Corporate Governance Problems facing Kenyan parastatals: A case study of the sugar industry

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July 17, 2009
This is a Bucerius/WHU MLB thesis
13,348 words (excluding footnotes)
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<th>Full Form</th>
</tr>
</thead>
<tbody>
<tr>
<td>AGM</td>
<td>Annual General Meeting</td>
</tr>
<tr>
<td>CCGC</td>
<td>Centre for Corporate Governance</td>
</tr>
<tr>
<td>CCMAU</td>
<td>Crown Company Monitoring Advisory Unit</td>
</tr>
<tr>
<td>CEO</td>
<td>Chief Executive Officer</td>
</tr>
<tr>
<td>CFO</td>
<td>Chief Financial Officer</td>
</tr>
<tr>
<td>CGD</td>
<td>Centre for Governance &amp; Development.</td>
</tr>
<tr>
<td>CMA</td>
<td>Capital Markets Authority</td>
</tr>
<tr>
<td>COMESA</td>
<td>Common Market for Eastern &amp; Southern Africa</td>
</tr>
<tr>
<td>CPA</td>
<td>Certified Public Accountant</td>
</tr>
<tr>
<td>CPS</td>
<td>Certified Public Secretary</td>
</tr>
<tr>
<td>EASI</td>
<td>East African Sugar Industry</td>
</tr>
<tr>
<td>EU</td>
<td>European Union</td>
</tr>
<tr>
<td>FTA</td>
<td>Free Trade Area</td>
</tr>
<tr>
<td>HIV/AIDS</td>
<td>Human Immundeficiency Virus/Accquired Immune Deficiency Syndrome</td>
</tr>
<tr>
<td>ICPAK</td>
<td>Institute for Chartered Public Accountants of Kenya</td>
</tr>
<tr>
<td>ICPSK</td>
<td>Institute for Chartered Public Secretaries of Kenya</td>
</tr>
<tr>
<td>IDC</td>
<td>Industrial Development Corporation.</td>
</tr>
<tr>
<td>KCC</td>
<td>Kenya Cooperative Creameries</td>
</tr>
<tr>
<td>KERSREF</td>
<td>Kenya Sugar Research Foundation</td>
</tr>
<tr>
<td>KESGA</td>
<td>Kenya Sugar Cane Growers Association</td>
</tr>
<tr>
<td>KPLC</td>
<td>Kenya Power &amp;Lighting Company</td>
</tr>
<tr>
<td>KSA</td>
<td>Kenya Sugar Authority</td>
</tr>
<tr>
<td>KSB</td>
<td>Kenya Sugar Board</td>
</tr>
<tr>
<td>LSK</td>
<td>Law Society of Kenya</td>
</tr>
<tr>
<td>MIGA</td>
<td>Multilateral Investment Guarantee Agency</td>
</tr>
<tr>
<td>MW</td>
<td>Megawatts</td>
</tr>
<tr>
<td>NED</td>
<td>Non-Executive Director</td>
</tr>
<tr>
<td>NHC</td>
<td>National Housing Corporation</td>
</tr>
<tr>
<td>NSE</td>
<td>Nairobi Stock Exchange</td>
</tr>
<tr>
<td>NUM</td>
<td>National Union of Miners</td>
</tr>
<tr>
<td>OECD</td>
<td>Organisation of Economic Cooperation &amp;Development</td>
</tr>
<tr>
<td>PM</td>
<td>Prime Minister</td>
</tr>
<tr>
<td>PS</td>
<td>Permanent Secretary</td>
</tr>
<tr>
<td>R&amp;D</td>
<td>Research &amp; Development</td>
</tr>
<tr>
<td>SAP</td>
<td>Structural Adjustment Policy</td>
</tr>
<tr>
<td>SCA</td>
<td>State Corporation Act</td>
</tr>
<tr>
<td>SCAC</td>
<td>State Corporations Advisory Committee</td>
</tr>
<tr>
<td>SDF</td>
<td>Sugar Development Fund</td>
</tr>
<tr>
<td>SOE</td>
<td>State Owned Enterprises</td>
</tr>
<tr>
<td>SONY</td>
<td>South Nyanza Sugar Company</td>
</tr>
<tr>
<td>SSO</td>
<td>Sugar Settlement Scheme.</td>
</tr>
<tr>
<td>SWOT</td>
<td>Strengths Weakness Opportunities</td>
</tr>
<tr>
<td>TCD</td>
<td>Total Capacity</td>
</tr>
<tr>
<td>UK</td>
<td>United Kingdom</td>
</tr>
<tr>
<td>USA</td>
<td>United States of America</td>
</tr>
<tr>
<td>WESKL</td>
<td>West Kenya Sugar Limited</td>
</tr>
</tbody>
</table>
1 Introduction

Parastatals play a major role in most economies through the provision of public services such as transport and energy. Also, because they were established to foster wider developmental goals, some of them such as the sugar industry in Kenya provide infrastructure and social amenities like schools and health services to communities. For instance, Kenya’s sugar industry supports an estimated six million Kenyans directly or indirectly. In addition, the sub-sector saves Kenya in excess of US$ 250 million in foreign exchange annually. Despite these important socio-economic gains, most of the parastatals in Kenya are characterized by inefficiency losses and the provision of poor products and services. Subsequently, they have caused heavy budgetary burdens to the public. The stunning Kshs.59 billion debt of the sugar industry bears a testimony to this.

Against this background, the International Organizations such as the IMF (International Monetary Fund) and the World Bank proposed the privatization of Kenyan parastatals in 1994. The Structural Adjustment Programs (SAP) were aimed at reducing government participation in the economic sector and to increase the productivity of parastatals. Since then, this intervention has led to the popularization of privatization as a solution to the problems of parastatals even though the exercise did not bring the much coveted efficiency gains.

Seen in this light, this paper seeks to locate the problems facing parastatals from a rather different perspective, namely; from a corporate governance perspective an approach which has been seldom taken. Much of the ongoing research has addressed privatization or management issues (Wanyande 2001) but very few studies have been conducted on the governance issues facing the parastatals in Kenya. One such study was conducted by (Mwaura 2007). However, the quest for addressing corporate governance forms an imperative for developing Countries such as Kenya. If strong governance foundations can be laid at micro or corporate level, it will be more probable that parastatals can be more productive thereby enabling the country to achieve overall macroeconomic goals. Again, in what has been described as the duality of governance, which implies that weak public governance practices are usually mirrored in corporations, strengthening governance at corporate level might be a viable option for Kenya a Country which is faced by major public governance challenges such as corruption and misallocation of resources. A reverse-mentoring process can occur where companies take the lead and mentor the public sector.

The agency and stewardship theories will offer the theoretical framework for the thesis besides reviewing the State Corporations Act (SCA) which is the enabling legislation for most parastatals. The thesis aims to explain why the both theories do find application in parastatals as compared to public listed companies. The review of the SCA expects to ad-
dress the nomination processes of CEO (Chief Executive Officers), and the decision making processes involved in parastatals.

The thesis is structured as follows. Chapter two gives an historical account of the sugar industry thereby identifying the relevant institutions involved in the industry, besides addressing the development of corporate governance in Kenya. From this premise, the governance problems of the sugar industry are derived. In the penultimate, privatization and the link to corporate governance is addressed, and consideration is made whether the two-tier board system provide an optimal form of governance for Kenya’s sugar industry. Subsequently, mechanisms of strengthening the boards of sugar industries are considered.
2 Historical background and the development of Kenya’s sugar industry.

2.1 Rationale for post-colonial state’s involvement in the industry.

Kenya’s sugar industry retraces its History as far back as 1902 when sugar cane was introduced to the country. The first sugar mill was built in 1922 in Miwani present day Nyanza province. After Miwani, Ramisi Sugar Company Limited was established in 1927 in the Coast province. Prior to independence, the Asians were the sole owners of sugar companies and large-scale farms that supplied cane to the factories. The Asians then referred to as “coolies” had been brought to Kenya by the British colonialists to help in the construction of the Railway line from Mombasa to Uganda. Accordingly, Miwani was owned by the Hindocha family. Hindocha later became a very successful businessman in the Kisumu area. Ramisi sugar mill was owned by the Madhavani Group International of India. With the attainment of independence in 1963 however, the ownership landscape of the sugar industry changed tremendously as the next paragraphs will show.

The post-colonial period saw the Kenyan government’s direct involvement in the sugar industry a development which warrants some explanation. After the attainment of independence, the Kenyan government wanted to boost the sugar industry with the aim of making Kenya self-sufficient in sugar production. In order to achieve this goal, the government was guided by two policy documents namely; the Swynnerton plan of 1954 and the African Sessional Paper No 10 of 1965. The former was fundamental in so far as it for the first time introduced individual land tenure system in Kenya. Land therefore became a negotiable asset which could be used in the acquisition of loans. Prior to that, land was communally owned and Africans were not entitled to grow profitable export crops. Hitherto, growth of such crops was strictly restricted to the whites and Asians. To the other end, the latter which is fully known as the African Socialism and its Application to Planning in Kenya, visualized Kenya as a nation with a growing economy and citizens enjoying higher and growing per capita income equitably distributed.

However, the direct involvement of the post-colonial government in the sugar industry especially in Western Kenya has to be viewed from another prism. The government intended to provide its citizens in this region with the opportunity to improve their income. This involvement is consistent with development economic reasons which permit the state

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1 See: The Centre For Governance & Development 2005 Page 1.
to create parastatals to boost the economy of less developed regions thereby pursuing equality and social stability goals. By 1966 the Luos who live in Nyanza province in western Kenya already felt marginalized politically and economically by the Kenyatta administration. Jomo Kenyatta was Kenya’s first president at independence and belonged to the Kikuyu tribe which is Kenya’s largest tribe. His vice-president Jaramogi Oginga Odinga on the other hand belonged to the Luo tribe but he resigned from the Kenyatta administration after a disagreement with President Kenyatta in 1966. Given this development, the Kenyatta administration was compelled to introduce sugar-cane farming to assure the Luos who lived in the sugar belt that the government was still interested in their welfare even though President Kenyatta and Oginga Odinga had fallen out. Subsequently, to encourage sugarcane farming on a commercial scale, the government acquired land in present day Muhoroni to establish settlement schemes. The settlement schemes were allotted to settlers and were managed by the SSO (Sugar Settlement Scheme) in the Ministry of Lands. The schemes however, did not bring much of the expected productivity as rich people also acquired plots. Most of these rich people lived in Nairobi and delegated the management of the farms to workers who failed to ensure proper management. This was believed to be one of the reasons for cane shortages in most of the factories for quite sometime.

Since the previous sugar companies were privately owned, the government then decided to set up six new sugar factories. To this end the state set up EASI (East African Sugar Industry) popularly known as Muhoroni Sugar Company in 1966, Chemelil in 1968, Mumias in 1973, Nzoia in 1978 and finally SONY (South Nyanza Sugar Company) in 1979. More recent establishments of sugar Companies include, West Kenya Limited (WESKL) which was incorporated in 1979. Soin Sugar Company was established as a privately owned sugar company in 2006 to decongest the neighboring Muhoroni. Lastly, Kibos Sugar Allied was established in 2007 together with the Industrial Development Corporation (IDC) of South Africa Limited and a UK-based businessman, R. S. Chatthe. MIGA (Multilateral Investment Guarantee Agency) stepped in to guarantee up to ninety percent of the equity and about ninety-five percent of the investors’ non-shareholder loan to Kibos Sugar & Allied Industries Limited by issuing $6.7 million in political risk insurance.

5 See: Wanyande, Peter 2001: Again much research on the state’s involvement in the Sugar Industry was done by the late Chrispin Odhiambo Mbai on his Paper “State and International Capital in Agro-Industrial Development: The case of Muhoroni Settlement Scheme (1960-1980), M.A dissertation University of Nairobi.
6 See: The KSB Strategic Paper 2007; Page 8. See Also; Wanyande, Peter 2001 Page 126-127. Therein the shareholding level of government in the factories. For instance the management of Chemelil and Mumias was entrusted to Booker Tate International. Government held 95.38 % in Chemelil and 70.76% in Mumias. Booker is based in Thame. in the UK and it provides management services in the Sugar & agribusiness. The contract with Mumias expired in 2003 whilst the Chemelil one expired in 1986.
Table 1: Number of people employed in Sugar Mills as per 2006.

<table>
<thead>
<tr>
<th>Year</th>
<th>Sugar Plantations</th>
<th>Sugar Factories</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>3,976</td>
<td>6,576</td>
<td>10,552</td>
</tr>
<tr>
<td>2001</td>
<td>3,497</td>
<td>5,379</td>
<td>8,876</td>
</tr>
<tr>
<td>2002</td>
<td>2,634</td>
<td>6,357</td>
<td>8,991</td>
</tr>
<tr>
<td>2003</td>
<td>2,853</td>
<td>5,776</td>
<td>8,629</td>
</tr>
<tr>
<td>2004</td>
<td>2,579</td>
<td>5,210</td>
<td>7,789</td>
</tr>
<tr>
<td>2005</td>
<td>2,870</td>
<td>5,243</td>
<td>8,113</td>
</tr>
<tr>
<td>2006</td>
<td>2,692</td>
<td>4,686</td>
<td>7,378</td>
</tr>
</tbody>
</table>

Source: The Kenya Sugar Board Strategic Paper 2007

2.1.1 Organizations involved in the sugar industry.

The state’s involvement in the industry does not end with the establishment of factories. The state needs a regulator, a developer and a promoter of the industry. In Kenya the apex body entrusted with this function is the Kenya Sugar Board (KSB)\(^8\). KSB came into operation in April 2002 and was established through the sugar act of 2001. Prior to its establishment, the Kenya Sugar Authority (KSA) existed. KSA had been established under an Order of the Agriculture Act, CAP 318 through Legal Notice No. 32 in March 1973\(^9\). KSA was mainly government controlled and in line with the Economic Strategy Recovery Papers (ERSP) vision to develop the Kenyan sugar Industry into world class level., the de-funct KSA was deemed to be less fit to consolidate the interest of all stakeholders thereby achieving this goal. The clear definition of stakeholders still poses a big problem for the board. For instance, even though the Sugar Amendment Bill of 2004 proposed the inclusions of transporters in the boards AGM (Annual General Meeting), no legal definition of a transporter has been given. This is likely to spur controversy about who qualifies as a transporter because not everyone who transports sugarcane should have a real stake in the boards AGM\(^10\). However, this problem can only be solved with the amendment of the Sugar Act 2001.

The mandate of KSB is stipulated in section 4(1) and 4(2) of the Sugar Act of 2001. The Sugar Act was enacted by parliament in April 2002 to define the roles of major players and stakeholders in the industry including sugar cane farmers, out grower organizations and

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10 See: The Centre for Governance &Development Page 4.
research organizations such as KESREF (Kenya Sugar Research Foundation). In line with this mandate; KSB is charged with the responsibility of coordinating the activities of individuals and organizations in the industry. Another mandate of the board lies in the facilitation of equitable access to the benefits and resources of the industry by all interested parties. The Sugar Act further stipulates the core functions of the board to include licensing of sugar mills, intermediation between the government and the industry and in the collection, collation & analysis of the industry statistics thereby maintaining a database for the industry\(^\text{11}\). The board has other core functions which do not warrant mentioning at this point given the space constraints.

The operations of KSB are financed by a component of the Sugar Development Fund (SDF). The SDF was created in 1992 as a revolving fund to finance the activities of the sub-sector. The levy is utilized for the funding of cane development, factory rehabilitation, roads and infrastructure R&D (Research & Development) and for KSB administration. The SDF was until recently levied on both local and imported sugar. The levy was collected by the Sugar Companies and selected contracting agents\(^\text{12}\). However, when the financial budget of 2009/2010 was read on the 1\(^\text{st}\) of June 2009, the sugar levy which was seven percent was de-gazetted. This development threatens the financial position of the Board and the sugar industry as well. Given that the levy has helped millers use funds to rehabilitate their factories and improve their infrastructure.

Although the board has made tremendous leaps in the past years despite the many challenges it encountered with the transition from the defunct Kenya Sugar Authority to KSB\(^\text{13}\) the board is still faced with a myriad of challenges. Nonetheless, some of the achievements of the board include development of a strategic plan for 2007/2012. Besides the scarcity of financial resources, the board in its SWOT (Strengths, Weakness Opportunity, Threats), identifies inadequate computer systems, lack of a risk management policy and corporate governance problems such as the nature of board election processes as weaknesses. According to the board’s strategic paper, the election of directors is not conducted on a rotational basis to ensure continuity and corporate memory. The nomination process of board of directors is a problem in Kenyan parastatals therefore it will be given detailed analysis in the upcoming paragraphs. as one journalist commented in the daily nation. “The practice is all-too-familiar: one group comes to power and replaces all CEOs and directors appointed by the outgoing regime”\(^\text{14}\). At that point there is no discussion on due process or virtues of meritocracy according to the journalist. The winner-takes it all mentality is deep-
ly rooted in Kenyan politics and has even impeded progress in the current grand coalition according to the article.

Another organization of relevance is the Kenya Sugar Research Foundation (KESREF). The foundation was officially launched in 2001. The establishment of KESREF in 1998 stems from the reorganization of the Kenya Agricultural Institute (KARI) and the defunct KSA had commissioned the Inter-Ministerial committee to review the status of the sugar industry. Part of that review saw the establishment of KESREF in Kibos Kisumu District. KESREF was established with the mandate to do research on the sugar industry. Also in line with its strategic paper, KESREF identifies the provision of research & development (R&D) and extension services to the sugar Industry in collaboration with sugar companies and major research institutions and Universities such as Egerton which offer degrees such as agricultural engineering as its main objective.

The Centre for Governance & Development (CGD) has criticized the foundation for focusing its core research on sugarcane varieties. The centre argues that more research should be done on improving technology of the industry which is quite obsolete and exploring options for vertical integration in the industry. However, the paltry one percent which is awarded to KESREF from the SDF is not enough to engage in adequate research. Worse still, with the de-gazettement of the sugar levy, the foundations holds that its ability to deliver information and technology to millers is stretched real thin. The CGD has also pointed out that research is public good which the national budget should finance. It is wrong to perceive R&D as a sugar industry problem.

2.1.2 Current overview of the sugar industry

The performance of the sugar industry has continued to be quite dismal. Kenya therefore continues to live off its legacy of being self-sufficient in terms of sugar production. According to sources from the Mumias Sugar Company, current production stands at 520,000 metric tonnes and consumption which has increased steadily over the last years at 740,000 leaving the country with a deficit of 220,000 metric tonnes.

From the list of registered millers and jaggeries provided by the KSB, Muhoroni and Miwani Sugar Company are currently under receivership. Muhoroni Sugar has been under

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16 See: The KSB Strategic Paper (2007) Page 12. There are 4 licensed jaggery millers. The millers are important given that they provide an alternative market for sugarcane. They also employ 5000 people. However, their regulation remains a Kenya challenge for the industry.
receivership for the last four years Ramisi Sugar Factory collapsed in 1988 although plans are underway to revive it. According to the agricultural manager of the company sanctioned by the government to revive Ramisi, commercial growing of cane at the Kiscol project, is expected to commence by June 2010, while it is anticipated the factory will be fully operational by 2011\(^\text{17}\). According to the CGD, Chemelil, SONY, and Nzoia Sugar Company are operating way below their capacities for production of sugar. Only Mumias Sugar Company is still operating at full capacity.

Mumias Sugar Company supplies almost sixty percent of the Kenyan sugar demand and exports some sugar especially to the European Union (EU).20,000 metric tonnes\(^\text{18}\). Mumias Sugar Company remains one of the few success stories of privatization. Mumias Sugar Company embodies one of the few success stories of privatization. It converted in 2001 from a private to a public listed company and is listed in NSE (Nairobi Stock Exchange). The company has managed to diversify its products by cogenerating electricity from bagasse and fully supporting its power requirements\(^\text{19}\). From a stakeholder perspective, one could ask why Mumias exports sugar to the European Union yet consumption of sugar outstrips production in the Country. Here again, given the recovery of global sugar prices, Sugar from COMESA (Common Markets for Eastern & Southern Africa) is likely to find its way into other markets. Considering the premium price generated from export revenues which can further enable companies to import domestic requirements cheaply, the possibility of exporting Sugar is real. Mauritius has taken this approach and exports all her total production to the EU (European Union)\(^\text{20}\).Mumias being a public listed Company; it is mainly interested in maximization of shareholder value contrary to looking into broader stakeholder expectations.

In terms of production arrangements, most Sugar companies typically have a factory, human resources, agriculture and finance department. The factory department has recently been split up into quality control and engineering in a number of the factories such as Chemelil\(^\text{21}\). The sugar companies also maintain nucleus estates to ensure there is enough supply of cane. Out growers’ scheme on the other hand covers individuals or private sugar–cane farmers. Despite the existence of nucleus estates, sugar companies still complain of

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\(^\text{19}\) See: The Mumias Sugar Company: When (in operation power generation can have an excess of up to 4MW (Megawatts) . The Company exports excess power to (KPLC Kenya Power & Lighting Company). Plans are underway to attain a peak of 26MW, on completion of the on going Cogen project.


\(^\text{21}\) This transition was inevitable given the workload borne by one person running both quality control and engineering was too huge. Again, the right person to hold such a position should have been a chemical engineer. Chemical engineering was only introduced in Kenyan Universities in 1984 with the establishment of Moi University.
sugar cane shortage a problem which has also contributed to the production gaps in the industry\textsuperscript{22}.

Table 2: Rated Capacities of the Operating Factories.

<table>
<thead>
<tr>
<th>Year</th>
<th>Production (MT)</th>
<th>Consumption (MT)</th>
<th>Imports</th>
<th>Exports</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>401,984</td>
<td>517,270</td>
<td>118,011</td>
<td>2,088</td>
</tr>
<tr>
<td>2001</td>
<td>377,438</td>
<td>630,065</td>
<td>249,336</td>
<td>3,600</td>
</tr>
<tr>
<td>2002</td>
<td>494,249</td>
<td>652,129</td>
<td>129,966</td>
<td>12,046</td>
</tr>
<tr>
<td>2003</td>
<td>448,489</td>
<td>663,780</td>
<td>182,225</td>
<td>11,300</td>
</tr>
<tr>
<td>2004</td>
<td>516,803</td>
<td>669,914</td>
<td>164,020</td>
<td>11,580</td>
</tr>
<tr>
<td>2005</td>
<td>488,997</td>
<td>695,622</td>
<td>167,235</td>
<td>21,790</td>
</tr>
<tr>
<td>2006</td>
<td>475,670</td>
<td>718,396</td>
<td>166,280</td>
<td>13,533</td>
</tr>
</tbody>
</table>


2.2 Background and theoretical foundation of corporate governance

2.2.1 Corporate governance development in Kenya

The last decade has seen corporate governance emerge in business literature as a major area of interest. Unfortunately, this development was triggered by numerous corporate scandals which set the stage for the development of guiding principles in countries and supranational organizations such as the OECD (Organization for Economic Development & Cooperation). Supranational organizations such as the OECD released its guiding principles in 1999 and revised them in 2004. At national level, in the USA (United States of America) the collapse of Enron give birth to the Sarbanes –Oxley Act (SOA) in 2002 and in South Africa the Kings Committee on Corporate Governance has continued to make notable inroads as an innovator at the forefront in international governance. These codes therefore suggest that even though corporate governance is based on individual legal, historical and cultural systems, certain universal principles of governance do exist\textsuperscript{23}.

Kenya too was not exempted from corporate collapses over the past years. It bears to remind that in the 80s more than 33 banks collapsed and other parastatals such as Kenya Co-

\textsuperscript{22} See: KESREF Strategic Paper 2005 Page 4-5. According to the Paper, millers have delayed payment with the consequent that farmers have low moral to grow cane. Poor infrastructure has also hindered the Foundation from transferring its technology an estimated 163,000 farmers who grow sugarcane in Kenya.

operative Creameries (KCC), National Housing Corporation (NHC) etc few followed suit in the past decade\textsuperscript{24}. The Centre for Corporate Governance (CCGC) in its foreword highlights that in the light of the collapse of big corporations especially the parastatals with the negative social and economical consequences for the Kenyan public, corporate governance became a major policy priority. Again as the centre explains, the media and the Kenyan public started questioning how corporations were being run. Perhaps a point that warrants mentioning is that the Kenyan media is internationally credited for its high professionalism as it has overtly played a major role in offering checks and balances on government and on industry. Underlying these developments, in 2002, the Centre for Corporate Governance (CCGC)\textsuperscript{25} previously referred to as the private sector initiative for Corporate Governance adopted a Sample Code of Best Practice of Corporate Governance in Kenya.

Plessis et al have argued that no subject is as voluminous with literature as corporate governance yet, efforts to come up with a working definition have remained futile. Notwithstanding the fact that corporate governance borrow from law, finance and Political Sciences. For the purpose of this thesis however, corporate governance is referred to as “the manner in which the power of a corporation is exercised in the stewardship of the corporation’s total portfolio of assets and resources with the objective of maintaining and increasing shareholder value and satisfaction of other stakeholders in the context of its corporate mission”\textsuperscript{26}. The stakeholder view seems to be gaining more foothold compared to the purely shareholder value in the light of the ongoing financial crisis. For example in Germany, the Government Commission on Corporate Governance has called on Management to take the interest of stakeholders into consideration stakeholders in line with social market principles\textsuperscript{27}.

Such a definition bears its limitations given that the broader the scope of accountability and the parties that management is deemed accountable too, the wider the range of objectives and criteria that the governance of a firm will be compelled to meet. However, if objectives are narrowed to include shareholder value maximization or the Tobin’s Q measurement of objectives becomes easier\textsuperscript{28}. Given that parastatals such as the sugar industry were estab-

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\textsuperscript{25}The Centre for Corporate Governance was founded in 1999 is an affiliate of the Commonwealth Association for Corporate Governance.
\textsuperscript{26}See: The Centre for Corporate Governance, Sample Code Page 1.
\textsuperscript{27}See: Press release 19.06.2009 of the German Corporate Governance Commission Page. 2. Original text was in German. The Commission in its May Plenary session resolved that the Management Board in managing the Corporation should do that by orienting itself towards the goal of sustainable value creation in accordance with social market economic principles. This would enable the company in its own responsibility/interest to take into account shareholder, employee and stakeholder interests.
\textsuperscript{28}See: Lin, Cyril 2000 Page 30. The Tobin’s Q is a ratio devised by James Tobin. Nobel laureate in Economics. The Tobin’s Q hypothesizes that the combined market value of all the companies on the stock market should be about equal to their replacement costs.
lished to address regional economic imbalances and promote regional entrepreneurship amongst others. Streamlining their objectives forms an even more difficult task.

2.2.2 Legal Framework

From a regulatory framework, commercially oriented parastatals are governed by the Companies Act 1948 c.486 (Companies Act) laws of Kenya. However, in the case of utilities and commercial regulatory bodies, they are incorporated under specific enabling regulations. Being a former British colony; Kenya adopted the Act almost entirely from the England’s Companies Act of 1948 after the attainment of independence in 1963. The Act has only been subjected to minor amendments as the coming paragraphs shall highlight therefore it badly needs to be overhauled. The Companies Act is therefore an act of parliament which should amend and consolidate laws governing the incorporation, regulation and winding up companies and other associations. In terms of disclosure requirements, the Act addresses annual returns, accounts and audits, general meetings, disclosure to be made in prospectus, registers and inspections.

All parastatals in which the government has controlling equity interests directly or via public institutions are however governed by the State Corporation Act (SCA) of c.446 1986 under the SCA; parastatals can be established as either statutory corporations or companies. Parastatals which are established as ordinary companies are governed by the Companies Act. State Corporations have all the powers and privileges of a natural person subject to the SCA. For this reason, the SCA is a statute of general application and it therefore provides that in the event between its provision and other statutes and the Companies Act, the SCA prevails. The statute confers significant powers to the executive especially the president. The portfolio or parent ministry who can issue directives of general nature on the running of parastatals, the treasury, and the permanent Secretary of the parent ministry who is the accounting officer. The SCA just like the Companies Act is in dire need of improvement and is one of the bottlenecks of poor governance of parastatals.

Professional associations such as the Institute of Certified Public Secretaries of Kenya (ICPSK), the Law Society of Kenya (LSK) are equally important given that they continue

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34 See: SCA Part II Section 3(1). The SCA vests powers on the executive to order, establish a state corporation as body corporate to perform the functions specified in this order.
to enhance good governance practices. Traditionally, professional associations in Kenya have continued to play a vital role in ensuring high professional standards are adhered to by their members. By inculcating high standards of professional knowledge in their members, these associations increase productivity in both the public and the private sector.\(^{35}\) Section 2.5.3 of the CMA guidelines (Capital Markets Authority) requires Company Secretaries of public listed companies to be members of the ICPSK. This requirement has also found substantial application in some parastatals. The development must be hailed given the important role played by the Company Secretary. The Sample Code sees the core duties of the Company Secretary as organizing board committee meetings of audits & nomination committees etc. He/she is also responsible for formulating agendas of board meetings with the CEO or the board chairman. He/she is equally responsible for ensuring that all board committees are properly constituted and provided with clear terms of reference. The chairman and the board look into the company secretary for guidance on what their responsibilities are under the rules and regulations as to which they are subject and on how those responsibilities should be discharged\(^ {36}\). In fact in Australia it is commonplace that the company secretary is also a director of the company.

The ICPAK (Institute of Certified Public Accountants of Kenya) is another professional a statutory body established under the Accountants Act, 2008 to regulate the accountancy profession in Kenya. The body has achieved recognition for its achievements in the fields of education, professional development, maintenance of high accounting; auditing and ethical standards as expected by the Section 2.5.2 of the CMA guidelines require the CFO to be a member of the Institute. It also acts as the profession “mouthpiece” in Kenya and in this respect holds membership in the International Accountancy Organization\(^ {37}\). The institute is also credited for enabling the adoption of international accounting and audit standards which were in Kenya with effect from 1999\(^ {38}\).

The Cooperatives Act of 1966 plays an important role for most farmers who grow sugarcane. Farmers are usually organized in out grower and cooperative societies. This is especially true for farmers in Muhoroni, Chemelil and in Mumias Sugar Companies. Wanyande and other leading agricultural economists in the continent have argued that, agriculture will

\(^{35}\) See: [http://www.icpsk.com/profile.html](http://www.icpsk.com/profile.html).

\(^{36}\) See Plessis et al Page 82. All Directors should have access to the service and advice of the company secretary. The chairman of the board is entitled to the strong support of the Company Sectary to ensure the board functions effectively.


\(^{38}\) See: The UNCTAD 2003 Page 10.
get favorable prices and investments from government if notable inroads can be made in creating strong class of rural producers. This subscription was the underlying reason behind the formation of cooperative societies. At their foundation, the cooperative societies were designed to provide mechanisms for service network in the rural areas by providing marketing and credit inputs therewith integrating farmers into the modern economy. Sadly, the out grower and the cooperative organizations have not lived up to these expectations because their functioning has been impaired by the misuse of funds, by elected officials, illiteracy amongst officials and poor bookkeeping of the cooperative societies. The outgrower organizations have also failed to provide inputs to the small scale farmers at affordable prices. On the contrary, they have provided inputs in transportation and harvesting at higher prices compared to open market prices. Given that farmers lack alternative sources of credit, they must bear with these inflated costs. Much of the blame of also lies with the cooperative ministry which has failed to ensure that regulations of the cooperatives act are properly adhered to. Given the mismanagement problems of out grower organizations and cooperative societies, a parallel action to channel the concerns of farmers, the Kenya Sugarcane Growers Association (KESGA) was formed. KESGA however has not been effective because contrary to tea and coffee farmers, who have been organized for quite sometime, sugarcane farmers lack this organizational advantage.

Although the Centre For Governance and Development (CGD) has proposed that the societies should incorporate themselves under the Companies Act, the advantage being that they will be subject to usual corporate disclosures such as tax compliance, annual returns and proper minutes etc., it is doubtful whether such a proposal will yield the desired results. In the pursuit of strengthening corporate governance practices in China, Linn argued that if existing laws and regulations were complied with, governance practices would significantly improved. An analogy can also be made to the cooperatives Act which could yield reasonable results if properly enforced. Rural farmers do not require sophisticated solutions to their problems. Indeed initiatives such as raising awareness amongst farmers on their rights given that illiteracy is a problem most farmers are faced with through public campaigns could be a more formidable option.

39 See: Wanyande, Peter 2001Pages 129 -130.
40 See: The Centre for Governance &Development 2005Page 5.
41 See: Linn, Cyril 2000 Page 30.
The preceding paragraphs have demonstrated that the industry is confronted by a myriad of challenges some of which lie beyond the scope of this thesis. Subsequently, the upcoming chapter limits itself to the core theme of this thesis.

2.2.3 Agency theory

The theoretical foundation for corporate governance builds from the *Modern Corporation and Private Property* by Berle and Means (1932). In the book’s preface, Berle and Means contend that, “the translation of perhaps two-thirds of the industrial wealth of the country from individual ownership to ownership by the large, publicly traded financed corporation vitally changes the lives of property owners, the lives of workers, and the methods of property tenure. The divorce of ownership from control consequent on that process almost necessarily involves a new form of economic organization of society.” Without making an in-depth analysis of the book, mentioning some key points of the book remain inevitable. In line with the further arguments put forth by the authors, that the owners of passive property in surrendering control and responsibility over active property had given up the right that the corporation should be operated in their best interest. In so doing, they had released the community from the obligation to protect them to the full extent as the doctrine of strict property rights had previously implied. On the other hand, those in control by extending their corporate powers, had in their own interest broken the bar of tradition which required the corporation to be managed in the solely in the interest of passive owners. Central to Berle and Means was the new concept of property which deviated from the strict concept of property rights and henceforth revolutionized the way corporations were run.

According to Clarke, the separation of ownership and control and the managerial revolution continued to remain subjects of interest and occasionally of sparked by controversy. Until Meckling and Jensen in their ground breaking seminal paper (1976) defined an agency relationship as a contract under which one or more persons (the principal(s) engage another person(s) (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent. Jensen and Meckling understood the firm as a legal fiction which serves as a nexus of contracts for a set of contracting relationships among individuals. This exhibits the neoclassical view of the firm as unit of bargaining arrangements which participants in a company use to maximize wealth through

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beneficial gains. It is noteworthy that classical economics had hitherto conceived the firm as a single-product entity which was committed to maximizing profits. For the classical economists, what went within the firm was considered of subordinate interest to what went on markets.

Underlying the assumption that the agent will not act in the best interest of the principal, Jensen and Meckling proposed that the divergent behavior of the agent can be limited by establishing incentives for the agent. Additionally, the principal has to incur monitoring costs in order to mitigate aberrant activities of the agent. In fact in some situations the principal may have to pay bonding costs to guarantee that the agent will not take part in some activities which can harm the principal and in the event that the agent engages in these activities, he has to compensate the principal.46

A core requirement of the agency theory therefore is the separation of control and residual risk bearing by principals (owners) and control agents or the management. This separation leads to the optimal allocation of risk in the corporate economy. Shareholders will typically diversify their investments to minimize risks and in line with portfolio theory, they are best placed to take risks. Underlying this proposition, agency theorists locate the solution to mitigating agency costs in having efficient markets for; the corporate control, management labour and corporate information.47

Such markets for corporate control which exist in the public listed companies are absent in parastatals. Another requisite for the agency theory to find proper application is the existence of a principal which in the case of public listed companies is the shareholder who are the residual risk bearers and the agent of the shareholders being the management board. This pure agency relationship does not exist in parastatals. Instead, parastatals are characterized by multiple agents. The voters who elect public officials into office are presumed to be the principals of both the Ministries and the board of directors.48 One could also posit that the board is an agent of the controlling Ministry. This lack of clear ownership structure poses one of the biggest governance problems of parastatals. Linn sheds more light into this problem of lack of clear property or rather ambiguity of property rights in China. Some of the arguments explain that under a system of ownership by the state property rights intrinsically belong to everyone and to nobody in particular. In assigning the day to day operation of parastatals to managers, the state acts as an agent. However, the controlling ministries do not bear any residual risks over the control and use of SOE (State Owned Enter-

47 See: Clarke, Thomas 2004 Page 5.
prises) assets. This implies that losses and risks are simply passed to the public at large\(^{49}\). Contrary to public listed companies where shareholders are the residual risk bearers.

According to a survey conducted by the OECD on State-Owned Enterprises in 2005, the survey highlights that governance problems of parastatals are further exacerbated by competing owners and stakeholders and lack of clear objectives. This runs contrary to public listed companies where the sole objective is shareholder maximization. Public officials on the hand are likely to follow political imperatives in order to meet the strategic element of the electorate. In the worst case, such objectives may be traded off for commercial objectives. Public choice theory gives evidence to by this by underlining that politicians and bureaucrats are self-interested individuals who seek to attain, exploit and maintain power\(^{50}\). For this reason, they cannot be the best overseers of corporations. The recent de-gazettment of the sugar levy gives evidence into the conflicting objectives of ministries involved in running parastatals. The abolishment of the levy may have been in the interest of the treasury but it was not applauded by the Agricultural Ministry who might also have even expected the treasury to write off the 59 billion Kshs. debts owed by the industry to provide a clean slate for the upcoming privatization.

Other control mechanisms present in public listed companies such as take-over threat and insolvency are absent in parastatals. The absence of these two threats inherently undermines the discipline of parastatal boards. Parastatals are not subject to usual bankruptcy procedures\(^{51}\). Chemelil, Nzoia, Muhoroni and Sony companies’ total debt stood at a stunning 59 billion Kshs. in March 2008. Technically, the Industry has been insolvent for a long time. However, the treasury continues to bailout the sector and injects more capital into it. Ideally governments should lend to parastatals at arms length by imposing the same repayment terms as private lenders. A perhaps better option would be that parastatals borrow from private lenders. The Swedish government took this approach and the results have been quite impressive given the SOE are paying dividends to the Swedish government. By borrowing from private lenders, government influence on parastatals is reduced and the need to pay principal and interest regularly would discipline state owned enterprises.\(^{52}\) The Swedish government reasoned that the benefits of market-discipline would outweigh the potentially higher costs of borrowing.

Parastatal boards equally lack incentives that can motivate them to manage more prudently. Compared to their peers in the public listed Companies who enjoy better remunera-

\(^{49}\) See: Linn, Cyril 2000 Page 8.

\(^{50}\) See: Wong, Simon C.Y 2004 Page 10.


salaries in the public sector are relatively low. In Kenya, the remuneration of parastatal chiefs depends on how the subsequent parastatal is ranked. There exists a system of ranking where parastatals are ranked from A to F in terms of their importance. Reality, however, is that the closer the CEO is to the President, the better the ranking of his parastatal and the higher the salary. The recent introduction of performance contracts might be a move in the right direction. However, performance contracts have failed to yield the proper results in the past especially in the sugar industry. Unless performance targets are properly set and sanctions are implemented incase targets are not achieved, the whole fad about performance contracts will not increase productivity and efficiency in the sector. Mwaura argues that performance contracts must be accompanied by more autonomy for managers and employee motivation. If CEOs are not well qualified, the will rarely find the support of the senior management and the employees. Close monitoring of managers is also necessary so that they do not manipulate performance targets to get contract extensions.

Additionally, the market for shares in the case of public listed companies can sanction directors in the sense that shareholders can sell their shares if they are dissatisfied with the management. External shareholders can also sanction directors because a lower share price may lead to a take-over thereby dismissing the directors. In parastatals, markets for shares do not exist implying that there are no voice or exit options. The principal if they are voters usually have to wait until the next election to for new boards to be selected.

Another mechanism which can instill discipline in managers is product competition. Kenya being a member of the COMESA it sought the intervention of safeguard mechanisms from COMESA to protect its sugar industry from threats by imported sugar. COMESA safeguards thus limit imports into Kenya from the COMESA region to 200,000 metric tonnes since 2003. The safeguards were to expire in March 2008 but Kenya was given an extension and the import quota has increased to 220,000 metric tonnes. The quotas are set to expire in 2012 a provision which is bound to imply unlimited export of sugar from COMESA countries to Kenya. Until then, the sugar industry must look into options of product diversification to deal with the post COMESA period. After 2012, Kenya’s Sugar Industry will face stiff competition from cheap producing countries such as South Africa which produce sugar at much less costs. According to the KESREF strategic paper, Kenya has the highest sugar production costs in the COMESA region at $600 per tonne, compared to South Africa’s all time low of US $270 per tonne.

53 See: Musikali, Mwendwa L. Page 13. Remuneration of top management in public listed companies stood at $33,000 per month. It is very unlikely that the public sector remuneration will be this high.
54 See: Kiarie, Mwaura 2007 Page 8.
A last mechanism of corporate control lies in director liability. The case of Muhoroni Sugar Company where one of the current receiver managers was a former director of Uchumi supermarkets sheds light into how lightly directors’ liability is still taken in Kenya. Uchumi supermarkets which collapsed in 2006\(^{56}\) presents one of the greatest corporate collapses in Kenya’s recent past. Uchumi had a dysfunctional board coupled with careless expansion strategies and lack of a risk management strategy\(^{57}\). Apparently the board members had failed to exercise proper business judgment in pursuing the expansion strategies. Directors who were responsible for the collapse of companies still continue to find their way into the boards of other companies or simply in management positions.

2.2.4 Stewardship theory

The stewardship theory presents a rather different model compared to the agency theory. Stewardship theory has its foundations in the psychology and sociology critics of the agency theory especially from the stakeholder perspective had argued that it presented a rather narrow view of the corporation. Stewardship theory is therefore based on a model of man who is a steward contrary to the agency theory’s model of managerial opportunism resulting in control and incentive mechanisms. The steward’s behavior is ordered in a manner such that it is collectivistic and pro- organizational. A steward will not give up cooperative behaviors for self-serving behavior because he/she draws higher utilities through collectivistic behavior. Steward theorists argue that even when the interests of the principal and agent are not aligned, the steward will still place high value in cooperation than in defection an argument which is underpinned by game theoretical models\(^{58}\) because cooperation rather than defection gives higher payoffs in the long run.

Although Donaldson and Davis (1989,1991) in their seminal paper „Towards a Stewardship Theory of Management“ introduced stewardship as a means of defining relationships based upon other behavioral premises, other foundations underpinning the stewardship theory which have been much forgotten are being revisited today given the current financial crisis. The much forgotten concept of the honorable merchant is precisely in line with the stewardship theory. In deed the good reception of Pope Benedict’s encyclical letter

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\(^{58}\) See: Schoorman and Donaldon 1997 “Towards a Stewardship Theory of Management” In Clarke, Thomas Page 120.
caritas in veritate\textsuperscript{59} by the portal of honorable merchants a website which disseminates information to honorable merchants and managers who subscribe to ethical codes of conduct is a good signal that managers are beginning to view themselves as stewards\textsuperscript{60}. The Pope’s call is timely because corporate governance is about human behavior and at the end of the day governance problems cannot only be solved by law and regulations. As the Pope calls for the application of moral conscience in business, managers are called upon to subscribe to the principles of the honorable merchant.

Given the advantages that principles can derive from the agents as stewards, the question arises as to why the stewardship theory does not find much application. One of the exceptions of having managers act as stewards of their principals exists in family business. Family businesses typically have a strong tradition built by the founder. Founders of a business typically display transformational leadership behaviors which are more apt to create family firm culture\textsuperscript{61}. Such cultures may embody commitment and stewardship characteristics which are likely to engage employees to the firm. Transformational leaders inspire followers to put aside their own interests and engage for the collective or better still to act in the best interest of the firm\textsuperscript{62}. Such strong cultures do not exist in parastatals. Given there establishment by the by the state, is really no founder as such who lays the groundwork for any culture that future generations can subscribe to. It is therefore more difficult for the stewardship theory to find any substantial application in parastatals.

One of the major differences between the agency and the stewards theory lies in extrinsic vs. intrinsic motivation. Intrinsic motivational rewards are difficult to quantify because they focus on the higher order needs of Maslow such as affiliation\textsuperscript{63} and are motivated to enable the manager to work harder behalf of the company. Parastatal heads do not find much approval in the event that they perform well and again, to serve as stewards, some level of empowerment is required. For this reason, the stewardship theory posits empowerment rather than control. The preference for empowerment rather than control ordinates

\textsuperscript{59} See: Pope Benedict XVI Caritas in veritate 2009 Page 18. Although the Pope makes reference to markets and financial instruments, he underscores that the instruments that are good in themselves can be transformed into harmful ones. This is especially true if those at them helm are motivated by selfish ends. He argues that the instruments must not be called to account but rather the individuals with their personal and social responsibility. Because it is mans darkened reason that produces the consequences not the instruments per se Pope argues Benedict. An analogy can be drawn here to corporate governance. The governance systems themselves may not be the only problem.

\textsuperscript{60} See: http://www.der-ehrbare-kaufmann.de/zum-leitbild-des-ehrbaren-kaufmanns/das-leitbild/ueberblick/.

\textsuperscript{61} See: Khouza, Reuel J.; Mohamed Adams 2005 Page 51. They define transformational leaders as those who have a vision and are able to take people along with them to achieve these ends.

\textsuperscript{62} See: Edelston, Kimberly A. 2008 Page 1055-1056. Edelston extends her article the “leadership perspective of the founder “from Zahara et.als “Culture of Commitment and Strategic Flexibility.

\textsuperscript{63} See: Clarke, Thomas 2004 Page 123.
steward theorists to unite the position of board chairman and the CEO. In parastatals however, the separation of the positions of CEO and board chairman and CEO is mandatory as stipulated in the State Corporations Act (SCA). Not to mention the excessive ministerial and political intervention into the affairs of parastatals which leave the CEO with less autonomy. Under these circumstances, it is almost impossible to expect intrinsic motivation from managers. Finally, the large size of parastatals also makes it difficult for the stewardship theory to find application. Because the principal takes a risk by trusting that the agent will be a steward he can do that if the group of managers is small but, as the numbers grow, subscription to ethical codes becomes less probable and trusting that the agents will act in the best interests of the principal even becomes more difficult to expect.

2.3 Corporate governance challenges facing the sugar industry

Ensuring that parastatals have qualified boards is not only a critical but also a priority issue if boards are to ensure proper oversight over the corporations. The nomination process of board members in Kenyan parastatals is intrinsically flawed. In a recent press release to all Ministers, the Kenyan PM (Prime Ministers) circular reminded that the appointment of managing directors of parastatals is the responsibility of Ministers and the PS(Permanent Secretaries) should stick to their role of advising the ministers. The Prime Ministers intervention came against a backdrop of constant wrangling in ministries over the appointment of heads of state corporations64. To an extent that appointment of parastatal heads was a source of disquiet in some sectors of the Kenyan Society. Such a call is timely though it overlooks the reality in Kenyan public life. Ministers are usually under pressure to appoint their cronies. Not to mention the lack of regard for the SCA and other laws, it is clear that Permanent Secretaries have no powers to appoint ministers, yet most of them still act out of the scope of their duties by making appointments. The appointment of the CEO of Che-

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64 See: The Daily Nation: [http://www.nation.co.ke/News//1056/621360/-/ukvu92/-/index.html](http://www.nation.co.ke/News//1056/621360/-/ukvu92/-/index.html). According to the Prime Minister, some ministers had openly flouted the guidelines of appointment of heads of parastatals as outlined in the State Corporations Act by filling the ranks of public sector bureaucracy with cronies and political allies. The appointments were being made without reference to the boards of directors of the affected parastatals and sometimes without competitive recruitment. In some cases the Ministers had asked the parastatal heads to handover to their deputies a sign that their contracts would not be extended. The permanent secretaries however, asked the heads to stay put as their contracts would be extended.
melil Sugar Co. in 2008 lends support to the complexity which may arise in the nomination process.

In the case of the sugar industry, the chairman of the board is appointed by the president in line with SCA; the CEO who holds executive powers is appointed by the parent ministry in consultation with state advisory committee (SCAC). It is common practice that the CEO is the secretary to the board. Seven non executive directors are appointed by the parent minister in this case, the Ministry of Agriculture. Of the seven, three are public officials and the four are usually from the private sector and are non employees of the corporation. The permanent Secretaries of the finance and agricultural ministries are ex-officio board members. Sugar industry boards typically have a total of eleven members. Contrary to German boards which have an average size of around eighteen, ten board members offers a reasonable size for directors to actively participate in meetings.

Another problem pertinent in parastatal boards lies in the conflict of interest. Directors at common law must subscribe to the duty of loyalty and the duty of good faith amongst others. They must equally adhere to the no conflicts and the rules against managerial opportunism. The no conflicts rule requires directors not to put themselves in a position where their duties and interests conflict. Directors therefore cannot turn down a business offer of a third party and then take up the same offer. If a Director takes up a business contract in his or her name, he thereby creates an opportunity for self interested behavior. One of the cases in the industry involved the CEO of the company and the local area MP (Member of Parliament) who owned an external Security Firm that provided Security Services to the Company. It bears to remind that Part III Section 8(h) of the SCA expects a board member to declare his interest in a proposed contract or work to be done for the corporation that

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65 See Odera, Omolo L.: The position of CEO fell vacant in June 2008 after the former CEOs contract was not extended. The former CEO left Chemelil Sugar Company technically insolvent. This did not come as a surprise given that he was an academic who had no sugar industry expertise which should be an imperative. However, it is not quite clear which criteria is applied in appointing the CEO. The incumbent Agricultural Minister’s role of picking up the right candidate was so complicated due to political pressure mounted by his cabinet colleagues from Nyanza province who might have preferred to have a fellow tribesman the position which was finally filled in October. In the Chemelil appointment there was so much jostling between the Luos and the Nandis. Fortunately, enough farmers and other stakeholders rejected tribal sentiments and called for the Agricultural minister to appoint someone with management skills and knowledge of the industry Farmers in the sugar belt region mostly dominated by the Luos were tired of tribal politics after the tenure of the former CEO who was a fellow tribesman but had run down Chemelil Sugar Company.

66 See: The SCA Part III Section 6(1).

comes before the board for consideration. In which case, he should leave the meeting and shall be entitled not to vote on that matter. A director cannot do business with the a company in this case where he is the CEO and at the same time perform his duty of skill and care. His duty of skill and care is compromised completely because his loyalty may be more in the interest of his business and not with the company as such. Musikali has argued that robust laws must be put in place to protect against insider dealing. Because given the weaknesses in Kenyan laws and the culture of impunity present in the country, nothing deters directors from acting against the interests of the Company.

Kenyan parastatals continue to lose huge sums of money due to such fraudulent transactions conducted by directors. Cases of CEOs and local MPs borrowing money from sugar companies have become commonplace. This happens because apparently, internal audit teams are often locked out of board committees. It bears again to remind that section 17 of the SCA prohibits granting of loans or credit facilities except if they are in accordance with the State Corporations Regulation and are approved by the treasury. Vagiliasindi argues that in many instances parastatal managers are given autonomy in areas where they should have been closely monitored such as financial reporting and they generally lacked decision making power in day-to-day operations. Parallels drawn to sugar companies imply that for a CEO to have been granted a 15 million loan by the school headmaster, it can only imply that he usurped powers from internal auditors or that they simply did not exist.

Excessive ministerial intervention equally continues to impair the ability of parastatals boards to make sound decisions. For instance, a major area of conflict between KSB and the millers lies in the pricing of sugar cane delivered by farmers. KSB recently ordered the

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69 See Odera, Omolo L.: http://africanpress.wordpress.com/2008/10/03/farmers-union-call-for-payment-of-bonuses-to-sugar-cane-growers-and-abolition-of-cess-levy-to-civic-bodies/. According to the newspaper article, the MP who borrowed 4million kshs. From the company made sure that the former board chairman who had been pressing him to pay off his debt was replaced. By his cousin the new Chairman is unlikely to find the support for the employees given that he comes from a different clan.

70 See: http://www.eastandard.net/editorial/InsidePage.php?id=1144017518&cid=16&. The article sheds light into a multibillion fraud at the Kenya Pipeline Corporation. The author argues that weaknesses in internal audits of parastatals are common factor in losses in the process of procurement and asset disposal to the extent that Kenyans must begin to view weak internal audits as an advance to defraud the state.

millers to pay 2500 kshs\textsuperscript{72}. per tonne of cane delivered. However, millers complained that the decision was made without their input. The board on the other side questioned what the millers had been doing with the savings generated from the Sugar Development Levy. The board had reduced the levy from four percent in 2007 year to three per 2008. Such directives are usually given by the minister of Agriculture who has powers to issue directives of general nature over state corporations. In the Mumias case, arsonists use the conflict to burn sugarcane from the nucleus estates of the companies with the expectation that millers will succumb to pressure and increase the price paid to farmers. In deed in these cases, the real losers’ are the millers and farmers. Taking into account that politicians can make such directives to gain popularity amongst farmers, it is very unlikely that they will make interventions which can lead to efficiency in parastatals.

The numerous approval requirements to be fulfilled by parastatals inherently slows down decision making processes. Parastatals, including the ones with enabling legislations must report to the parent ministry because the ministry in conjunction with the treasury approves their budgets and remuneration systems. They must also obtain approval for investments from the treasury. Usually, their accounts are justified before the Public Accounts Committee of Parliament. Also, parastatals are subject to review by the State Corporations Advisory Committee (SCAC), the controller, the Auditor-General and the Inspector of State Corporations. The numerous approval requirements effect and constrain the ability of directors to make commercial decisions\textsuperscript{73}. Also, from the vantage point that the members of these state committees are politicians, highly skilled staff with business find it frustrating to wait for approval of decisions from persons who may have very little or even no knowledge of the industry. This makes the task of maintaining qualified staff in parastatals equally difficult.

This subsection has shown that parastatals are confronted with numerous governance issues of which fraudulent transactions and opaque board nomination processes plague parastatals the most. It is against the background of such problems that privatization has been much looked into as a viable option.

\textsuperscript{72} Mumias Sugar has been paying 2300Kshs. per tonne but the Agricultural minister has ordered the company to pay 2500Kshs. Secondly, the current system of weighing cane at the factories causes farmers losses, because a lot of the cane is stolen on the way to the factory. Unfortunately, the other option, weighing cane at the farm gate, is expensive because of the high costs involved: Weighbridges would have to be built in all sugar growing areas. According to the Company’s report, the government should subsidize the building of weighbridges: as other Sugar producing Countries such as Mauritius do. Leaving the construction of weighbridges to the companies is unjust. Given that the millers spend a lot of money repairing feeder roads. Building infrastructure should be left to the government.

\textsuperscript{73} See: Kiarie, Mwaura 2007Page 10-11.
3 Possible solutions to governance problems in the industry

3.1 The Limitation of Privatisation.

Given the ongoing debate on the privatization of Kenya’s sugar Industry, failure to address this hotly contested issue would almost make this thesis incomplete. Against the background of high costs of production, punitive tax regimes, unharmonized industry regulatory framework, obsolete technology, liberalization under COMESA and WTO(World Trade Organization) protocols, poor supply chain management and many other challenges facing the industry, privatization has almost been perceived as the holy grail\textsuperscript{74}. According to an article published in Business Daily, a privatization commission has started the sale process and already picked advisors to help identify strategic buyers for the state owned enterprises (SOE) amongst them the sugar companies Chemelil, Muhoroni, SONY and Nzoia. The privatization process is expected to offset sixteen parastatals amongst them Kenya Wine Agencies (KWA), National Bank Corporation and the consolidated bank just to mention a few.

Also, from a macro-economic perspective, the state may have its reasons for privatization. The Kenyan government did this\textsuperscript{1994} when it implemented a parastatal reform project financed by the World Bank. The aim of the project was to reduce government’s involvement in the economy, enhance the efficiency of public enterprises thereby reducing the financial burden of parastatals on the public. The reform was also aimed at assisting parastatals to operate on market principles and be more accountable\textsuperscript{75}. However, apart from Mumias Sugar and Kenya Airways, privatization did not bring the much coveted efficiency gains. Failure of privatization should therefore not come as a surprise in the cases where unplugging budget deficits seems to be the only underlying rationale behind privatization.

Unfortunately the past has shown that privatization is not always a viable option. Black et al. have shown that rapid mass privatization of SOE (State Owned Enterprises) in Russia did not bring the much expected efficiency incentives which should have been unleashed by privatization. Again, privatization ordeals are many at time likely to be met with resistance by employees who may fear retrenchment. This is particularly true for the sugar belt region which is characterized by high unemployment. The privatization of the sugar industries especially of Muhoroni and Chemelil are most likely to be met with high resistance from the local KANO people who feel that they have not benefited from the presence of

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\textsuperscript{74} See: The Kenya Sugar Board Strategic Paper 2007 Page 12.

the industries in their area\textsuperscript{76}. The KANO people would like to reclaim ownership of Mu-
horoni, Miwani and Chemelil Sugar Companies all which are located in the KANO region.

Experience has shown that certain measures must be taken at micro- level, if mass privati-
ization of state owned enterprises as it is current intended in Kenya is to prevent insider-self
dealing on a large scale. Failure to undertake certain measures will enable well connected
politicians to manipulate these privatization processes. The crucial point here is that Kenya
does not have the proper infrastructure to control self-dealing. Contrary to the much held
notion that the details of privatization plans can hedge against self-dealing, the past has
illustrated that this is not usually the case\textsuperscript{77}. For instance, the sale of East Kenya Bottlers to
a South African company Coca-Cola Sabco in 2001 gave the former a seventy percent
stake in the entire carbonated soft drinks market and ran contrary to the monopoly laws of
Kenya. Worse still, privatization exercises in Kenya have never safeguarded employees
and shareholders rights to buy shares in the parastatals.

Again, the risk with the Kenyan divesture strategy is that it perceives privatization as an
end to itself. In such a myopic view of privatization, the government forgets to complete
the cycle which is quintessential to catalyze economic growth. In the process of completing
the privatization of the sixteen parastatals, the government should begin to unfold new in-
vestments in co-energy generation which the sugar industry badly needs to enable product
diversification in the industry. Product diversification is going to be paramount if the in-
dustry is to survive after the COMESA safeguards expire in 2012.

To hedge against such developments, decent legal and enforcement must prevail before
privatization is done or in the least accompany the process. Although the Privatization Act
of 2005 albeit may be perceived as a step in the right direction, because it proposes com-
mercialization rather than entire privatization. Unfortunately it still vests too much power
with the Finance Minister\textsuperscript{78}. The finance minister has the power to appoint the executive
director of the privatization commission. The executive commission has exclusive rights to
administer the privatization fund. A perhaps better option would be to appoint the executive
director through parliamentary scrutiny just as other commissioners are appointed.
This would ensure that the executive director does not owe allegiance to the finance minis-

\textsuperscript{76}See: Odera, Omolo L: \texttt{http://africanpress.wordpress.com/2008/07/07,kano-people-vowed-to-stop-the-sale-
of-miwani-farm-in-piece-meal-at-all-cost/}. According to the article Jo-Kano a sub-clan of the Luo
claims that the Miwani Sugar Mills was seized from them by the British. Again the 99 year old lease of
the land has expired.RIDOKAM an association formed by the people of KANO to spur development in
the area claim they have not benefited from the four mills being present in the KANO area.Neither from
contracts, nor tenders and employment opportunities.

\textsuperscript{77}See: Black et al. 2000Page1734-1735.

\textsuperscript{78}See: Section 2 of the Privatization Act 2005.
ter\textsuperscript{79}. Even event of improving the privatization act, strengthening corporate governance measures before hand remains imperative unless which weaknesses from the state owned enterprises will simply be transferred to the private sector.

3.2 The two-tier board system vs. the one-tier board system of governance.

Given the existing governance problems in Kenyan parastatals, it would be of interest to look into the German two-tier board system a viable solution for the Kenyan Sugar Industry. Germany has a two-tier board system. Characteristic of the two-tier board system is the existence of a supervisory and a management board. The Stock Corporations Act of 1965 imposes a mandatory requirement on all German stock corporations to have a management and a supervisory board. The act prohibits simultaneous membership in the management and supervisory board. The supervisory board is usually composed of shareholder and employee representatives\textsuperscript{80}. The presence of employee representatives in the supervisory board usually intrigues those who view the two-tier board as exemplary.

The major role of the supervisory board is to appoint and dismiss members of the management board\textsuperscript{81}. Lately, other soft functions of the supervisory board include networking with stakeholders. The Supervisory board also represents the corporation in all affairs that concern the management board. This implies that the supervisory board can initiate court proceedings against the management board. Additionally, the supervisory board must approve annual accounts. The supervisory board can also intervene in cases where the corporation’s interests are seriously affected. Again, for certain extensive and fundamental decisions, the by –law must impose that the authorization of the supervisory board is required\textsuperscript{82}.

The management board on the other hand is responsible for managing the stock corporation as stipulated in the stock corporations act § 76(1). Consequently, the major difference between the supervisory and management board lies in the separation of control and management which is often viewed as the genius of the two-tier board system.

\textsuperscript{79}See: Kiarie, Mwaura 2007 Page 14.

\textsuperscript{80}See: Jungmann, Carsten 2006 Page 432. An explanation is given to the composition of supervisory board. Co-determination laws require companies with more than 500 employees to have a supervisory board. Depending on the size of the corporation, up to 50 % of members of the supervisory board are employees. The employee representatives are elected in rather complex process. as determined by the enabling co-determination act. While the shareholder representatives are elected by the shareholders meeting.

\textsuperscript{81}See: Zschocke, Christian 2001 § 84. (1).The dismissal of management board members is governed by § 84(3).

The most profound critic on the German two-tier board system lies in the ineffectiveness of the supervisory board. Contrary to what is perceived as the advantage of the two-tier board system, there exist practical difficulties in trying to understand the nature of the supervisory and management roles of the supervisory and management boards respectively. It is particularly unclear who should be regarded as a director of the company in terms of the law. More importantly, the role of the directors may be obscured because it is not clear to whom the director is accountable. The question therein is to whom does the director owe his fiduciary duty is it to the company as it is the norm in company law or does he owe his fiduciary duties to the stakeholder group which he represents. Accountability is therefore inherently impaired or rather diluted in the two-tier model. Another disadvantage of the two-tier board asymmetries as highlighted by Jungmann lies in the existence of information asymmetries between the management and the supervisory board. This stems from the absence of the supervisory board members in the meetings of the management board. Subsequently, the supervisory board members rely on the management board to disclose information. The information asymmetry is further exacerbated because members of the management board receive information from the junior management which is unfiltered. Supervisory board members are not permitted to collect information on their own and therefore are likely to be devoid of sensitive information.

Further disadvantages of the two-tier board system are also viewed to lie in the defects of the composition of the supervisory board particularly with regard to employee participation in the Supervisory board. The OECD has argued that the effects of employees on the board will depend on how they are elected, trained and remunerated. Also, unless the employee representatives are accepted on the boards, they will continue to be fleet-in-beings. Typically shareholder representatives, will not be willing to share information which they perceive to be confidential with the employee representatives. By and large thorough surveys conducted conclude that the success of employee representatives in boards is limited because employees are not in a position to influence strategic decisions. Finally, when they disapprove of decisions, management which usually prefers unanimous approval of decisions perceives that as a bad signal. For the Kenyan setting employee representatives are most likely to use board membership to as a political bargaining field more rights. This is particularly true for the sugar industry where workers rights are not adequately addressed. Also with the emerging trend of professionalizing supervisory boards, employee representatives might to be free in choosing their representatives.

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83 See: Plessis et.al 2005 Page 307. See also Khouza J and Adam Page 144.
84 See: Khouza, Reuel J.; Mohammed, Adam. 2005 Page 144-145.
85 See: OECD 2005 Page 83. The Survey on the effects of employee representatives was conducted in France.
In Kenya on the contrary, a board system prevails. One-tier board typically exist in Anglo-Saxon countries such as the UK (United Kingdom), the USA, Canada and Australia. One-tier boards are composed of executive and non-executive directors. Distinct from the two-tier board system where management and control is separated, in a unitary board both functions are performed by the same board. One of the major challenges facing one-tier boards is the issue of independence. Section 2.1.4.2 of the CMA guidelines defines a non-executive director as one who is not involved in the administrative or managerial operations of the company. The Sample Code of Governance in Kenya also called upon non-executive directors to bring independent judgment to matters of strategy and appointments. Typically the code expects, one third of board members to be nonexecutive directors. By sitting in the audit, nomination and remuneration committees, NED (Non-Executive Directors) are expected to play a monitoring role and not be meager observers. However, ensuring independence of NED in parastatals is difficult given that middle-level civil servants with little commercial experience sit in many other boards, which dilutes their capacity to monitor corporate events. Again, they often protect the interests of their ministries which can be at odds with the efficiency objectives of the company. The problem of independence is not only reduced to SOE but equally to public listed companies.

3.3 Constraints posed by the adoption of a new system

Adopting a new governance system is usually a difficult decision for any Country. To make to make. Corporate governance systems like legal systems are influenced by Historical and societal accounts in what Roe defined as path dependence. This explains why systems do survive overtime even when they are not as efficient. Consequently, legal or even governance models only change under exceptional cases. Italy for example, in its company law reform in 2003 adopted the unitary and dualistic board systems from Anglo-Saxon Countries and German respectively. The adoption of these governance models was made for regulatory reasons to discourage Italian companies from incorporating elsewhere. Again, the alternative systems were expected to attract foreign entities from elsewhere to the Italian legal system.

Such a decision to adopt a new system of governance must be given wide range of consideration. Amongst them, a cost–benefit analysis. Only in cases where the benefits of adopting a new system outweigh the costs, then the new system could be worth consideration. Such costs include disclosure costs which are relevant for public listed and SOE but not in

87 See: Ghezzi, Federico; Malberti, Corrado 2008 Page 3
family owned business. The public has a stake in state owned enterprises and therefore in line with accountability and transparency and requirements, such a transition in governance model would warrant disclosure. Furthermore, the commonly held notion held that the one and two-tier board systems are starkly different is farfetched. For example today non-executive directors have assumed the position of the supervisory board by taking more of the monitoring role. Ghezzi and Malberti find out in their paper that striking similarities exist amongst the three models prevalent in Italy. According to their findings, the limits of legal transplants are clear. Even if the models are inspired by the German and Anglo-American traditions they are still Italian legal creatures. The authors seal the fate of legal transplants by arguing that even if distinctive features existed in each model, it is very difficult to anticipate the immediate success among corporations of the new alternative systems. In their opinion, the possibility of changing the model of governance can be viewed from a prisoner’s dilemma perspective. Given that the decision to adopt a new governance system is a risky one and it is very difficult to weigh ex-ante the costs and benefits. Again, new models suffer a disadvantage given the lack of judicial decisions posing even more uncertainty.

Nonetheless, in the case of the sugar industry, an adoption of the two tier board system may offer an advantage if public officials are appointed to the supervisory board. Such a provision would imply that the management board members are not replaced when a new regime takes power given that the management board is appointed by the supervisory board. This would mitigate the problem of corporate memory loss given the current situation in Kenya where directors are replaced as new governments take office.

The Chinese experience has also shown that the independence and effective overseeing are not necessarily achieved in a two-tier board system. In the Chinese system which was modeled after the German two-tier board system, the CEO had excessive powers. In fact the non-executive directors were captured by the CEO and could not perform any oversight functions over the executive board and the management.

Eskom’s case also highlights further that a two-tier board system may only be useful during a transition period. Eskom the South African electricity Company adopted a two-tier board system in the early 1990s. At the time, state-owned enterprises wanted to involve stakeholders who were excluded in the decision making process under the apartheid system. In order to rectify these inequities, representatives from the NUM (National Union of Mineworkers) were appointed to Eskom’s board. Such populations did not have access to

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88 See: Ghezzi, Federico; Malberti, Corrado 2008 19-28
89 See: Khouza, Reuel J.; Mohamed, Adam 2005 Page 148-149. The comments were made by Frans Baleni a senior member of the National Union of Mineworkers (NUM) who was appointed to the Eskom Electricity Council as a representative of organized labour in terms of the Eskom Act.
electricity under the apartheid system because it was viewed as unlikely that these representatives would act in the best interests of Eskom if they felt Eskom’s interests run contrary to the expectations of the NUM. At that time, it was not practical to expect directors to work in the best interest of Eskom at all times. There were vested interests and at stake and so directors did not have to fear any legal liability. Today however, the necessity of a two-tier board does not arise given that South Africa has transcended from the apartheid period. One could argue that Kenya today finds itself in a transition period after the events of the post-election violence in 2007 a development which led to the formation of a grand coalition. In the light of the post electoral violence, need arises for the inclusion of under-represented groups in corporate and public sector, thereby considering regional balance and other diversity considerations such as age and gender. However, even in the wake of the transitional process, a single-board with appointments based on professionalism is more likely to achieve better results than the two-tier board system.

Again, the high incidences of corporate scandals have demonstrated that Kenya is unable to cope with self-regulation. The Sample Code of Corporate Governance for instance was not a home grown solution but rather a construct from developed countries such as the UK where different legal and market environments prevail. Against this background Musikali advocates for the pursuit of homegrown solutions which take into account underlying market conditions. This is even truer given that Kenya like many other developing countries has a different institutional and regulatory framework. Characteristic of such Countries are, weak legal and regulatory frameworks which are compounded by lack of independent judiciaries, outdated bankruptcy, companies and contract laws. Other challenges facing these countries include complexity of ownership structures dominated by public sector companies and family owned and managed conglomerates usually in the hands of political elites\(^\text{90}\). It is, therefore, unlikely that models which have worked in more developed markets and legal environments can function in Kenya. Logical conclusions from such empirical evidence may well imply that the strengthening of the existing one-tier boards could be a more viable option.

### 3.4 Strengthening parastatal boards in the sugar industry

In the wake of a wave of scandalous appointments, the Kenyan Prime Minister in a press release to all ministers called for them to appoint parastatal chiefs with integrity, thereby taking gender and regional balance into consideration. It bears to remind that the PMs Office is responsible for the coordination of the activities of government ministries. The PM

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\(^{90}\) See: Gatamah, K.2002 Page 142.
called on ministers to equally take into consideration of the relevant professional qualification of potential directors. Although such calls can be welcomed, the way forward for Kenyan parastatals can only be achieved if appointment processes are streamlined and conducted in a transparent fashion.

Given these flouted appointments, one wonders what role is played by the State Advisory Committee (SCAC). At its formation, the SCAC was established to play a role equivalent to that of the CCMAU (Crown Company Monitoring Advisory Unit) of New Zealand. The SCAC functions would include the formulation of guidelines on corporate governance for state-owned enterprises, the establishment and co-ordination of performance objectives, ensuring that there exists proper selection of directors. The CCMAU also maintains a register of state-owned enterprises. Khouza and Adam in their book the power of governance have argued that as long as the SCAC plays the co-coordinating role as a shareholder, it can add value. However, they argue that caution has to be exercised so that the SCAC does not usurp on the role of the boards of state owned enterprises.

With regard to the appointment of parastatal chiefs, the CCMAU maintains and creates a database of possible candidates for directorships. The CCMAU primarily manages the appointment process by interviewing and accessing the potential directors. Furthermore; it CCMAU manages the induction process of directors, monitors the board and individual directors performance. The nomination process of directors is therefore codified and involves both the CCMAU and the shareholding Ministries. Even though the final say of appointments lies with the shareholding minister; they seek advice from the CCMAU. Such an approach hedges against backdoor influence and encourages transparency and open consultation. Once appointments are made, the shareholding ministry must certify in writing that the candidate selected is the best available and that there are no conflicts of interest. Seen in the light of scandalous appointments, perhaps Kenya move towards the approach used in New Zealand. Very few Kenyan ministers would objectively justify the appointment of parastatal heads if asked to do so.

The recent attempt to advertise CEO positions in newspapers may be a good move in the short term but in the long run it may not be a viable option. As the Chemelil case evidenced, fifty applications were made but only six were shortlisted. The CCMAU used this method in the past but surrendered it given that a large number of people had aspirations for CEO positions but they were not suitable. Proper succession planning processes therefore have to be in the agenda of parastatal boards. Unfortunately again, the SCAC is silent

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91 See: Part V Section 26(1) for the Composition of the SCAC and Section for roles. See also Khouza J and Adams Page 154.
on the vital issue of succession planning of CEO positions. Just like in the private sector where directors are appointed by shareholders on the recommendation of the board, state owned enterprises should take such an approach which is best practice. After all the board is better placed to know which skills are requisite for the relevant corporation\textsuperscript{93}. Nomination committees though only common practice in public listed (SOE) may serve parastatals well. This is especially true for the sugar industry which is suffering from the adverse effects of HIV/AIDS. Nomination committees would be quite instrumental in succession planning of senior management. It would also prevent corrupt CEOs from awarding senior management positions to their relatives and friends as it has been the case in the past.

Merit based appointments will also assist in raising the fiduciary and the duties of care and skill owed by directors at common law\textsuperscript{94}. Negligence in the performance of duties attaches liability to a director. Therefore, any damages caused by a negligent act are recoverable by the company. However, if a director is in total ignorance of the business of the company, he cannot be held liable for negligence. Worse still, Kenyan courts continue to apply subjective standards in assessing the liability of directors\textsuperscript{95}. Mwaura’s paper (2003) sheds light on the low standards of duty and care originated from the traditional reluctance of English courts to punish directors who were part time officials without executive skills. The English courts therefore did not want to interfere in the internal affairs of management and instead argued that shareholders should bear the burden if they hired amateur directors. Such judgment obviously came to the detriment of employees, creditors and the society at large.

Mwaura argues that contemporary industrial imperatives require more objectivity in assessing directors’ liability which other common law Countries such as the UK, Australia and Nigeria have recognized. The Nigerian Law Review reform Commission sought to raise the low standard set by \textit{Re City Equitable Fire Insurance Co} by requiring directors to conform to a professional standard of care, just as doctors or lawyers must\textsuperscript{96}. The case formulated three principles. Namely; the subjective test of skill which does not require a director to exhibit, in the performance of his duties, a greater degree of skill which may be reasonably expected from a person of his knowledge and experience. A director is not bound

\textsuperscript{93} See: Khouza, Reuel J.; Mohamed, Adam 2005 Page 153-154.
\textsuperscript{94} See: Gupta: Quoted from Britannica. A fiduciary duty is the highest standard of care imposed at either equity of law. A fiduciary duty is expected to be extremely loyal to the person they owe the duty(principal). The fiduciary duty is highlighted by good faith, loyalty and trust derived from the Latin \textit{fides}, meaning faith and honesty. When a fiduciary duty is imposed, equity requires stricter standards of behavior than the comparable tortuous duty of care at common law.
\textsuperscript{95} See: Kiarie, Mwaura 2003 Page 3-4.
\textsuperscript{96} See: Kiarie, Mwaura (2003). The standards of care and expected from executive directors were also considered and raised in Australia in \textit{Daniels vs Anderson}. Executive directors were held to have been negligent for failing to establish proper internal controls, failing to maintain proper system of records, failing to supervise adequately a particular manager, and failing to act on the warning of an auditor.
to give continuous attention to the company’s affairs and finally a director can trust an official to perform duties that can be entrusted to him in accordance with the articles.

If Kenyan courts can recognize the necessity of applying the objective element in accessing; directors will take their duties more seriously. However, this will involve a broader process of overhauling institutions such as the judiciary whose independence has been compromised.

Indeed there is urgent need to improve the regulatory framework both the Companies and State Corporation Acts Even though the SCA has certain provisions which if strictly observed, would improve governance, this has not been the case. Monies continue to be misappropriated from parastatals but the culprits walk scot-free. As a matter of fact the Inspector General of State Corporations, together with the Auditor General and SCAC should surcharge any monies misappropriated after the inspection of books, records and documents of state enterprises. If the person surcharged feels wrongly aggrieved, they can appeal to the State Appeals Tribunal which has never convened since its establishment. even though fraudulent transactions and misappropriation of resources is commonplace in parastatals.

Against the background of fraudulent transactions, the formation of audit committees is inevitable for parastatals. Waweru et al have located the primary functions of audit committees in the review of the systems of internal control and, financial information that is provided to shareholders and other stakeholders. The OECD guidelines recommend that even in the presence of the Auditor General, parastatals should subject themselves to external independent audits. A key provision of the Sample Code of Governance also lies in the formation of audit committees by non-executive directors. The SCA also provides for the formation of committees to improve board efficiency. In the event of forming such committees, parastatals must service the SCAC with a notice thereof. However, the formation of audit committees in parastatals poses some challenges. Board members who serve by virtue of being in government may not really be keen on performing such tasks. Again, Directors usually serve in more than one company which impairs their independence. This has impacted audit committees negatively as Waweru et.al in their study of audit committees find that some senior dominant managers interfere easily with the work of audit committees

Composition of audit committees in these settings is one of the most important variables. The question which arises therein is whether members must possess financial skills. The views here contrast. The Blue Ribbon committee recommends that all members of the audit committee must be financially literate. Jonathan and Carey (2001) on the other hand contend that even more knowledgeable accountants are sometimes outpaced by develop-
ments given the ever changing dynamics of accounting principles. The chairman of the audit committee therefore plays the most important role in coordinating the activities of the committee\textsuperscript{97}. Given the importance of the chairman, he should be elected by an independent body not the CEO or the Chairman. By electing him through an independent body, an independence of the audit committee can be ensured. Even for the sheer reason of encouraging independence of directors from CEO Vagliasindi calls for the formation of task specific committees in areas where management and shareholder interests conflict. Given the ownership and accountability for a specific critical task, independence from the CEO is automatically gained. Secondly, the practice of acting jointly and autonomously may spill over to other board activities such as the evaluation of management performance and in the evaluation of strategy.

Despite these constraints, independence from the CEO and clear terms of reference or the presence of a tailor made charter will strengthen the audit committees. Without which, they will simply perform a compliance function\textsuperscript{98}. Also the presence of independent audit committees will facilitate communication between the internal auditor and the audit committee. In fact Waweru et al highlights this channeling of communication as one of the major achievements of audit committees in Kenya. According to their findings, the communication channel ensured that internal audit issues raised were attended to promptly which enhanced the independence of the internal audit departments\textsuperscript{99}. Other achievements noted were the significant improvement in corporate governance practices and improved risk management.

Induction courses for directors are gaining foothold in many Countries as best practice. Even when independent directors have a proven track record, they may know little about the corporate culture of the company at the time of their nomination. For instance, the UK combined code provides guidelines for such induction courses based on guidelines offered by the Higgs Committee (2003). These courses enhance performance of directors especially in knowing the key drivers of success of the relevant industry. Company directors who attended induction courses affirmed that the courses enabled them to better understand their roles\textsuperscript{100}. In the Kenyan context, Mwaura’s study showed that directors did not take

\textsuperscript{97} See: Waweru et al Page 9-10.
\textsuperscript{98} See: Waweru et al 2008 Page 8. The authors refer to Guy and Burke (2001) who argued that the charter must be tailored to describe the committee’s composition and appropriate resources.
\textsuperscript{100} See: Plessis et al 2005 Page 84. The Sample code on corporate governance also recommends that directors receive some formal training on their roles, duties, responsibilities as well as Board procedures on first appointment. The code further underscores that the induction courses are imperative given the fast-changing corporate environment especially for first time directors. H
their duties of skill, care and diligence seriously. Especially, for the sugar industry, understanding the key performance driver the FTE (Factory Time Efficiency) is imperative. Induction courses would also introduce directors to the senior executives and other directors thereby improving board effectiveness.

Finally, the OECD has called on the state acting as an owner to simplify and streamline the operational practices and the legal form under which State Owned Enterprises operate. One of the measures recommended by the OECD would be to have legal forms which can permit creditors to press their credit claims and initiate insolvency procedures. Australia has been exemplary in this regard by clarifying ownership structures between shareholding ministries. The Ministry of Finance and Administration takes the lead on financial matters while the parent ministry focuses on the operational issues of the parastatals. In the State of Queensland in Australia, any decision affecting parastatals made by the ministers must be published. Directors therefore have powers to make decisions on the use of resources. In the corporatization process; ministries only come in when a strategic decision is involved. Such a system would be instrumental prioritizing objectives of parastatals. Also, given the clear separation of responsibilities, accountability which lacks in most parastatals can be enhanced.


102 See The Centre for Governance & Development Page 6. A well-run factory by global standards should be able to run a minimum of 22 Hours without shutting down. For such a requirement to be fulfilled, factories must perform regular maintenance. Otherwise they experience a lot of breakdowns. The Global FTE is 91.7% whilst Kenyan Sugar Companies manage an average of 57%.

103 See Kiarie, Mwaura 2007 Page 10.
4 Summary

The poor performance of the sugar industry has negatively impacted the Kenyan economy, as evidenced by budgetary burdens. Although the initial objective of the sugar industry was to foster regional development and lead to the provision of self-sufficiency in sugar production, it has not lived up to this legacy. Weak governance structures such as opaque board nomination processes, fraudulent transactions, poor remuneration and overlapping regulations have led to inefficiencies in the industry. Unless the current regime governing parastatals is overhauled and parastatals are put on completely new corporate governance architecture, they will continue to be a burden to the public.

In the government’s pursuits to find solutions, the thesis has highlighted that the much sought after privatization will not necessarily bring efficiency gains unless governance problems are addressed before hand. Furthermore, the adoption of the German model of corporate governance might not be a viable option given the limitations of legal transplants. Given these constraints, there is need to strengthen parastatal boards as they are in the one-tier system. In so doing, Kenyan courts might apply objective standards in accessing directors’ liability. Parastatals must also introduce audit committees to strengthen communication with the internal audit department. A perhaps more imperative step lies in the streamlining of multiple regulations to give parastatals more autonomy and accountability. This is also goes in hand with contemporary industrial imperatives which both the SCA and Companies Act do not provide a good basis for. This will require the scrapping of statutes of the State Corporations Act.

Finally, procurement provides an opportunity for the participation of locals in supply and contracting processes but it equally provides openings for corruption. Future research should focus on the PPOA (Public Procurement & Disposal Act) and its correlation to corporate governance. From the review of the agency theory, it is evident that the mechanisms for corporate control such as take-over and insolvency threats present in public listed companies lack in parastatals. The stewardship theory does not find application too given the lack of transformational leadership. Future research could be conducted on the applicability of the stakeholder theory to parastatals.
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