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**Case study on corporate governance disclosures in Kenya**

**Executive summary**

The nineteenth session of the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR), which took place in Geneva from 25 to 27 September 2002, requested that field case studies be conducted in the area of transparency and disclosure requirements in corporate governance. Accordingly, five country case studies were conducted, focusing on major issues in implementing corporate governance disclosure requirements. The countries on which the case studies were conducted are Brazil, France, Kenya, the Russian Federation and the United States of America.

This report presents findings of a case study on the implementation of corporate governance disclosure requirements in Kenya. The report provides an overview of the legal and regulatory framework covering the Companies Act, relevant Acts of Parliament and the State Corporations Act. Sector-specific laws such as those relating to banking and insurance, the Capital Markets Act and regulations issued by the Capital Market Authority and various voluntary initiatives are also discussed. The study used as reference points the transparency and disclosure requirements discussed by the Intergovernmental Working Group of Experts (TD/B/COM.2/ISAR/15).

The main objectives of the study are to draw lessons from the experience of Kenya in promoting improved transparency and disclosure in the corporate sector and to share the findings with member States that wish to strengthen transparency and disclosure in their respective countries.

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## BACKGROUND

1. Kenya, the gateway to East Africa, is strategically located on the Indian Ocean coast, thus providing easy access to regional and world markets. It borders Somalia, Ethiopia, Sudan, Uganda and the United Republic of Tanzania. It is aptly described as a land of contrasts, with 582,646 sq. km of beaches, desert, highly arable land, vast grasslands, forests, mountains and, of course, the Great Rift Valley, which runs through the country from the North to the South.

2. Straddling the equator, Kenya enjoys a pleasant tropical climate and an abundance of both plant and animal life. The country's wide range of ecological zones facilitates the cultivation of a variety of crops and rearing of livestock. By and large, agriculture has been and remains the principal economic activity, accounting for about 24 per cent of Gross domestic product (GDP), although its importance has gradually declined from a high of about 40 per cent.<sup>1</sup> Although tea and coffee have for a long time been the key foreign exchange earners, horticulture is becoming increasingly important.

3. While its rapid growth has in the recent past been negatively impacted by persistent threats to world peace, tourism has in the last decade or so grown significantly in stature, quickly becoming the second most important industry in terms of its contribution to GDP at almost 20 per cent. The manufacturing sector has also experienced steady growth over the years and currently contributes about 13 per cent of GDP. Traditionally composed of large and medium-size enterprises, it has in the recent past seen the proliferation of small and micro enterprises, which are making a significant contribution particularly with regard to employment creation.

4. Kenya has fairly well developed infrastructure, including international and domestic air transport facilities, one of the most modern ports in Africa, an extensive road network with all-weather roads connecting major commercial centres, a railway system and a well-established communication system. Relative to other countries on the continent, it has fairly well developed financial and capital markets, with its stock market rated by the International Finance Corporation (IFC) the most promising emergent market in 1994. The media are liberalized and the quality of journalism is high. Its major cities are cosmopolitan, populated by people of all types of racial and cultural backgrounds. The Kenyan people themselves are relatively well educated, highly skilled and hardworking.

5. Since 1964, a year after its independence from Britain, Kenya has been a democratic republic led by a president who is directly elected by the people and in whom significant executive powers are vested. The Government as established under the independence constitution has three arms—the Executive, responsible for the day-to-day running of government; the Legislature, which is the law-making authority; and the Judiciary, responsible for the determination of disputes and dispensation of justice.<sup>2</sup> The constitution provides for the separation of powers between the three arms of government

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<sup>1</sup> Further details and statistics can be found at the Investment Promotion Centre website [www.ipkenya.org](http://www.ipkenya.org).

<sup>2</sup> The constitution is currently under review.

to ensure checks and balances and prevent the abuse of power. The effectiveness of this in practice has, however, been the subject of intense debate, culminating in the constitutional review process currently underway.

6. For the most part, Kenya has and continues to enjoy political stability. In 2002, there was a significant general election in which the Kenya African National Union (KANU), a party that had ruled the nation for the previous 39 years, handed over power to the National Rainbow Coalition (NARC), an opposition alliance. The peaceful transition was heralded the world over as a sign of the political maturity of the Kenyan people and an example to be emulated elsewhere. Kenya continues to excel in sports and contributes to conflict resolution and peace-keeping missions, which have further endeared the country to the rest of the world and made it a natural leader on the continent. The country continues to play a leading role in many regional and international initiatives, including the East African Community (EAC), the Common Market for Eastern and Southern Africa (Comesa), the African Union (AU), the African Caribbean and Pacific Group of States (ACP) and the United Nations—with the United Nations Environment Programme (UNEP) and United Nations Human Settlements Programme (UN-Habitat) headquarters in Nairobi along with the regional offices of other UN agencies.

7. All these factors have combined to make Kenya the economic hub of East Africa and a respected country within and beyond the continent. Economically, however, the country is yet to realize its potential. Kenya has pursued a mixed economy since its independence in 1963. In the decade immediately after independence, it enjoyed strong economic growth, averaging an annual growth rate of 6.5 per cent. Performance has since then, however, declined sharply, hitting an all time low of -0.2 per cent in 2000. All other economic indicators have shown a similar downward trend. This poor performance is largely attributed to poor governance and its attendant consequences, over-reliance on primary products and the sizable role played by the State in the economy, coupled with an increasingly competitive and demanding global market.

8. In a bid to address this sad state of affairs and improve performance, there has been a marked shift in emphasis from public investment to private-sector-led growth. The Government has in its development plans recognized the private sector as the wealth-creating organ of society. Consequently, it has initiated various reforms to restrict its active participation in economic activity and focus its resources on creating an environment within which enterprise can flourish. Such reforms include trade liberalization, review of the exchange rate policy, including the removal of price controls and repeal of the Exchange Control Act, and various financial sector reforms.

9. The need for reforms has not been felt by the Government alone. Chiefly owing to the concern over declining economic performance and the urgent need to remedy the situation, the corporate leadership recognized in the mid-1990s the urgent need for corporate governance reform to enhance economic performance. This pressure culminated in a workshop held in Mombasa in November 1998. The workshop brought together a wide array of stakeholders who recognized the urgent need for corporate governance reform. Consequently, it launched the Private Sector Initiative for Corporate Governance Trust to spearhead the promotion of good corporate governance in Kenya.

10. What began as a national private-sector-driven initiative has grown in leaps and bounds since its inception. While it was initially mandated to address issues of corporate governance in Kenya, the success of its programmes, particularly in training and research, has resulted in high demand from the rest of the region. During a regional meeting held in Johannesburg, South Africa, in 2001, its efforts were publicly acknowledged and it was appointed the secretariat of the Pan African Consultative Forum on Corporate Governance, around which all other national initiatives on corporate governance are expected to coalesce. Now known as the Centre for Corporate Governance, its training programmes and the results of its research efforts are being replicated throughout Africa with much success. The choice of Kenya as the case study for Africa is therefore appropriate.

## **FRAMEWORK GOVERNING CORPORATE DISCLOSURE**

11. The corporate disclosure framework in Kenya comprises legal and regulatory requirements and voluntary initiatives.

## **OVERVIEW OF THE LEGAL AND REGULATORY FRAMEWORK**

### *The Companies Act*

12. The principal legislation governing corporate disclosure is the Companies Act (Cap 486) of the Laws of Kenya, which is an act of Parliament to amend and consolidate the law relating to the incorporation, regulation and winding up of companies and other associations and to make provisions for other matters relating thereto and connected therewith. It is the Act under which the bulk of companies in Kenya, both private and public, are incorporated or registered.<sup>3</sup> The Act is based on the United Kingdom's 1948. Companies Act. Only minor amendments have been made to it since it was imported into the country.

13. In terms of disclosure requirements, the Act addresses at considerable length the following issues:

- Disclosures to be made in a prospectus
- Annual returns
- Accounts and audit
- Disclosures on matters pertaining to directors
- Registers and inspections
- General meetings

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<sup>3</sup> Registration is a requirement for foreign companies operating in Kenya.

### ***Relevant Acts of Parliament***

14. There are also organizations that are set up by specific Acts of Parliament. These are largely State-owned corporations, particularly those classified as "regulatory" or "strategic".<sup>4</sup>

15. In terms of disclosure requirements, the acts largely mirror the provisions of the Companies Act, save that they contain provisions that entrench the control of the State. Such provisions pertain to the appointment of boards, reporting mechanisms and audit requirements. For these corporations, audits can only be conducted by the Controller and Auditor General, who report to parliamentary committees on public accounts and investment.

### ***The State Corporations Act<sup>5</sup>***

16. As in many other African economies, State-owned corporations play a significant role in Kenya. Owing to the plethora of State corporations subject to different legislative regimes, the State corporations Act was enacted to streamline the operations of State corporations. For this reason, it is a statute of general application and specifically provides that in the event of conflict between its provisions and those of other statutes, including the Companies Act under which some state corporations are enacted, the State Corporations Act prevails.

17. In terms of disclosure requirements, the provisions of the State Corporations Act do not differ materially from those of the Companies Act. However, the statute confers significant powers on the Executive and particularly the President, the Responsible Minister, the Treasury and the Permanent Secretary of the parent ministry, who is the accounting officer.

### ***The Cooperatives Act<sup>6</sup>***

18. The Cooperative movement in Kenya is a key player in the economy, contributing about 40 per cent of GDP. Cooperatives are incorporated and regulated by the provisions of the Cooperatives Act.

19. The Act addresses among other issues:

- Registration and dissolution of cooperative societies
- Rights and liabilities of the societies and members

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<sup>4</sup> These are largely corporations whose primary objective is not commercial but have a wider national interest or impact e.g.

<sup>5</sup> Cap 446 of the Laws of Kenya.

<sup>6</sup> Act no. 12 of 1997.

- Management
- Amalgamation and division of societies
- Property and funds (management of)
- Settlement of disputes

20. The act has recently been revised with the express purpose of reducing the role of government in the management of cooperatives, which has been cited as one of the major reasons for the collapse of many of the large cooperatives. The new act, which does not effectively address issues of governance and disclosure, has come under intense criticism and another review is already in the offing.

### **SECTORAL LAWS ON BANKING AND INVESTMENT AND OTHER LEGISLATION**

21. Various legislative and regulatory requirements are scattered in other laws, including manufacturing laws, intellectual property laws, property laws, labour laws, tax laws and, particular, sectoral laws on banking and investment, including insurance, retirement benefits, capital markets and banking laws. Of particular interest in terms of corporate governance disclosure are the last four.

#### ***Insurance***

22. The insurance industry, which is still regulated by a department of government, has not made much progress in enhancing the legal and regulatory framework.

#### ***The Capital Markets Act and Regulations made by the Capital Markets Authority***

23. Capital markets bring together owners and users of capital and, in so doing, play an important role in mobilizing and allocating resources for development. Through various instruments, they provide a mechanism through which savings can be channelled into productive activities. Robust markets in particular play an important role not just in the allocation of capital but also in its optimization by ensuring that scarce resources go to the most effective users. They also separate ownership from control of resources, enabling entrepreneurs to finance their ventures in an effective and accountable manner to the benefit of the entrepreneur, the investor and society at large. By providing reasonable and reliable returns in an effective and transparent manner, capital markets provide an incentive for investment, thus promoting a culture of thrift and saving.

24. Capital markets in Kenya, though fairly well developed by African standards, are small and volatile. The diversity of products offered is limited. Trading volumes and liquidity are low. The technology employed in trading and settlement is archaic and unreliable. Rules are opaque, compliance is low and enforcement is weak.

25. For a long time, disclosure requirements were insufficient and there was inadequate protection of investors. At the same time, outdated laws and cumbersome licensing complicated entry, impeded efficient operation and discouraged orderly exit.

26. In 2002 the Capital Markets Authority, working with the Nairobi Stock Exchange, developed a new legal and regulatory framework that conforms to the best international practices.

27. Of the rules so developed, the key ones in ensuring corporate disclosure by listed companies include<sup>7</sup>:

- Nairobi Stock Exchange Listing Manual;
- The Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations 2002;
- The Capital Markets Guidelines on Corporate Governance Practices by Public Listed Companies in Kenya.

28. The rules have greatly enhanced disclosure requirements for listed companies on both initial listing and continuing listing obligations. They have also improved timeliness, requiring quarterly reports as opposed to the previous half yearly ones. The level of disclosure has also been enhanced.

29. The Authority has also issued fairly comprehensive guidelines on corporate governance for listed companies, building on the code developed by the Centre for Corporate Governance. Appendix 1 contains a summary of the Capital Markets Corporate Governance Guidelines.

30. These enhancements have already made some quick gains, with many listed companies making changes to their governance practices. Of particular interest is the establishment of audit committees with independent, non-executive directors and corporate governance disclosure in annual reports.

### ***Banking regulations***

31. Given the importance of the financial system in a country's economy and the problems that have plagued the financial industry in Kenya, it is not surprising that the

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<sup>7</sup> The Capital Markets Authority developed and gazetted the following regulations and guidelines:

- The Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations 2002;
- The Capital Markets (Licensing Requirements) (General) Regulations 2002;
- The Capital Markets (Takeovers and Mergers) Regulations 2002;
- The Capital Markets (Foreign Investors) Regulations 2002;
- The Capital Markets Guidelines on Corporate Governance Practices by Public Listed Companies in Kenya<sup>7</sup>;
- The Capital Markets Guidelines on the Approval and Registration of Credit Rating Agencies.

The Exchange reviewed its existing rules and regulations, including:

- Nairobi Stock Exchange Listing Manual;
- Trading & Settlement Rules;

Management & Membership Rules.

Central Bank of Kenya has been at the forefront of improving corporate governance disclosure in banks and financial institutions. Through its Prudential Regulations and circulars, the Bank has greatly enhanced the depth of reporting by banks and financial institutions, particularly regarding bad loans portfolios and credit practices. Banks are required to publish detailed balance sheets and profit and loss statements as well as their lending rates in national newspapers. Timeliness has also been boosted, with the banks being required to submit audited reports within three months of the close of the financial year.

32. The Bank has also addressed the issue of audit committees, making them mandatory, and vets all director appointments.

***The Retirement Benefits Act and Regulations issued by the Retirement Benefits Authority***

33. Although one of the youngest regulatory authorities in Kenya, the Retirement Benefits Authority has kicked off on a high note with simple but elaborate legislation touching on all critical areas of corporate governance practices, including disclosure for retirement benefits schemes. The Authority is also one of the more highly respected in terms of its ability to respond proactively, monitor, encourage and enforce compliance, and inject a level of professionalism into an industry with some of the poorest governance standards, which have resulted in unbridled plunder. This is particularly significant given the massive resources that retirement benefits schemes control.

## **VOLUNTARY INITIATIVES**

### ***THE NAIROBI STOCK EXCHANGE***

34. The Nairobi Stock Exchange was constituted as a voluntary association of stockbrokers and registered in 1954 as a society under the Societies Act.<sup>8</sup> In 1990, it was incorporated under the Companies Act as a company limited by guarantee and without a share capital. To date, it has 18 broker and three dealer members. There are 53 companies listed on the various tiers of its Official List, in addition to 18 month, 1, 2, 3, 4, 5, 6, 9 year, Government of Kenya treasury bonds, and in July 2003 a 10-year Government of Kenya treasury bond. As of 31 May 2003, total market capitalization (both equity and debt) was US\$ 4.44 billion,<sup>9</sup> constituting 33.57 per cent of GDP<sup>10</sup>.

35. Although like itself its members are licensed by the Capital Markets Authority and the listed companies are approved by the Capital Markets Authority, the Exchange is

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<sup>8</sup> Cap 108 of the Laws of Kenya.

<sup>9</sup> US\$ 2.43 billion for equity and US\$ 2.02 billion for debt securities, using an exchange rate of US\$ 1: Ksh. 73.25, as per the 2003 annual report of the Nairobi Stock Exchange.

<sup>10</sup> Provisional (GDP market prices) for 2002 is quoted at Ksh. 969353.9 million on page 10, Republic of Kenya Economic Survey 2003.

primarily responsible for regulating members and the conduct of listed companies through its various rules and regulations. Of particular importance is its role in monitoring and enforcing continuing listing obligations, which are geared to ensuring comprehensive and timely disclosure, particularly of material information pertaining to the performance of listed companies. This is geared to enhancing information symmetry and stemming market manipulation.

36. The Nairobi Stock Exchange Listing Manual and the Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations 2002 requirements on corporate disclosures are similar, so as to ensure that there is no discrepancy between what the Exchange and the Authority require from issuers of listed securities.

37. While the Stock Exchange, working with the Capital Markets Authority, has contributed significantly to improving corporate governance disclosure amongst listed companies, its impact at the national level has not been significant owing to the small number of listed companies, most of which are foreign-owned and controlled. However, the Exchange has played a critical role in the development of capital markets and stock exchanges in Africa to facilitate and ease the flow of capital, an important factor in enhancing corporate governance and disclosure. The Exchange is also in the process of automating its trading and settlement systems, which have hitherto been manual, to ease trading, shorten settlement cycles and significantly reduce systemic and operational risk.

### ***PROFESSIONAL ASSOCIATIONS***

38. Professional associations continue to play a critical role in enhancing corporate governance disclosure in Kenya. The Institute of Certified Public Accountants has been the main crusader for the adoption of international accounting and audit standards, which were adopted in Kenya with effect from January 1999. This has brought Kenyan reporting standards to world-class standards. This endeavour has been supported by regional organizations such as the Eastern, Central and Southern African Federation of Accountants and the Association of Certified Chartered Accountants.

39. Other professional associations that have in various ways contributed to enhanced corporate governance disclosure include:

- The Institute of Certified Public Secretaries of Kenya
- The Law Society of Kenya
- The Association of Kenya Stockbrokers
- The Association of Practitioners in Advertising

### ***TRADE AND BUSINESS ASSOCIATIONS***

40. Much like the professional associations, trade and business associations have played a significant role in improving corporate governance practices in general and responsibility and reporting in particular. Some of the key associations are:

- The Kenya Flower Council
- The Federation of Kenya Employers
- The Nairobi Central Business District Association
- The Association of Micro Finance Institutions
- The Kenya Institute of Bankers
- The Association of Kenya Insurers

### ***NON-GOVERNMENTAL ORGANIZATIONS***

41. A number of non-governmental organizations such as Action Aid and Transparency International have also in the course of executing their mandates agitated for improved disclosure, particularly as it pertains to the impact of the activities of corporations on the environment and the communities in which they operate.

### ***THE CENTRE FOR CORPORATE GOVERNANCE***

42. The Centre for Corporate Governance, which is the heart of the corporate governance initiative in Kenya, is private-sector-led. It is an initiative to improve the quality of life in Kenya and the African region by fostering the highest standards of corporate governance in all organizations. In this endeavour, it has adopted an all-inclusive approach, which demands that all stakeholders, including government, corporations, value-led organizations and society as a whole, effectively play their role.

43. Over the period from March to August 1999, the Centre, then called Private Sector Corporate Governance Trust, reviewed various codes of best practice developed internationally<sup>11</sup> and the circumstances prevailing in Kenya, and drafted a set of principles and a sample code of best practice for Kenya, which were circulated to the corporate sector and regulatory authorities.

44. Thereafter, the Centre made recommendations to a national seminar on corporate governance held on 8 October 1999, where it was resolved that the “Principles for Corporate Governance in Kenya and Sample Code of Best Practice” be adopted. These were published and distributed in November 1999. The principles and sample code incorporating international standards were deliberately drafted to excite and incite debate on good corporate governance in Kenya and facilitate local ownership of efforts to promote good governance.

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<sup>11</sup> The international, regional and local codes and materials included the following:

- 1968 NCCK working party report on “Who Controls Industry in Kenya”
- The December 1992, UK, Cadbury Committee Report on Financial Aspects of Corporate Governance
- The November 1994 South Africa King Report on Corporate Governance
- The July 1995 UK – Sir Richard Greenbury Committee Report on Director’s Remuneration
- The January 1998, UK Hampel Committee Report on Corporate Governance
- The November 1998, Kenya Institute of Bankers’ “Code of Ethics”
- The February 1999, Draft OECD Principles of Corporate Governance for the Commonwealth.

45. At the national seminar, it was agreed that standard setting was the start of a process, the most difficult part of which was implementation. It was therefore agreed that the Centre would create the national capacity to implement those principles; install a culture of compliance; and create a suitable mechanism to recognize and reward good governance.<sup>12</sup>

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<sup>12</sup> Specifically, the Centre was requested to:

- ◆ Build appropriate institutions with the requisite capacity to implement the principles and code of best practice
- ◆ Build national capacity to implement and apply the Principles of Corporate Governance through training, education, research, monitoring, evaluation, knowledge management and advocacy programmes.

To date, the Centre has achieved the following:

- ◆ The Principles and Sample Code of Best Practice for Corporate Governance in Kenya, Guidelines for Good Corporate Governance in State-owned-corporations and Corporate Governance Guidelines for Members (Shareholders) have been published and widely disseminated;
- ◆ Corporate governance has now been put on the Kenyan policy agenda, evidenced by the fact that:
  - The Central Bank of Kenya now demands good corporate governance for financial stability and sustainability from all licensed banks and financial institutions;
  - The Capital Markets Authority requires all listed companies to comply with principles of good corporate governance;
  - The Government has formally adopted the Principles of Good Corporate Governance in State-owned corporations, and the Inspectorate of State Corporations is now reviewing corporate governance in State-owned enterprises;
  - Universities are now examining their own governance practices;
  - Many public, private and State corporations boards are requesting seminars or training on corporate governance;
- ◆ Collaborated with the African Capital Markets Forum, the United Nations Economic Commission for Africa, the Secretariat for Institutional Support for Economic Research in Africa and the CACG to organize the African Consultative Corporate Governance Forum in Johannesburg held from 16 to 18 July 2001 with the support of the GCGF, CIPE, the World Bank and the Commonwealth Secretariat, where it was requested to act as the Interim Secretariat for the Pan-African Initiative.
- ◆ Has successfully conducted a variety of training courses throughout the region, including the CACG Five Day Certification Courses training about 1000 directors and 40 trainers in corporate governance.
- ◆ Has developed postgraduate and diploma curricula and initiated discussions with local universities with the objective of facilitating introduction of diploma and graduate courses in corporate governance.
- ◆ Facilitated the setting up of an Institute of Directors for the primary purpose of promoting director professionalism.
- ◆ Facilitated the setting up of the Kenya Shareholders' Association to mobilize shareholders to effectively play their role in demanding and enforcing good governance.

## **PRINCIPLES OF GOOD CORPORATE GOVERNANCE IN KENYA AND SAMPLE CODE OF BEST PRACTICE**

46. The Kenyan Code, which is principles-based, encourages a "comply or explain" type of reporting. It supports the disclosure requirements that UNCTAD-ISAR identified at its nineteenth session as critical aspects of disclosure.

### **COMPARISON OF KENYAN PRACTICES WITH GLOBAL BEST PRACTICE**

47. Various efforts to improve corporate governance practices in Kenya, including disclosure, are beginning to bear fruit. Much has been done to improve the legal and regulatory framework. The key regulators have recently reviewed and continue to improve their specific frameworks. The Capital Markets Authority, Central Bank and the Retirement Benefits Authority particularly stand out in this regard. The Companies Act, however, is still a serious bottleneck. It is terribly outdated and badly in need of reform. This is particularly serious as it is in many ways the foundation on which the other laws are built. Fortunately, the Government has recognized this. A task force was set up to study the act and make recommendations as to its review. The task force has completed its task and what remains is implementation of its recommendations.

48. The composition of boards and their performance are improving. Recruitment of non-executive directors is more rigorous. The areas of strategy and risk management, which have generally been ignored, are gaining more attention. Committees, and particularly audit committees, are a common feature. In the capital markets and the banking industry, they are a legal requirement. Stakeholders are being recognized and respected. Disclosure is improving. In the banking industry, it is fairly elaborate, public and timely. Listed companies are beginning to issue statements of corporate governance in their annual returns.

49. The voluntary code, on the other hand, developed by the Centre for Corporate Governance compares favourably with international standards and particularly with the disclosure requirements that UNCTAD-ISAR identified as outlined above, and has been hailed by the Commonwealth Association for Corporate Governance as an example to be emulated throughout the Commonwealth.

50. Enforcement remains the primary problem in Kenya. The capacity of regulators to enforce compliance with the law is terribly weak. They lack the resources both human and material to be effective and are largely perceived as ineffective. The Office of the Registrar General is particularly constrained and is unable to enforce many of the most basic requirements. The same applies to most professional, trade and business associations.

51. It is partly due to the recognition of the resource constraint that the Centre has chosen a principle-based approach and focused on creating credible leadership in corporations that is committed to, rather than forced to, comply with the principles of good corporate governance.

## **THE CHALLENGE OF PROMOTING GOOD CORPORATE GOVERNANCE PRACTICES IN KENYA AND THE REST OF AFRICA**

52. Africa, arguably the second most endowed continent in the world in terms of natural resources, is also ironically by far the poorest. For almost as long as history has been recorded, it has been mired in abject poverty.

53. Conflict is one of the principal reasons for Africa's misery. Conflict renders it impossible for economic actors to plan and undertake the activities necessary for the creation of wealth. Poor political governance and the subsequent concentration of political and economic power in the hands of a small, privileged and entrenched elite similarly continue to bedevil many countries on the continent.

54. Physical infrastructure, including transport and communication facilities, is either non-existent or decayed in most of the continent. Legal and regulatory systems are weak, and capital and financial markets are underdeveloped and in most countries non-existent. Social inequalities are prevalent. People are not meaningfully involved in the formulation and implementation of development plans.

55. To be successful, efforts to improve corporate governance (including disclosure) in Africa must be cognizant of these problems as well as other peculiarities of the continent. These include the great diversity of enterprises, the complexity of the ownership structures, weak legal and regulatory systems, poor political and public governance where institutions are absent, underdeveloped and ineffective, small volatile and financial markets, and an unenlightened and dependent populace.

56. The issue of public governance, which has largely been weak — particularly public policy and national economic priorities — and the broader issues of the national ideological framework, values, justice systems, ethics and social infrastructure that underpin the business environment must be addressed. In spite of the poor public governance that characterizes the continent, experience has shown that the demonstrated willingness of the private sector to become competitive well governed and the efficient agent of growth compels the Government to play its role in improving and supporting the private sector. It is not an easy task, but the private sector can lead the way in introducing, facilitating and promoting good corporate governance practices even in an environment of non-supportive public governance.

57. The need for further legal, regulatory and policy reform is paramount. The capacity of regulatory authorities to enforce the law must be addressed. Many of the public

scandals, grand theft and corruption cases reported in recent years have involved all types of enterprises, including transnational or offshore companies, and private and family companies established to use “the veil of incorporation” as a cover for fraud or to conceal the identity of the real owners, who have manipulated local directors and innocent shareholders in order to use those companies as conduits for fraud or market manipulation. Systems for monitoring and evaluating compliance with good corporate governance practices and strengthening the incentives for good corporate governance must be developed. To maximize effectiveness, they must be coupled with effective networks for research to document good practices and demonstrate their benefits to encourage their replication as well as identify bad practices and their effects so as to discourage them.

58. Self-regulation must also be strengthened. National capacity must be created to provide effective leadership to those entrusted with the governance of corporations. Many of the financial institutions, the huge public land buying companies and cooperative societies that have collapsed have done so because of improper governance and severe conflicts of interest. Efforts must be stepped up to enhance the capabilities of directors.

59. For the bulk of the people of Africa, the Government is not a facilitator but an active player in every facet of life, including business. This has had two major and unfortunate consequences. The first is the emergence of a culture of dependence by the citizenry. The second is an unhealthy preoccupation with political power where political power is synonymous with economic power and wealth. There is thus an urgent need to promote inclusive partnerships for sustainable wealth creation, which involve the public and private sectors and civil society, as well as to encourage greater public and community involvement in promoting, demanding and enforcing good corporate governance.

## **CONCLUSION: LIFTING AFRICAN STANDARDS TO WORLD CLASS STANDARDS**

60. Globalization means greater reliance on market forces and calls for highly effective corporations with world-class standards of governance. In his book *Corporate Governance: The New Paradigm*,<sup>13</sup> Gopalsamy accurately notes that more than ever before, to survive and thrive, corporations are required to gear up to exploit global market opportunities while defending and increasing their domestic shares in a liberalized and highly competitive global environment.

61. Unfortunately, Africa appears totally unprepared for this reality. As long ago as 1991, Duncan N. Ndegwa, then the Governor of the Central Bank of Kenya observed in a paper entitled "Africa and the world: Africa on its own"<sup>14</sup> that Africa, and especially sub-Saharan Africa, continues to be marginalized economically – a development he described

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<sup>13</sup> Gopalsamy, 2000, *Corporate Governance: The New Paradigm*, A H Wheeler Publishing Co Ltd.

<sup>14</sup> Africa: Rise to Challenge by Obasanjo and Mosha, Africa Leadership Forum, New York, 1993.

as negative, unfortunate and not in the interest of the international community. The consequence of this marginalization is deepening poverty in an already desperate continent and the serious threat that this poses to world peace and security.

62. Under the New Partnership for Africa's Development (NEPAD) the political leadership of Africa has recognized the critical importance of good economic and corporate governance buttressed by effective peer review to economic development and prosperity. African Governments have in principle agreed to the following as key priority thrusts to address the challenges facing Africa:

- Restoration of peace, security and stability with consolidation of democratic gains and strengthening of democratic structures and institutions;
- Establishment and entrenchment of good economic and corporate governance;
- Bridging the infrastructure gap and creating social capacity for development;
- Human resource development and capacity building;
- Reduction of poverty and income inequalities through accelerated economic growth and sustainable wealth creation;
- Reconfiguration of global financial architecture with emphasis on investment promotion and redefinition of relationships with development partners focusing on debt reduction, increased aid and aid reform;
- Integration of the continent into the world economy and enhanced market access; and
- Preservation and conservation of the environment.

63. The same leadership through NEPAD has gone further to initiate preparatory actions that would: Facilitate negotiations with the developed world through a united African front;

- Highlight critical infrastructure projects;
- Create and enforce standards of political, economic and corporate governance;
- Declare the period 2002- 2012 the capacity-building decade for Africa;
- Rationalize the institutional framework for economic integration.

64. One of the key strategic thrusts of NEPAD is the improvement of economic and corporate governance. It is important to make the point that the Government alone cannot achieve this. It calls for the establishment of effective partnerships between the public sector, the private sector and civil society that will enhance the spirit of participatory development and increase citizen engagement in creating a secure and stable environment in which the private sector can grow and thrive. Determined efforts must be made to inculcate a culture of transparency and accountability. The community cannot be left behind, since much depends on the extent to which society is able to inculcate in, and demand of those in whom it vests power over its resources, a philosophy that regards the common good of society as the most critical success factor.

65. These are some of the concerns that emerged at the regional meeting held in July 2001 which resulted in the formation of the Pan African Consultative Forum on Corporate Governance with a mandate to *inter alia*;

- Coordinate corporate governance initiatives in Africa and facilitate agreement on minimum principles of best practice that are compatible with international standards;
- Support the establishment of national initiatives on corporate governance where they do not exist and help build capacity to implement good corporate governance practices;
- Facilitate the exchange of information and experiences and promote joint programmes and research, culminating in the optimal use of limited resources and establishment of an interactive Pan African Corporate Governance website.

66. The Forum, with its secretariat at the Centre for Corporate Governance in Kenya, has been working together with various development partners and other regional initiatives, including NEPAD, to network, facilitate the exchange of information, and to jump-start and support country initiatives. In July this year, it will be holding the second regional meeting in Nairobi to consider the progress made since the last meeting and to chart the way forward.

67. Much has been achieved, but more remains to be done for Africa to rise to the challenge posed by Dr. K. Kaunda, former president of Zambia, when he said that "The ability of the leaders of Africa to lead the people of Africa into the exploitation of the resource of their continent to the greatest advantage of the people of Africa is the greatest challenge to us the people of Africa today and tomorrow. It is this which will decide the difference between the Africa of yesterday and today, on one side, and the Africa of tomorrow and the future ahead, on the other side".<sup>15</sup>

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<sup>15</sup> Statement by Dr. Kenneth Kaunda, then President of Zambia, at the Africa Leadership Forum, Kampala, Uganda, 19 May 1991. See Africa Obasanjo and Moshia, 1993.

## APPENDIX 1. SUMMARY OF THE CAPITAL MARKETS AUTHORITY'S CORPORATE GOVERNANCE GUIDELINES

No.	Items	Corporate Governance Guidelines (Ref.)
1	<p>General:</p> <p>A statement by the directors as to whether the company is complying with the guidelines on corporate governance.</p>	1.8
2	<p><b>General:</b> Where the company is not fully compliant with the guidelines on corporate governance, the reasons for non-compliance are to be stated and steps are to be taken to be compliant.</p>	1.10
3	<p>Board and Board Committees:</p> <p>Disclosure of the establishment of relevant committees</p>	2.1.1 (i)
4	<p><b>Board and Board Committees:</b> Establishment of an audit and nominating committee</p>	2.1.1 (ii)
5	<p>Supply and disclosure of information:</p> <p>Disclosure of policies for remuneration and incentives for the Board and senior management, and particularly the following:</p> <p>(a) Quantum and component of remuneration for directors, including non-executive directors, on a consolidated basis in the following categories:</p> <ul style="list-style-type: none"> <li>(i) executive directors' fees;</li> <li>(ii) executive directors' emoluments;</li> <li>(iii) non-executive directors' fees;</li> <li>(iv) non-executive directors' emoluments;</li> </ul> <p>(b) A list of ten major shareholders of the company;</p> <p>(c) Share options and other forms of executive compensation that have to be made or have been made during the course of the financial year; and</p> <p>(d) Aggregate directors' loans</p>	2.1.3
6	<p>Re-election of directors:</p> <p>Disclosure of all directors approaching their 70<sup>th</sup> birthday in the respective year.</p>	2.1.7
7	<p>Resignation of directors:</p> <p>Disclosure of a resignation of a serving director together with the details of</p>	2.1.8

No.	Items	Corporate Governance Guidelines (Ref.)
	the circumstances necessitating the resignation.	
8	Annual General Meetings:  Disclosure to all shareholders of sufficient and timely information concerning the date, location and agenda of the general meeting as well as full and timely information regarding issues to be decided during the general meeting	2.3.2
9	A balanced board constitutes an effective board:  Disclosure as to whether independent and non-executive directors constitute one third of the board and if it satisfies the representation of the minority shareholders.	2.1.4 and 3.1.2
10	Best practice relating to the rights of the shareholders:  Disclosure in the form of highlights of the operations of the company and the financial performance.	3.3
11	The audit committee:  Establishment of an audit committee composed of at least three independent and non-executive directors who shall report to the board, with written terms of reference which deal clearly with its authority and duties. The chairman of the audit committee should be an independent and non-executive director.  Disclosure by the Board as to whether it has an audit committee and the mandate of such a committee.	3.5.1  3.5.1