Separation of Ownership and Control: A Catalyst for Corporate Failure in Kenya?

Nathan W. Wamalwa*

1.0 Introduction

The term "separation of ownership and control" typically refers to a corporate phenomenon that is attributed to publicly traded business enterprises in which the shareholders, who are frequently referred to as the residual claimants, have little to no direct control over management choices in that enterprise. Separation of ownership and control makes a distinction between those in charge of running the business, the managers, and the financiers, the shareholders or owners. As a fundamental component of corporate governance, this phenomenon has existed at least since Adam Smith's time. In *The Wealth of Nations,*[1] Smith, while writing on joint-stock companies, observed that:

> *The directors of such companies ... being the managers rather of other people's money than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own. Like the stewards of a rich man, they are apt to consider attention to small matters as not for their master's honour and very easily give themselves a dispensation from having it....*[2]

* Advocate of the High Court of Kenya. He holds a Bachelor of Laws degree from Moi university and a post-graduate diploma from Kenya School of Law. He is currently pursuing a Master of Laws (LLM) degree in Corporate and Financial Law at the University of Nairobi.

[1] See Adam Smith, *Wealth of Nations* (1st edn, Methuen & Company Limited 1776), 575.

[2] Ibid.

Jensen and Meckling acknowledge the existence of separation of ownership and control in their work by highlighting the crucial role that separation of ownership and control play in the agency theory and the use of agency cost to address the agency problem brought on by the conflict of interest.[3] The underpinning theory's is primarily the agency problem, which entails the fact that key decision-makers in an organization are protected from taking the higher risk of the decisions they make. In designing, overseeing, and bonding contracts, an organization is seen as a nexus of interconnected contracts from which agency costs emerge. Controlling agency problems during the decision-making process is crucial to preventing decision-makers from making choices that do not benefit risk-takers.[4]

This theory could also be compared with the shareholder theory, which holds that the management of a firm has a fiduciary duty to the shareholders and that they must take the interests of the shareholders into consideration while exercising their authority.

1.1 Ownership Structure

In his book, Zhuang contends that the ownership structure plays a significant role in determining the corporate governance framework of any nation.[5] This is because the ownership structure directly affects how the agency problem is addressed. Specifically, whether the main conflict is between shareholders and managers or between minority and controlling shareholders. Therefore, Zhuang identified concentration and composition as two crucial elements of company ownership structure. He contends that a company's level of ownership concentration determines the balance of power between its shareholders and managers.

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[3] Michael C. Jensen, and William H. Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs, and Ownership Structure', (1976) 3 *Journal of Financial Economics*, 305-360.

[4] Eugene F. Fama, and Jensen C. Michael, 'Separation of Ownership and Control', (1983) 26 Journal of Law and Economics, 301-325.

[5] J. Zhuang, (1999). *Some Conceptual Issues of Corporate Governance*. EDRC Briefing Notes Number 13 [Online] Available at: www.adb.org/Documents/Books/Corporate_Governance/Vol1/chapter2.pdf

1.1.1 Dispersed Ownership

Shareholding control is typically weak in dispersed ownership due to inadequate shareholder monitoring. A small shareholder, for example, is unlikely to be interested in monitoring because they would be responsible for all of the costs and only receive a small percentage of the rewards.[6] This raises the question of what might happen if all small shareholders act in this manner. In that case, managerial efforts wouldn't be monitored.

1.1.2 Concentrated Ownership

Large shareholders would be crucial in monitoring the management activities of the company when ownership of the company is concentrated. The main issue with this style of ownership, according to Zhuang, is how minority shareholders would be shielded from abuse by controlling shareholders who might act against their best interests.[7]

Second, ownership composition seeks to define the shareholders and identify those who belong to the controlling groups. On the basis of this, it is largely assumed that better overlap between ownership and control should, in fact, result in fewer conflicts of interest and, as a result, greater corporate value.[8]

1.2 Corporate Control.

Corporate control is defined as the set of rules and policies established by the management of a company to regulate its operations and effectively manage the company's resources in order to increase a company's value and maximize shareholders' returns.[9]

[6] Ibid.

[7] Ibid.

[8] C. G. Holderness, (2009). The Myth of diffuse ownership in the United States. Review of Financial Studies, 22(4), pp.1377- 1408. doi:10.1093/rfs/hhm069, available at: http://dx.doi.org/10.1093/rfs/hhm069.

[9] K. Keasey, & M. Wright, (1993). Issues in corporate accountability and governance. *Accounting and Business Research*. 23 (91a), 291-303.

Companies with effective corporate control procedures draw more investors, allowing them to optimize their capital structure by securing less expensive financing, hence maximizing returns to shareholders. The separation between control and ownership, according to Berle and Means,[10] is directly proportionate to the size of the organization and inversely related to equity ownership, thus increasing agency costs. This results in agency conflict as management starts to pursue selfish interests contrary to those of shareholders.[11] The management's general inefficiency, theft of funds, and investments in less profitable portfolios are the cause of the agency costs. Through adequate oversight and governance, corporate control practices increase a company's efficiency and effectiveness, reducing agency conflicts and aligning management's interests with those of investors in order to maximize corporate value.[12]

In Kenya, we have seen a number of banks fail, including Chase Bank, Dubai Bank, and Imperial Bank. Similar operational issues have recently occurred at the National Hospital Insurance Board, Uchumi, and Nakumatt Supermarkets, as well as Kenya Airways', continuing huge losses and constant government bailouts of Kenya Airways, among others.

2.0 Challenges of Enforcing a Strict Regime of Separation of Ownership and Control.

2.1 Agency Problem.

Adam Smith considered the separation of ownership and control to be problematic since managers in such businesses would not have the same incentives to run the company as owner-managers, leading to inefficient operations.[13] Following Adam Smith, Jensen and Meckling

[10] A.A. Berle Jr, and C. Gardiner, (1932), *The Modern Corporation and Private Property, New York,* MacMillan.

[11] Ibid (n 3).

[12] A. Shleifer, & R. W. Vishny, 'A Survey of Corporate Governance' (1997) 52 (2) Journal of Finance 737, 783.

[13] Ibid (n 1).

classified the separation of ownership and control as an agency problem.[14] In the agency model, managers are fashioned as agents and shareholders as principals. In this approach, agents seek to maximize personal utility. How to give the agent incentives to encourage behavior that will benefit the principals and shareholders is the problem. Agency analysis examines the costs associated with providing such incentives as well as the costs related to how far agents will still deviate from the principal's interests even in the presence of such incentives. Therefore, the costs associated with the separation of ownership and control are the usual principal-agent costs: the costs associated with monitoring by shareholders, the costs associated with bonding by managers, and the residual loss from the divergence of behavior (even with monitoring and bonding) from the ideal.

2.2 What is an Agency Problem?

In the broadest sense, an "agency problem" occurs whenever the welfare of one party, referred to as the "principal," depends on actions taken by a different party, referred to as the "agent." The challenge is getting the agent to behave in the principal's best interests rather than just their own.[15] When seen in this wide sense, agency problems occur in a variety of situations that go far beyond those that lawyers would expressly classify as agency relationships.[16]

In business firms, three generic agency problems arise. The first is a conflict between the business's owners and its hired managers. In this situation, the managers are the agents and the owners are the principals. The challenge is ensuring that the managers are receptive to the owners' interests rather than pursuing their own personal interests.[17]

[14] Ibid (n 11).

[15] John Armour, Henry Hansmann, and Reinier Kraakman, Agency Problems, Legal Strategies, and Enforcement (Harvard John M. Olin Discussion Paper Series, No. 644, July 2009). Available at: http://www.law.harvard.edu/programs/olin_center/.

[16] Ibid.

[17] Ibid.

The second agency problem involves the conflict between, the majority or controlling owners of the company, on the one hand, and the non-controlling or minority owners, on the other. In this situation, the non-controlling owners can be viewed as the principals and the controlling owners as the agents. The challenge is preventing the expropriation of the former by the latter. While this issue is most evident when there are conflicts between majority and minority shareholders,[18] it also arises whenever a small group of a company's owners has the power to influence choices that have an impact on the class of owners as a whole. In light of this, a species of the second agency problem may arise if minority shareholders have the power to veto specific decisions. Ordinary and preferential shareholders, as well as senior and junior creditors in bankruptcy, may experience similar problems in situations when creditors are the owners of the firm.

The third agency problem entails a conflict between the company's owners and other parties the company contracts with, such as creditors, employees, and clients. The challenge in this situation is ensuring that the firm, acting as an agent, does not act in an opportunistic manner toward these many other principals, such as by expropriating creditors, exploiting employees, or deceiving customers.

In each of the aforementioned agency problems, it is more difficult to guarantee agents' responsiveness when there are several principals, particularly when those principals have divergent objectives. Costs associated with coordination will prevent several principals from engaging in collective action.[19] These will then have two different interactions with agency problems. First, the inability of the principals to coordinate will force them to hand over more of their decision-making to agents.[20] Second, it becomes increasingly difficult to verify

[18] See, Luca Enriques and Paolo Volpin, 'Corporate Governance Reforms in Continental Europe', (2007) 21 Journal of Economic Perspectives 117, 122

[19] James M. Buchanan and Gordon Tullock, *The Calculus of Consent: Logical Foundations of Constitutional Democracy* (University of Michigan Press, 1962), 63-116.

[20] Frank H. Easterbrook and Daniel R. Fischel, *The Economic Structure of Corporate Law*, (Harvard University Press, 1996), 66.

that the agent does the most appropriate thing.[21] since principals find it harder to coordinate on a single set of objectives for the agent. Agency problems are, therefore, made worse by coordination costs between principals.

When it comes to State-Owned Enterprises (SOEs) that are publicly traded, they often take the shape of a joint-stock corporation. Due to the corporate form, there are two main agency problems that arise: (1) between managers and shareholders (which is more severe if company ownership is dispersed); and (2) between controlling shareholders and non-controlling shareholders (which is more severe if company ownership is concentrated).[22] The relative strength and dimensions of these problems will depend on how the state behaves as an owner, but they do not go away and in fact, get worse when the state holds a significant amount of stock. The state is a distinctive type of owner. It is a political and economic entity unto itself, creating a further level of agency costs that could be referred to as "agency costs of state capitalism."[23]

Listed SOEs may have various problems depending on how the state conducts itself as a shareholder. SOEs may have managerial slack and managerial tunneling if the state who is the owner takes a passive or absentee role (i.e., theft of corporate assets). On the other hand, if the state actively participates as a shareholder, this might theoretically minimize management agency problems at the expense of raising the risk of abuse by the controlling shareholder.[24]

[21] Hideki Kanda, 'Debtholders and Equity Holders' (1992) 21 Journal of Legal Studies 431, 440; Henry Hansmann, *The Ownership of Enterprise* (Harvard University Press, 1996), 39–44.

[22] Curtis J. Milhaupt & Mariana Pargendler, (2017) "Governance Challenges of Listed State-Owned Enterprises Around the World: National Experiences and a Framework for Reform," (2017) 50 (3) Cornell International Law Journal 473.
50: No. 3, Article 3. Available at: https://scholarship.law.cornell.edu/cilj/vol50/iss3/3

[23] Ronald J. Gilson & Jeffrey N. Gordon, 'The Agency Costs of Agency Capitalism Activist Investors and the Revaluation of Governance Rights' (2013) 113 Colum. L. Rev. 863.

[24] Ibid (n 21).

As a result, while the state's significant shareholder position may help to reduce managerial agency problems, it also provides a platform for corruption, political favoritism, and private benefits of control. The combination of these two layers of agency cost results in instances of alignment and misalignment between the interests of the general public and outside shareholders in listed SOEs.[25]

Shareholders and the public have a common interest in (1) raising management effort, (2) lowering managerial tunneling, and (3) preventing politicians from acting in a rent-seeking manner (from favoritism to outright corruption). However, mixed ownership also generates conflicts of interest between shareholders and citizens with regard to other dimensions, such as; (1) "policy channeling," which is the pursuit of social welfare or other non-financial policy objectives by governments through ownership of SOEs,[26] favouring citizens but not shareholders; (2) The awarding of subsidies to SOEs, which may interfere with the level playing field between SOEs and private businesses and restrain competition by favouring shareholders—not necessarily citizens—who pay for these subsidies; and (3) the state's appropriation of unequal financial benefits (which benefits citizens over shareholders, at least temporarily).

A multi-step process is involved in analysing the costs of the separation of ownership and control, including (1) articulating societal goals, (2) determining how managerial behaviour affects those goals, and (3) assessing institutional arrangements in terms of how they affect managerial behaviour and at what cost. In general, there are two causes for management behaviour that deviates from the ideal. The first is that managers may not be motivated to do so, which is also known as the moral hazard problem. The second is that managers might not be

[25] Ibid.

[26] See Curtis J. Milhaupt & Mariana Pargendler, RPTs in SOEs: *Tunneling, Propping and Policy Channeling, in The Law and Finance of Related Party Transactions Transactions* (Luca Enriques & Tobias Tro¨ger eds., forthcoming), Stanford Law and Economics Olin Working Paper No. 517, Stanford Public Law Working Paper, European Corporate Governance Institute (ECGI) - Law Working Paper No. 386/2018, Available at SSRN: https://ssrn.com/abstract=3119164.

able to do it (that is, managers may be incompetent). This is sometimes called the adverse selection problem.[27]

3.0 The Legal and Regulatory Framework on Corporate Governance in Kenya: An Overview.

In terms of listed firms, security exchanges are essential to corporate regulations that strive to maximize efficiency. In Kenya, the regulatory agency in charge of making sure corporate governance principles are followed is the Nairobi Securities Exchange (NSE), which was established to address any shortcomings that may arise. Although the NSE has largely succeeded in achieving its goals, a number of the NSE-listed companies continue to face fiscal and control difficulties as a result of dispersed ownership structures brought on by the public offering of shares, high debt levels as a result of rising agency costs, and corporate control failures as a consequence of inadequate monitoring.[28]

3.1 The Constitution

The Kenyan Constitution, which is the country's supreme law, contains a number of provisions that support corporate governance in the administration of businesses and other entities. First, good corporate practices are encapsulated in article 10 of the Constitution of Kenya which provides for the national values and principles of governance that are binding to the state corporations and also private entities.[29]

3.2 The Companies Act 2015

This Act, which was signed into law on 11th September 2015 and came into force on diverse dates thereafter, modernizes Kenyan company law. Without a doubt, it is a culmination of years of efforts to transform Kenyan company laws.[30]

[27] Ian, Ayres and Peter, Crampton (1994), 'Relational Investing and Agency Theory', (194) 15 Cardozo Law Review 1033.

[28] R. M. Kiruri, (2013). The effects of ownership structure on bank profitability in Kenya. *European Journal of Management Sciences and Economics,* 1(2), 116-127.

[29] The Constitution of Kenya, 2010, Article 10(2).

[30] The Companies Act No 17 of 2015.

The most notable manner in which the Companies Act 2015 safeguards, shareholders, against the excesses of directors include the strengthening and enhancement of the duties of directors and the enforcement of the same.

3.2.1 General Duties.

These are what were formerly referred to as the common law duties of directors. In other words, these are duties that, before September 11th, 2015, were administered in accordance with English common law.[31]

The first of these duties is the duty to act within powers, which calls for a director to behave in accordance with the company's constitution and to only use their authority for the specific purpose for which it has been granted.[32] The second duty is to promote the firm, which requires directors to behave in a manner they believe to be in the best interests of all shareholders. Third, a director has a duty to prevent instances where their interests can conflict with those of the firm. This is especially important when it comes to the exploitation of any property, information, or opportunities. It does not matter if the business may benefit from the property, information, or opportunity.[33] These duties are legally enforceable, and anyone who violates them can be sued in court.[34]

3.2.2 Specific Duties.

First, directors must ensure that their interests do not conflict with those of the company.[35] This means that if a director has any kind of interest in a transaction or agreement that the company has entered into or is about to enter into, that director has an obligation to disclose that interest to the other directors and, in the case of

[31] They are set out in sections 140 to 150 of the Companies Act 2015.

[32] Companies Act 2015, section 142.

[33] Companies Act 2015, section 146.

[34] Companies Act 2015, section 148.

[35] Companies Act 2015, section 151.

a public company, to the company's shareholders. Second is the duty to obtain shareholders' approval before entering into certain transactions.[36]

3.3 The Capital Markets Act[37]

The Capital Market Act, Cap 485A[38] establishes the Capital Markets Authority (CMA).[39] The Act gives the CMA power to establish regulations aimed at enhancing corporate governance by Kenyan publicly listed companies. These companies are required to observe the CMA Guidelines.

To ensure accountable and responsible business operations among the listed businesses, the Capital Market Authority of Kenya (CMA) has set rules and regulations on governance practices. Although there has been some reasonable acceptance of corporate governance practice due to NSE and CMA's collaboration, it is still not widely used.

3.4 The Code of Corporate Governance Practices for Issuers of Securities to the Public 2015.

For the purpose of ensuring proper management, the code outlines the corporate governance standards for boards of directors. It emphasizes that excellent corporate governance is essential to promoting efficient and effective use of limited resources, improving accountability and performance of those charged with managing corporations.[40]

3.5 Mwongozo- The Code of Governance for State Corporations.

Mwongozo was released in 2015 as part of the parastatals reform agenda with the goal of ensuring the efficient, effective, and sustainable use of public resources while taking into consideration the evolving

[36] Companies Act 2015, section 158.

[37] Cap 485A, Laws of Kenya.

[38] Sections 11(3) (v) and 12.

[39] Chapter 5.

[40] See *The Capital Markets* Act Cap 486A: Guidelines on Corporate Governance Practices by Public Listed Companies in Kenya. Gazette Notice No. 3362.

requirements of society.[41] It was created in order to address challenges with state corporations such as political interference and the Board's incompetence. The Code was created to help in establishing best practices for corporate governance in state corporations. Mwongozo addresses issues relating to the efficacy of the board, good corporate citizenship, accountability, internal controls, risk management, transparency and disclosure, and ethical leadership.[42]

3.6 The Code of Corporate Governance for Listed Companies 2016

This Code does not bind all companies in Kenya, but only those public companies whose shares are listed at an approved securities exchange. In order to increase the value of the shareholders' investment in the company, the Code of Corporate Governance for Listed Companies 2016 provides several recommendations and instructions on how boards of directors of corporations should handle their shareholders.[43] This Code does not, however, bind companies in general, and it is still up for debate as to whether or not shareholders can enforce it in court against irresponsible directors.

3.7 Nairobi Securities Exchange (NSE) Regulations

The Nairobi Securities Exchange (NSE) was initially registered as the Nairobi Stock Exchange under the Societies Act (1954), but later changed its name. The CMA has granted the NSE authorization to provide a trading platform for securities. The oversight of the trading companies is also necessary. It is also required to oversee the trading companies. Even after companies meet the qualifications for listing on the NSE; they are still required to observe some rules and regulations such as the NSE Market Participants (Business Conduct and Enforcement) Rules, 2014.[44]

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[41] Mwongozo, The Code of Governance for State Corporations, 2015, 7.

[42] Ibid.

[43] See, Guidelines 2.1.1.(a), (b) and (c).

[44] Nairobi Securities Exchange Market Participants (Business Conduct and Enforcement) Rules.

However, some companies registered at the NSE continue to perform poorly and display fundamental weaknesses. While some of them are on the verge of failing,[45] others have already collapsed. The recent failure of Uchumi Supermarket Imperial Bank, Dubai Bank, and Chase Bank, as well as Kenya Airways' ongoing poor performance, among others, have somewhat undermined the public's confidence in the NSE's ability to regulate corporations. There is active debate as to whether the failure was caused by a lack of control, financial distress, ownership attributes, or a combination of these factors.

4.0 Collapse of Companies in Kenya

4.1 Dubai Bank.

On August 14, 2015, Dubai Bank Kenya Limited (DBKL, "Dubai Bank") was placed under statutory management by the Central Bank of Kenya (CBK), and Kenya Deposit Insurance Corporation (KDIC) was appointed as the receiver-manager in accordance with the 2012 Deposit Insurance Act.[46] Concerns with the bank's functioning had been brought up. The late Jacob Juma, one of its customers, raised several critical issues. Jacob Juma alleged many instances of fraud against Dubai Bank in a letter dated March 17, 2015, and submitted to the CBK. However, its downfall was a progressive one, heavily attributed to egregious violations of the banking laws by its directors.

On August 24, 2015, KDIC presented a report to the CBK on Dubai Bank's financial position, stating that it was beyond recovery and that liquidating the bank was the best practical course of action given its dire conditions.[47] It was revealed that the bank's daily cash reserve ratio was being breached because of its capital and liquidity challenges. Ultimately, the bank was unable to meet its financial obligations as

[45] Dominic, O. O., & Memba, F. (2015). 'Effect of Corporate Governance Practices on the Financial Performance of Public Limited Companies in Kenya' (2015) 3 (1) International Journal of Management and Commerce Innovations 122, 132.

[46] Section 54.

[47] Robert N. Gathaiya; 'An Analysis of Issues Affecting Collapsed Banks in Kenya from year 2015 to 2016' International Journal of Management and Business Studies. Available at <http://www.ijmbs.com/Vol7/73/1-robert- n-gathaiya.pdf> Accessed 16 July 2022.

required by the Banking Act,[48] which forced the CBK to close it down. There were a number of factors contributing to this, including among others, failure to maintain adequate provisions for non-performing loans, and poor corporate governance.

Following the receivership of Dubai Bank, one of the bank's largest depositors, Richardson and David Limited, filed a lawsuit to stop the bank's liquidation, claiming that KDIC's decision to advertise the bank's assets for sale would ultimately harm creditors and depositors because the bank would be left with no assets.

Some of the reasons for Dubai Bank's collapse and which were highlighted in the case of ***Richardson and David Limited -vs- Kenya Deposit Insurance Corporation & another***[49] include the following:

a) The Board of the DBK comprised of three (3) Directors less than the minimum 5 board members as required by the Banking Act.
b) Several unapproved and unsecured loans and other transactions entailing guarantees and overdrafts advanced to the defendants or to companies **linked to the bank's Chairperson, Mr. Zubedi.**
c) Investigations also established that the bank's Chairman, Mr. Zubedi, contravened the provisions of the Banking Act Cap 488, by being both an Executive and a non-executive director of the board and **had absolute control** over the bank's operations and affairs.
d) Suleiman Enterprises Company, M/s Africa Energy Limited, Kemu Salt Parkers Production Company, Kamp General Engineering Company, and Maestro Properties Company, **all associated with Mr. Zubedi, were beneficiaries of large questionable loans and other forms of credit.**

[48] BD Africa.com Reporter, 'Dubai Bank Kenya placed in Receivership for a Year' *Business Daily Africa* (24 August 2015).

[49] [2015] Eklr.

4.1.1 Analysis

From the foregoing, it is evident that the failure of Dubai Bank's management to follow corporate governance principles is viewed to be one of the main reasons for its collapse. The management of the said banks breached both the law governing banking operations and the rules of good corporate governance, including the role of shareholders in corporate governance, openness, and disclosure, as well as shareholder rights and key ownership functions.

The collapse was also a result of the actions of top officials who engaged in shady dealings and flagrant disrespect for the provisions of the law. The bank's board should have swiftly informed the shareholders as soon as it became aware that some of its managers were working together with prominent businessmen to defraud the bank.[50]

4.2 Imperial Bank

Only a few months after placing Dubai Bank under receivership, CBK placed Imperial Bank under statutory management on October 13, 2015, by publishing Gazette Notice Number 7715 in the Kenya Gazette Special Issue Volume CXVII - No 111. This effectively suspended the bank's banking services and prevented it from accepting any deposits or honoring customer requests for withdrawals or access to the deposited funds.[51]

Following the death of Janmohamed on September 15th, 2015, Naeem Shah, then Head of Credit, and James Kaburu, then Chief Finance Officer (CFO), were elevated to the positions of acting managing director and deputy managing director, respectively. The two managers disclosed information to the bank's board accusing the late Janmohamed of fraudulently disbursing loans totaling billions of shillings to close friends and business associates while completely ignoring the institution's internal lending policies and prudential

[50] Jacob Owuor Ogola et al, 'The Effect of Corporate Governance on Occurrence of Fraud in Commercial Banks in Kenya' (2016) 4 (7) The International Journal of Business & Management 1.

[51] Ibid.

guidelines and routinely concealing the transactions in the books of accounts by coercing, intimidating, and threatening the CFO to come up with inventive accounting techniques to avoid the board's scrutiny.[52]

Alnashir Popat, the Chairman of Imperial Bank, called an urgent board meeting on September 25, 2015, in reaction to the Shah and Kaburu's accusations. The bank's board assigned the chairman of the audit committee to conduct an inquiry into the alleged fraud, after which the directors would request a meeting with the Governor of the Central Bank to brief him on their findings. On October 2, 2015, the board also hired an independent external forensic advisor after internal inquiries proved to be very slow and with preliminary findings implicating senior officers of the bank. Therefore, it was only prudent to hire an external investigator.[53]

The forensic auditors from London, FTI Consulting, were engaged on October 5, 2015, and they arrived the following day. The former group managing director and accomplices within and outside the bank, including some employees at CBK, had been operating a scheme of illegal and fraudulent disbursements that was operational for several years and cost the bank approximately 380 million dollars in custodial fees, according to the FTI Consulting audit, which found discrepancies between the actual figures of overdrafts, unsecured loans, deposits, and investments and those previously reported to the bank's board.[54]

The investigations revealed a number of debtors who had defaulted on their loans before Imperial Bank went under. Investigations also revealed that the directors awarded themselves huge dividend payments with complete disregard for the bank's fragile financial status. They failed to first consider the performance of the bank before they paid themselves huge perks.[55]

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[52] Dominic Wabala, *"How Imperial Bank fraud was discovered"* The Star (15 February 2016)

[53] Ibid.

[54] Ibid.

[55] Dominic Wabala, *'CBK, Imperial Bank staff colluded in fraud Report'* The Star (12 February 2016)

4.2.1 Analysis

Poor corporate governance standards led to the collapse of Imperial Bank of Kenya Limited, which resulted in substantial losses for shareholders and the loss of depositors' access to their money as the bank was in receivership. Weak corporate governance was evident in the following areas. Firstly, the board size, composition, and remuneration. The board's effectiveness and growth are dependent on its composition and size, hence the need to have the right size and composition. At the time of its collapse, Dubai bank had only three directors as opposed to the required minimum of five directors thereby compromising its oversight and monitoring role.

Secondly, in both banks, conflict of interest was flagged. The Managing Director of Imperial Bank, the late Janmohamed, was the Founder, the Chairman of the Board as well as the principal shareholder. A position he used to run a plan of fraudulent and unlawful money transfers that affected the bank. The Chairman of the Dubai Bank served as both an executive and a non-executive director of the board. Due to the concentration of power in one person in these situations, possibilities for conflicts of interest are created. In both cases, we see companies' friends and relatives of the two chairmen being the main beneficiaries of large questionable loans and credits and their involvement in conspiracies, fraud, and theft of funds.

4.3 Uchumi Supermarket

The Uchumi supermarket, which had been in business for more than 30 years, was declared bankrupt in June 2006. The board of directors resolved that the company stops operations and was later placed under receivership. In the same vein, the Capital Markets Authority (CMA) suspended the listing of the troubled supermarket on the Nairobi Stock Exchange (NSE). Following a framework agreement between the Kenyan government, suppliers, and holders of debentures, the company was revived and began operating on July 15, 2006, under interim management and a specialized receiver manager (SRM). The firm hired Dr. Jonathan Ciano, the former CEO of Uchumi Supermarket, as a specialist receiver manager in 2006.

In an effort to turn around the retail chain, restructuring was done and some managers were removed. The company reported profits in each of the next three fiscal years after management and staff put in a lot of effort to turn around the company as a result of restructuring.[56] The lending banks in turn lifted the company's receivership in 2010 and the company was successfully re-listed in the Nairobi Securities Exchange on 31st May 2011. The retail chain enjoyed profits until the year 2015 when it fell sick and was bedridden again.[57]

Apart from having challenges with several of its indebted suppliers, the retailer also engaged in egregious misconduct, conflict of interest, and failed to make payments to its creditors. Indeed, companies would emerge out of nowhere and still be permitted to supply goods to the retail chain without following the due processes, a factor that resulted in having uncompetitive prices.[58]

The board of directors and managers were also accused of making investments that were not profitable and this became one of the premises upon which the directors of Uchumi were charged with the offence of conspiracy to defraud. In ***the Republic versus Chris Kirubi and 13 others*** (unreported), part of the board of directors of Uchumi was charged with the offence of conspiracy to defraud the supermarket chain and a second charge of breach of public trust. The criminal charges were a result of the board's resolution to sell the Aga Khan Walk branch property.[59]

[56] Green Belt Communications, (2016). Company History - Uchumi Supermarkets. Retrieved July 22, 2022, from Uchumi Supermarkets: http://kenya.uchumicorporate.co.ke/aboutus/history.

[57] M. Karanja, (2016, March 21). Business News. Retrieved July 29, 2022, from Citizentv: http://citizentv.co.ke/business/uchumi-closes-five-more-branches-sacks-253-employees119159/#

[58] IPSOS, Kenya, (2016, July 2). http://www.ipsos.co.ke/NEWBASE_EXPORTS/Nestle/150614_Sunday%20Nation_10_9ab55.Pdf

[59] Ibid.

By the time Uchumi was experiencing governance challenges, the Capital Markets Authority had published and gazetted Guidelines on Corporate Governance Practices by Public Listed Companies in Kenya. The retailer was at the time a public listed company and the guidelines applied to it. The prosecution, however, did not lend any evidence to show that the board flouted these guidelines. Even though the prosecution's case was based on the premise that the supermarket was a parastatal, the evidence produced in court proved otherwise since the government with 26 percent shareholding only held a minority interest in Uchumi. The court, therefore, held that the supermarket chain was not a parastatal and thus the board did not breach the public trust.

4.3.1 Analysis

A common characteristic of public companies, such as Uchumi, is the fact that they have a large number of small owners. In this case, there are two distinct challenges that emerge. First, despite the fact that shareholders often have ultimate residual control rights in the form of votes, they are typically too small and numerous to actively exercise control on a daily basis. As a result, they delegate control to the board of directors, which then delegates it to management. There is, therefore, a separation of ownership and control.

Secondly, as already pointed out dispersed shareholders have little or no incentive to monitor management because of high agency costs. Each shareholder, therefore, joy rides in the hope that other shareholders will do the monitoring. Regrettably, there will be absolutely no monitoring because all shareholders think the same way. Because of the separation of ownership and control and the lack of monitoring, there is a danger that the managers of a public company will pursue their own goals at the expense of those of shareholders. Among other things, managers may overpay and give themselves extravagant perks and may seek to entrench themselves.

5.0 Conclusion.

The collapse of the companies discussed above is firmly ascribed to the failure of corporate governance mechanisms. The failures are illustrative of the fact that managers are usually self-interested, risk-averse, and committed to pursuing their own interests at the expense of those of shareholders. Tighter corporate control mechanisms are needed to sanction managers and reduce agency costs.