Corporate Governance to attract Investors, THE STANDARD, Nov. 18, 2010, at 16.

[167] See John & Angus, supra note 3 at 306. See also Mathias M. Siems, Shareholder Protection around the World, 33 DEL. J. CORP L. 111 (2008); Julie Hembrock Daum, How corporate governance has changed overtime, BUSINESS DAILY, Jan. 4, 2011 at 9 (explaining that in the United Kingdom, boards of directors have become smaller, more professionalized, meet less often and have fewer inside directors). This is unlikely to happen in Kenya in the short term because of the concentrated character of share ownership.

[168] See Christopher John, supra note 18 at 81.

The table below illustrates the distribution of share ownership in twenty nine companies randomly selected from those listed on the Nairobi Securities Exchange.[169]

Company	Issued Shares	Top ten Investors	Percentage Ownership	Other Investors	Percentage Ownership	Number of investors	Majority Shareholder
Eveready East Africa	210,000,000	143,637,286	68.9	65,251,614	31.07	134,911	35.1
Olympia Capital Holdings Ltd	40,000,000	30,952,229	65	9,047,771	35	2,344	18.5
Total Kenya Ltd	175,064,706	142,000,000	82	33,064,706	18	5,410	72
Diamond Trust Bank Ltd	163,037,108	86,000,000	53	83,037,108	57	11,581	17.3
Eaagads Ltd	8,039,250	7,520,235	94	519,015	6	123	61.7
Limuru Tea Ltd	600,000	5,340,000	89	66,000	11	93	51.99
Athi River Mining Ltd	99,055,000	72,310,150	73.1	26,744,850	26.8	6,695	45.4
Kapchorua Tea Ltd	3,912,000	3,122,7990	85	790,210	15	261	39.5
Williamson Tea Ltd	8,756,320	5,000,000	65	3, 756,320	35	1,296	51.4
Crown Berger Ltd	23,729,000	17,684, 225	73	6,042,755	27	2,977	48.06
East Africa Breweries	790,774,356	510,579,882	64.5	280,194,474	35.4	26,878	42.8
East Africa Portland Cement Co.	90,000,000	86,526,725	96.1	5,310,543	3.9	unavailable	27
Cooperative Bank Ltd	3,492,369,900	2,464,313,500	70.4	1,028,056,400	29.6	116,068	64.5
Jubilee Insurance Co. Ltd	45,000,000	23,640,647	52.5	22,358,353	47.4	6,317	37.9
CFC Bank	273,684,211	255,350,610	93.3	18,333,601	6..7	3,637	41.4
Barclays Bank Co.	1,357,884,000	996,218936	73.3	361, 665,364	26.6	60,917	68.5
Kengen	2,198,361,456	1,607,054,284	73	591,307,172	26.9	220,089	70
Equity Bank	3,702,777,020	2,328,877,360	63.8	1,373,899,66o	36.1	25,969	24.4
Bamburi Cement	262,959,275	322,509,452	88.6	40,449,823	11.1	2,999	29.3
Kenol Kobil	147,176,120	114,877,720	78	32,298,400	22	2,634	24.9
Sameer Africa Ltd	278,342,393	219,722,458	78.9	58,619,935	21.06	15,025	*57.2*
Kenya Power &Lighting Co(KPLC)	79,128,000	61,077,526	76.8	18,050,474	23.1	7,664	50.1
Unga Ltd	630,090,728	380,000,000	62	250,000,000	38	7,829	50.9
Standard Chartered Bank Ltd	271,967,811	214,461,595	79	57,506,206	21	32,755	73.8
Pan Africa Ins. Co.	48,000,000	38,831,640	80.9	10,162,360	19.1	2,876	50
NIC Bank	326,361,622	178,993,867	54.8	147,367,755	45.1	25,154	15.8
Scangroup	220,689,655	174,214855	78.9	46,474,800	21	34,253	27.5
Kenya Airways	461, 615,483	267, 203,889	57.8	194,411,594	42.1	76,703	26
BOC Gases	19,525,446	12,919,048	79.4	7,606,398	20.6	721	65.3

The statistics, establish beyond controversy that concentrated ownership characterizes Kenya's publicly held companies. Virtually all companies have block holders who can significantly influence major decisions of the company. In all the twenty nine companies, ten shareholders control between 53 and 96 % of the respective companies. A similar picture emerges with regard to the quantum of shares held by the majority shareholder. This scenario symbolizes the symbiotic relationship between strong ownership concentration and poor corporate governance.[170] It is arguable that the small individual investors play an insignificant role in making company decisions or shaping its policy. They are rationally apathetic.[171]

[169] Annual Reports of the respective companies for the year 2009.

[170] See generally Erica Gorga, Changing the Paradigm of Stick ownership from Concentrated towards Dispersed Ownership? Evidence from Brazil and Consequences for Emerging Countries, 29 NW. J. INT'L L. & BUS. 439, 445 (2009).

[171] See Bernard S. Black, Shareholder passivity reexamined, 89 MICH L. REV. 520 (1990) (arguing that legal barriers, manager control and conflict of interest are the principle causes of shareholder passivity); Lee Harris, Missing Activism: Retail Inventors absence in Corporate Elections, 2010 COLUM BUS. L. REV. 104 (2010).

Institutional investors are either unwilling or unable to play an active role in the promotion of principles of good governance. They have failed to institutionalize shareholder activism. Another obstacle to the enhancement of corporate governance is the considerable presence of government controlled companies which are averse to good corporate governance.[172] The Government of Kenya is the controlling shareholder of several listed companies and exercises overwhelming influence in the appointment and removal of directors. Most of the companies in which the government is the majority shareholder have not embraced the Guidelines on corporate governance.[173] The leadership challenges that confronted the East Africa Portland Cement Company Ltd, Housing Finance Company of Kenya and Kenya Re-insurance Corporation in 2010 and the stalled secondary offerings of National Bank of Kenya and Kengen implicated the principles of good corporate governance.[174] Dubiously, the boards of directors of these companies owe allegiance to the appointing authority as opposed to the welfare of the company.

Conclusion

The foregoing analysis is unequivocal that the ineffectiveness of principles of corporate governance in Kenya is attributable to the weaknesses of the underlying legal framework, unwillingness or inability by the Capital Markets Authority to enforce the Guidelines, and the failure of publicly held companies to embrace the corporate culture of accountability.[175] The Companies Act which is undoubtedly a repository of historical relics is largely ineffectual in relation to the mandate of independent non-executive directors, role of external auditors, director's duties, and member's rights. More importantly, it is based on the "shareholder" not "stakeholder" paradigm of corporate governance and recognizes a unitary board. The Act neither recognizes nor empowers board committees and rules on related party transactions are exceedingly director friendly. The fact that compliance with the Guidelines is voluntary was intended to encourage compliance, but listed companies have not been exuberant in embracing them as part of their corporate culture. The novel concepts of independent non-executive directors and board committees do not appear to have endeared corporate governance.

Moreover, the principles do not institutionalize director training which is imperative in nurturing corporate governance. Relatedly, the fact that there is no time limit within which a company must implement a specific principle means that a company may keep on explaining its non compliance for years on end without attracting penalties. Most importantly, the Capital Markets Authority has not been particularly enthusiastic in enforcing certain requirements of the Guidelines. In sum, it is not implausible to surmise that soft corporate governance is largely dysfunctional and because of the incessant corporate scandals, there is need for a paradigmatic shift. Although the resurgence of hard governance in the United States with the passage of the Sarbanes-Oxley Act of 2002 was not received with enthusiasm in other jurisdictions, it is perhaps an important reference point and may be the harbinger of the nascent approach to global corporate governance.[176]

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[172] See Silvia Fazio, Corporate Governance, Accountability and Emerging Economies, 29(4) COMP. L. 105, 110-11 (2008); Paul Wafula & Mwaura Kimani, Institutions fail Good Governance test at Awards, BUSINESS DAILY, Nov. 16, 2010, at 25 (arguing that listed companies were still sluggish in implementing the principles of good corporate governance. The report isolates government owned corporations as major culprits).

[173] See generally Charles C. Okeahalam, Corporate Governance and Disclosure in Africa: Issues and Challenges, 12(4) J.F.C. 539 (2004).

[174] See Allan Odhiambo, supra note 69. See also Wei Cai, Path Dependence and Concentration of Ownership and Control of Companies Listed in China, 20(8) I.C.C.L.R.281, 286-87 (2009).

[175] See generally Moeen Cheema & Sikander Shah, Corporate Governance in Developing Economies: The Role of Mutual Funds in Corporate Governance in Pakistan, 36 HONG KONG L. J. 341,

[176] See generally Roberta S. Karmel & Claire R. Kelly, The Hardening of Soft Law in Securities Regulation, 34 BROOK J. INT'L L. 883 (2009); Miguel Lamo De Espinosa Abarca, The need for Substantive Regulation on Investor Protection and Corporate Governance in Europe: Does Europe need a Sarbanes-Oxley? 19(11) J.I.B.L.R. 419 (2004) (arguing for substantive regulation of the principles of corporate governance. The author postulates that the Sarbanes-Oxley Act, 2002, is a good example for Europe to emulate); Larry E. Ribstein, Market vs. Regulatory Responses to Corporate Fraud: A Critique of the Sarbanes-Oxley Act of 2002 28 J. CORP. L. 1 (2002); Jill E. Fisch, The new Federal Regulation of Corporate Governance, 28 HARV. J. L. & PUB. POL'Y 39 (2004); Anita Indira Anand, An Analysis of Enabling vs. Mandatory Corporate Governance: Structures post- Sarbanes Oxley, 31 DEL. J. CORP. L. 229, (2006).