

**A CRITICAL ANALYSIS OF TANZANIAN CORPORATE
GOVERNANCE REGULATION AND ITS IMPACT ON FOREIGN
INVESTMENT**

By

JUDITH V. NYAKI

Student Number: 3280180

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KEYWORDS

Corporate governance, foreign direct investment (FDI), company, legal and regulatory framework, the DSE listing requirements, cross listing, capital markets, company director(s), shareholder, stakeholder



DECLARATION

‘I declare that **A critical analysis of Tanzanian corporate governance regulation and its impact on foreign investment** is my own work, that it has not been submitted before for any degree or examination in any other university, and that all the sources I have used or quoted have been indicated and acknowledged as complete references’.

Nyaki Judith V

Signed

15 May 2013



DEDICATION

To my beloved husband Elias Samson Mtibilo and my daughter Ellen



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ABBREVIATIONS

CACG Commonwealth Countries Association of Corporate Governance

CEO Chief Executive Officer

CMA Capital Markets Authority

CMSA Capital Markets and Securities Authority

DSE Dar-es-Salaam Stock Exchange

EAC East African Community

FDI Foreign Direct Investment

IFC International Finance Corporation

IoDT Institute of Directors of Tanzania

JSE Johannesburg Stock Exchange

MEMARTS Memorandum and Articles of Association

NEC National Executive Committee

NSE Nairobi Stock Exchange

OECD Organisation for Economic Co-operation and Development

SADC Southern African Development Community

UK United Kingdom

US United States

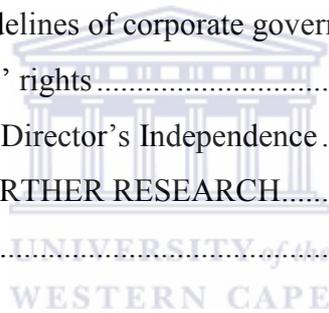


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CHAPTER ONE

INTRODUCTION

Corporate governance is the system by which companies are directed and controlled.¹ The function of corporate governance is to ensure that the directors discharge their duties effectively, responsibly, with fairness and transparency and to make sure that they are accountable for their acts.²

Theories underlying the development of corporate governance and the area it covers are not new concepts as this date back to the 19th century.³ However, corporate governance attracted more attention in the last few decades due to various crises such as the East Asian crisis of the late 1990's and various other fraudulent activities in the corporate world.⁴ Another example is the fraud case which resulted in 25 years in jail for the former WorldCom boss Bernard Ebbers for his part in the fraud which caused \$11billion collapse of the company,⁵ and reports of overly-exuberant compensation arrangements at United State (US) insurance company Fannie Mae, in which large rewards were provided to company executives despite the company failure and sub-standard company performance.⁶

¹ Cadbury A *Codes of best practice: Report from the Committee on Financial Aspects of Corporate Governance*. (1992).The term corporate governance and its importance are dealt with in chapter two.

²Cassim FHI et al *Contemporary Company Law* 2ed (2012) 473.

³Mongalo T 'The Emergence of Corporate Governance as a Fundamental Research Topic in South Africa' (2003)120 *SALJ* 179.

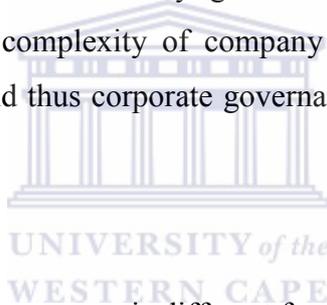
⁴ Kregel J 'Why don't the bailouts work? Design of a new financial system versus a return to normalcy' (2009)33. *Cambridge Journal of Economics* 653 available at <http://cje.oxfordjournals.org> (accessed 27 August 2012).

⁵McConvill JA 'Positive Corporate Governance' (2005) 16 *Germany Law Journal* 1778 available at <http://ssrn.com/abstract=835185> (accessed 27 August 2012).

⁶ Bebchuk L & Fried J 'Executive Compensation at Fannie Mae: A Case Study of Perverse Incentives, Non-Performance Pay, and Camouflage' (2005) 30 *Journal of Corporate Law* 810.

The collapse of many companies in the last decade was as a result of much power that was vested in directors without checks and balances from other company stakeholders. Directors were executing their duties without any control and the board was unable to restrict them because of the poor corporate governance which empowered a director who is also a Chief Executive Officer (CEO) to be the chairman of the Board.⁷

The recent collapse of big companies as a result of poor corporate governance has raised the concern of investors who finance the firms.⁸ The investors are becoming conscious about their investment capital and the trend of the corporate business making it more difficult for direct control of company business by the shareholders. This was facilitated by globalization which has increased the volume as well as the complexity of company business making the external control more difficult and thus corporate governance is inevitable in the modern world.⁹



The modern corporate governance is different from those experienced in the mid-nineteenth century because of changes in modern corporate governance principles such as the requirement to have executive and non-executive directors, the establishment of remuneration committees which determine the directors' remuneration and so many other issues.¹⁰ Modern corporate governance is more diversified than the traditional one. Whilst under the traditional corporate governance the main objective was to pursue the interests of the shareholders in the modern era the company in order to achieve long term profit; should also look

⁷ Coyle B *Corporate Governance* (2003) 8-10.

⁸ Naidoo R *Corporate Governance: An essential for South African Companies* (2009) 7 &35. The collapses of big company such as LeisureNet in South Africa in 2002 raise a big concern to the credit providers and investors. During the inquiry the Delloite & Touche partner Lester Cotten told the inquiry commission that no bank or credit committee would have relied on the company's financial statement to determine whether the company had financial commitment.

⁹ Mongalo T (2003)179.

¹⁰ Mongalo T (2003) 179.

at the interest of other stakeholders like employees, consumers and the community at large.¹¹

The global development of corporate business in the 20th century where there is a separation between ownership and control of the company, made the requirement of reviewing corporate governance inevitable. For example there exists a possibility of the shareholders from one country owning shares in a company listed in another country or continent and therefore focus has been shifted on how to govern the business in such circumstances.

The developed economies have been reviewing their corporate governance laws to make sure that they are in a position to control the corporate business in order to attract more capital from investors.¹² The developing economies need investors to invest in their capital markets. Corporate governance has a great impact on the efficiency of stock markets as the investors predict the future performance of a company by looking on the stability of stock prices. The former US Securities Exchange Commissioner once said:

‘[I]t serves us well to remember that no market has a divine right to investors’ capital...if a country does not have a reputation for strong corporate...practices capital flow elsewhere...All enterprises in that country regardless of how steady a particular company’s practices may suffer the consequences. Markets must now honour what they perhaps, too often, have failed to recognize. Markets exist by the grace of investors. And it is today more empowered investors who will determine which companies and which markets will stand the test of time and endure the weight of greater competition.’¹³

Corporate governance thus requires a legal and regulatory framework which is robust in order to attract investors to invest their capital in a company or organization. This development of corporation and the complexity of markets make the requirement of good corporate governance inevitable in the modern

¹¹ King III emphasised and focused on the sustainability of the company. It recommended that the company when doing its primary obligation of making profit should also make sure that the company business is sustainable by considering other stakeholders and environment.

¹² The development of various codes of corporate governance such as the United Kingdom (UK) Combined Code, the US Sarbanes-Oxley Act, the South African King Report and many others.

¹³ Quoted in Naidoo R (2002) 4.

corporate business. There is evidence that countries with good corporate legal rules are more developed in capital markets and enjoy the flow of investors funds compared to those with poor corporate regimes. For example La Porta et al¹⁴ presented data that illustrate the vast differences across countries in legal rules aimed at investor protection and the quality of the enforcement of these rules. In countries with strong legal protections, capital markets are larger since, as La Porta et al argue, potential investors are protected against expropriation by insiders.¹⁵ These differences of protection of investors are reflected in both the legal rules and the quality of their enforcement.

The preamble to the Organisation for Economic Co-Operation and Development (OECD) Principles of Corporate Governance provides that: 'If countries are to reap the full benefits of the global capital market, and if they are to attract long-term 'patient' capital, corporate governance arrangements must be credible and well understood across borders'.¹⁶ This means that the ability of countries to attract foreign capital is affected by their systems of corporate governance and the degree to which corporate management is compelled to respect the legal rights of lenders, bondholders, and non-controlling shareholders.

The foregoing makes it imperative to analyse and evaluate the extent to which the Tanzanian legal and regulatory framework has provided for corporate governance issues. Despite the presence of such a regulatory framework, there remain some inherent grey areas which cause the low level of flow of Foreign Direct Investment (FDI), small number of listed securities and small number of local and foreign investors¹⁷ in the country despite an abundance in natural resources and investment opportunities.

¹⁴ La Porta R et al 'Legal Determinants of External Finance' (1997) 52 *Journal of Finance* 1113.

¹⁵ La Porta R et al (1997) 1131.

¹⁶ OECD Principles of Corporate Governance, (OECD, April 1999) available at <http://www.oecd.org/database/32/18/31557724/> (accessed 20 June 2009). See also Ruda-Sabater EJ. 'Corporate Governance and the Bargaining Power of Developing Countries to Attract Foreign Investment' (2000) 8 *Corporate Governance* 117-124.

¹⁷ Compared with other countries in SADC and EAC region like South Africa and Kenya respectively Tanzania's capital markets are still small whereby there are only seventeen

1.1 PROBLEM STATEMENT

Good corporate governance attracts investor's capital flow and influences the growth of any country's economy. Despite the existence of many underdeveloped resources in the country and established corporate governance laws and regulations,¹⁸ Tanzania is still experiencing relatively low flow of FDI and small securities market compared to Kenya and South Africa which are fellow members of the East African Community (EAC) and the Southern African Development Community (SADC) respectively.¹⁹ The Dar es Salaam Stock Exchange (DSE) like other developing countries' stock exchanges was formed during the privatisation process and there were no comprehensive and pro-active strategies to deal with post privatisation investment contributing to underdevelopment and stagnation of DSE to date.²⁰ There are only seventeen companies listed on the DSE and among them are parastatal companies listed for privatisation. Currently, there are sixty two companies listed on the Nairobi Stock Exchange (NSE)²¹ but only three companies are cross listed with DSE.²² In the meantime, there is no company cross-listed between DSE and the Johannesburg Stock Exchange (JSE)²³ whereas there are some companies listed on the JSE which have cross listed with countries like Namibia and Mauritius which are members of SADC.²⁴

companies listed in Dar es Salaam Stock Market (DSE). South Africa's securities markets are developed whereby in Johannesburg Stock Exchange (JSE) there are companies cross listed with London Stock Exchange (LSE) and with SADC countries like Namibia, Botswana and Mauritius stock exchanges. In case of Kenya it is the leading economy in Eastern Africa and its capital markets were developed back during the British colonialism.

¹⁸ Companies Act No. 12 OF 2002, and Capital Markets and Securities Act of 1994 and other regulations.

¹⁹ The two regional blocs have concluded free trade area among their member states which could be an opportunity of flow of foreign investment in Tanzania. The free trade area encourages cross border business as well as cross border investment.

²⁰ Olweny1TO&Kimani D 'Stock Market Performance and Economic Growth: Empirical Evidence from Kenya using Causality Test Approach' (2011) *Advances in Management & Applied Economics* 180, they concluded that most of stock markets especially those in the developing countries face constraints which result in serious implications such as illiquidity, absence of activities and absence of well developed investor base.

²¹ This information was retrieved from <http://www.cma.ke.org>(accessed 4 October 2012).

²² DSE Blue Print available at <http://www.dse.ac.zaz> (accessed 4 October 2012)

²³ DSE Blue Print (available at <http://www.dse.ac.za> (accessed 4 October 2012).

²⁴ This information was retrieved from <http://www.jse.co.za/How-to-list/Main-Board/Dual-listed-companies.aspx> (accessed 27 October 2012). There are companies like Anglo Gold Ashanti Ltd which has got mining projects in Tanzania and is among the big mining companies in Tanzania

The main regulatory framework for corporate governance in Tanzania is provided under the 1992 Public Corporations Act, the 1994 Capital Markets and Securities Act, and the 2002 Companies Act, which came into force on 1st March 2006. The Capital Markets and Securities Act states that the guidelines on corporate governance practices by public listed companies have been developed. Despite established corporate governance bodies and the Capital Markets and Security Act in Tanzania there is still a low flow of FDI and a generally underdeveloped securities market. For instance, the 2009 Doing Business Report of the World Bank recorded that Tanzania was below the OECD average.²⁵

It seems therefore that there is a gap in the legal and regulatory framework of corporate governance in Tanzania which needs to be identified and revised in order to cope with current regional and international market competition. Therefore, this work intends to investigate those gaps on the legal and regulatory framework of corporate governance.

1.2 PURPOSE OF THE RESEARCH

The main objective of this study is to review the legal and regulatory framework of corporate governance in Tanzania with the focus on corporate governance laws and regulations. The study is intended to discuss the main legal and regulatory framework in Tanzania which plays a part in the corporate governance. The Companies Act No. 12 of 2002 will be reviewed in order to establish which corporate governance principles are provided and to what extent they are effective.

The capital markets and securities laws, guidelines on corporate governance in Tanzania with a focus on the listing requirements and other regulations applied at

but its shares are not listed in DSE while they are listed as primary and secondary securities in the JSE and Namibian Stock Exchange respectively.

²⁵ The World Bank & the International Finance Corporation (IFC) 'Doing business in Tanzania (2009) available at <http://www.doingbusiness.org> (accessed 4 April 2013).

the DSE will also be reviewed in order to establish their effectiveness in attracting investors to the market.

Given the comparative value of South Africa and Kenya in SADC and EAC respectively, this work will also discuss the legal and regulatory framework of corporate governance in Kenya and South Africa and compare with those in Tanzania in areas such as shareholders rights; stakeholder's right; board control and effectiveness and the effectiveness of compliance. Such comparative analysis is done in order to single out areas of focus in legal and regulatory framework in corporate governance law such as companies' law and stock market and security laws in Tanzania.

1.3 RESEARCH QUESTIONS

The following shall be used as research questions in exploring relevant information to meet the objectives of the study.

- i. How and why should the Tanzanian legal and regulatory framework address corporate governance issues?
- ii. Is the Companies Act of 2002 clear or unclear in addressing corporate governance matters?
- iii. Are the Capital Markets and Securities Act of 1994, DSE listing requirements and regulations clearly addressing the issues pertaining to corporate governance?
- iv. Can the South Africa and Kenyan regimes on corporate governance be of assistance in reviewing the Tanzania corporate governance laws?
- v. What kind of legal machinery should be adopted for proper, sufficient and expeditious restructuring of corporate governance in Tanzania?

1.4 SIGNIFICANCE OF THE RESEARCH

The study will point out and analyse the weakness and gaps in company law, securities law and other laws on corporate governance in Tanzania. Such analysis

will help to scope out areas which require improvement and hence help to foster flow of FDI as well as develop the securities market.

The study will also examine the legal and regulatory framework for stock markets which was established for the purpose of privatisation and suggest corrective measures in facilitating the development of stock markets in Tanzania.

Besides, this work will make a comparison between corporate regimes in Tanzania with those in South Africa and Kenya which are relatively more developed. Such comparative analysis will single out areas of focus in legal and regulatory framework in corporate governance law such as companies' law and stock markets review in Tanzania. The implementation of research findings is expected to give incentives to foreign investors through transfer of new technologies, managerial skills, and stimulation in the establishment of micro, small and medium enterprises, hence facilitate economic growth of the country.

1.5 RESEARCH METHODOLOGY

The research is of the qualitative type which involves study of books, electronic/internet sources, journal articles, theses and dissertations, decided cases and legislation. The study is principally scrutinising and evaluating the literature relevant to legal and regulatory framework of corporate governance in Tanzania. The analysis is done from the perspective of corporate governance by looking at how corporate laws and regulation play a role in corporate governance.

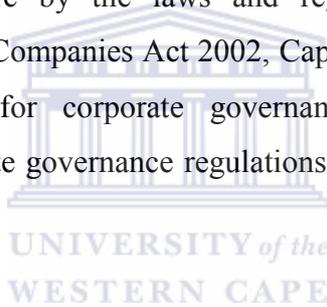
The comparative study is also made with Kenya and South Africa by scrutinising their legal framework on corporate governance. The two countries are members of SADC and EAC respectively and Tanzania is a member of both regional economic communities. Therefore the comparative study is important in assisting to review the Tanzanian corporate governance laws taking into account their level of development in the region and their relationship with Tanzania.

1.6 THE FRAMEWORK OF THE RESEARCH PAPER

The dissertation is organised into chapters as outlined below:

In Chapter 2, the general overview of corporate governance is discussed, the definition of the term corporate governance, importance of corporate governance and the development of corporate governance code are discussed.

In chapter 3 the analysis and evaluation of Tanzanian corporate governance regime is discussed. The evolution of corporate governance in Tanzania since independence to date is discussed. Corporate governance of the state owned corporations which was a major corporate structure until 1990s when privatisation took place is discussed in this chapter. The current corporate regime is also discussed where by the laws and regulation underlying corporate governance such as the Companies Act 2002, Capital Markets and Securities Act 1994 and guidelines for corporate governance are also discussed. The effectiveness of corporate governance regulations in Tanzania also forms part of this chapter.



In chapter 4, given the relationship existing between Tanzania and South Africa and Kenya in the region the comparison of the two countries legal system in corporate governance with that of Tanzania is undertaken. The main reason is to establish the Tanzanian legal and regulatory frameworks on corporate governance and its effectiveness compared with developed economies in Africa like South Africa, and Kenya as the leading economy in East Africa.

In Chapter 5, findings of the research, conclusion, recommendations and matters for further research are presented.

CHAPTER TWO

GENERAL OVERVIEW OF CORPORATE GOVERNANCE

2.1 INTRODUCTION

The need for good corporate governance in today's world is inevitable²⁶ due to the globalisation of economies, financial and investment markets which lead to the increasing convergence of originally separate initiatives in corporate governance.²⁷ During the current globalisation era, the traditional corporate governance laws and regulations are becoming increasingly challenged by circumstances and events which have an international impact.²⁸ The institutional investors for instance do insist on high standards of corporate governance in all companies before investment.²⁹

Public attention through high profile corporate scandals and collapses has forced governments, regulators and boards of corporations to carefully reconsider fundamental issues of corporate governance as essential for public economic interest.³⁰

Experiences of public sector reform and privatisation in many countries have set demands on state owned enterprises and government agencies to address

²⁶ See Commonwealth Countries Association for Corporate Governance (CACG) guidelines (1999)1.

²⁷ Coffee JC 'Dispersed Ownership: The Theories, the Evidence, and the Enduring Tension Between "Lumpers" and "Splitters"' (2010)5 *ECGI Working Paper Series in Law* No.144/2010 electronic copy available at <http://ssrn.com/abstract=1532922> (accessed 7 February 2012).

²⁸ Keasey K, Thomson S & Wright M 'Introduction: the Corporate Governance Problem Competing Diagnoses and Solution' in Keasey K et al (eds) *Corporate Governance* (1997) 7-12.

²⁹ Keasey K, Thomson S & Wright M (1997) 7-12.

³⁰ For instance the enactment of Sarbanes Oxley legislation in the United States which introduced many new requirements in the New York Stock Exchange listing rules after the collapse of Enron & WorldCom. Major developments in corporate governance such as corporate codes were effected during the past two decades.

standards of integrity expected of the public service.³¹ Another development in corporate governance is the rise of “ethical investors” requiring corporations to act in socially responsible manner in the communities in which they are operating in the areas of environment, health and safety, ethnic and community relations for their continued existence.³²

The fact is that good corporate governance practices are now becoming a necessity for every country and business enterprise, and are no longer restricted to the activities of public-listed corporations in advanced industrial economies; the developing countries should also adopt them in order to attract more investors from developed economies.

This chapter will examine the theoretical framework of corporate governance, definition of the term corporate governance from various authors and the importance of corporate governance.



2.2 THEORETICAL FRAMEWORK OF CORPORATE GOVERNANCE

The English word *theory* was derived from a technical term in philosophy in ancient Greek. As an everyday word, *theoria*, meant ‘a looking at, viewing, beholding’, but in more technical contexts it came to refer to contemplative or speculative understandings of natural things, such as those of natural philosophers, as opposed to more practical ways of knowing things, like that of skilled orators or artisans.³³

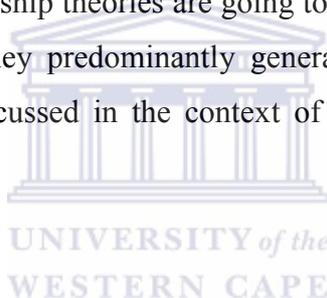
³¹ For example the OECD and CAGC guidelines provides for both principles to be followed by public and private companies. The King III Report on Corporate Governance for South Africa also applies to all companies and organizations.

³² See King ME A *Report on Corporate Governance* (2009) (King III) principle 1.2.

³³ See Encyclopaedia dictionary available at <http://www.en.wikipedia.org/.../Encyclopaedia> where the word ‘theory’ was used in Greek philosophy, for example, that of Plato. It is a

The word has been in use in English since the late 16th century.³⁴ Modern uses of the word ‘theory’ are derived from the original definition, but have taken on new shades of meaning, still based on the idea that a theory is a thoughtful and rational explanation of the general nature of things. Neuman³⁵ defines a theory as a system of interconnected ideas that condense and organize knowledge about the world.

There are many theoretical perspectives which are used to explain corporate governance. The best known theories are: transaction cost theory, agency theory, resource dependence theory, managerial hegemony theory, class hegemony theory, stakeholder theory and stewardship theory. For the purpose of this study only agency and stewardship theories are going to be discussed. The two theories have been chosen as they predominantly generate the principles of corporate governance that are discussed in the context of Tanzania legal framework for corporate governance.³⁶



2.2.1 Agency theory

According to Eisenhardt³⁷ the agency theory is concerned with analysing and resolving problems that occur in the relationship between principals (owners or shareholders) and their agents or top management. The theory rests on the assumption that the role of organizations is to maximize the wealth of their owners or shareholders. It has been pointed out that separation of control from ownership implies that professional managers manage a firm on behalf of the

statement of how and why particular facts are related. It is related to words such as ‘spectator’ ‘a view’ ‘to see’ literally ‘looking at a show’.

³⁴ Harper D ‘Theory’ available at www.onlineetymologydictionary.weakpedia.dictionary (accessed 14 February 2013).

³⁵ Neuman L *Social Research Methods-Qualitative and Quantitative Approaches* (5ed) (2003) 77.

³⁶ See Chapters 3 and 4 for detailed discussion.

³⁷ Eisenhardt KM ‘Building theories from case study research’ (1989) *Academy of Management Review* 532.

firm's owners.³⁸ Conflicts arise when a firm's owners perceive the professional managers not to be managing the firm in the best interests of the owners.

The agency theory holds that most businesses operate under conditions of incomplete information and uncertainty. Such conditions expose businesses to two agency problems namely adverse selection and moral hazard. Adverse selection occurs when a principal cannot ascertain whether an agent accurately represents his or her ability to do the work for which he or she is paid. On the other hand, moral hazard is a condition under which a principal cannot be sure if an agent has put forth maximal effort.³⁹

Donaldson and Davis⁴⁰ argue that managers will not act to maximize returns to shareholders unless appropriate governance structures are implemented to safeguard the interests of shareholders. Therefore, the agency theory advocates that the purpose of corporate governance is to minimize the potential for managers to act in a manner contrary to the interests of shareholders. The theory suggests that a firm's top management should have a significant ownership of the firm in order to secure a positive relationship between corporate governance and the amount of stock owned by the top management.⁴¹

The agency theory presents the relationship between directors and shareholders as a contract.⁴² This implies that the actions of directors, acting as agents of shareholders, must be checked to ensure that they are in the best interests of the shareholders. The proponents of this theory therefore believe that corporate governance is a response to the typical agency problem between investors and managers.

³⁸ Eisenhardt KM (1989) 533.

³⁹ Eisenhardt KM (1989) 535.

⁴⁰ Donaldson L & Davies JH 'Boards and Company Performance-Research Challenges the Conventional Wisdom' (1994) *Corporate Governance: An International Review* 151.

⁴¹ Mallin CA *Handbook on International Corporate Governance: Country Analyses* (2006) 116.

⁴² Stiles P & Taylor B *Boards at Work: How Directors view their Roles and Responsibilities* (2002) 52.

2.2.2 Stewardship theory

The stewardship theory is also known as the stakeholders' theory. It adopts a different approach from the agency theory. It starts from the premise that organisations serve a broader social purpose than just maximising the wealth of shareholders. Under this theory the stakeholder can be viewed as 'the end' as well as the 'means to an end.'⁴³

'The end' view of stake holders value means that everyone in a society has to be involved in the governance of the corporation. The corporation is viewed as a social institution in society. Clarke and Clegg⁴⁴ posit that 'stake holding represents a general sense of social inclusion; an economy or society in which every citizen is a valued member, everyone contributes and everyone benefits in some way'. This includes the process of corporate accountability which is reinforced and legitimised by either financial or material interest in the well-being of the corporation.

On the other hand stake holders' value can be viewed as 'means to an end.' This refers to stakeholders as an instrument to improve corporate performance and efficiency. Stakeholders are included in governance of the company on the ground that their participation will lead to an effective means to improve efficiency, profitability, competition and economic success. This view is expressed by Campbell who speculates that 'I support stakeholder theory not from a left-wing reason of equity, but because I believe it to be fundamental to understanding how to make money in business.'⁴⁵ The supporters of this theory believe that for its long term survival, corporations should serve multiple stakeholder interests rather than shareholder interests alone.⁴⁶

⁴³ Clarke T & Clegg S *Changing Paradigms: The Transformation of Management Knowledge for the 21st Century* (1998) 106-107.

⁴⁴ Clarke T & Clegg S (1998) 107.

⁴⁵ As quoted in Letza S, Kirkibride J & Sun X 'Shareholding versus Stake Holding: 'A Critical Review of Corporate Governance' (2002) *Paper presented at Queen's University Belfast International Conference for Corporate Governance: Belfast.*

⁴⁶ King III Report (2009) para2.3.

The stewardship theory holds that corporations are social entities that affect the welfare of many stakeholders.⁴⁷ Successful organizations are judged by their ability to add value for all of their stakeholders. Participation of stakeholders in corporate decision-making can enhance efficiency and reduce conflicts.⁴⁸ A firm's board of directors and its CEO, acting as stewards, are more motivated to act in the best interests of the firm rather than for their own selfish interests.⁴⁹ It is submitted that the stewardship theory of corporate governance should be adopted for the continued existence of the company.

2.3 DEFINITION OF CORPORATE GOVERNANCE

Different authors have conferred the term with both broad and narrow content. The narrow definition relates corporate governance relationship between the board of directors, managers and shareholders.⁵⁰ The supporters of this view associate corporate governance with the need to ensure the interests of the shareholder are secured in the firm's business.⁵¹ The pioneers of this view argued that when the interests of shareholders are efficiently implemented there will be a good chance for lump sum taxes⁵² hence used as a competitive symmetry.

The more broad definition of the term corporate governance encompass the way companies are controlled taking into consideration the interests of not only shareholders but also other stakeholders and society in general.⁵³ The proponents

⁴⁷ Donaldson L& Davis JH 'Stewardship Theory or Agency Theory: CEO Governance and Shareholder Returns' (1991) *Australian Journal of Management* 116.

⁴⁸ Turnbull S *Corporate governance: Its Scope, Concerns and Theories* (1997) as cited in Tricker RI (Ed.) *History of management thought: Corporate governance* (2000) ch 4.

⁴⁹ Clarke T 'Corporate governance: the State of the Art' (1993) *Managerial Auditing Journal* 5.

⁵⁰ Millstein IM 'The Evolution of Corporate Governance in the United States' Remarks to the World Economic Forum, Davos, Switzerland (February 2, 1998).

⁵¹ Allen F 'Corporate Governance in Emerging Economies' (2005) *Oxford Review of Economic Policy* 164.

⁵² See Allen F 'Corporate Governance in Emerging Economies' (2005) *Oxford Review of Economic Policy* 165.

⁵³ King III Report (2009) principle 1.1.

of this view emphasised that corporate governance is concerned with ensuring that the firms are run in such a way that society's resources are used efficiently.⁵⁴ This broad view covers the narrow view when the market is perfect and complete. In this case, if the firms pursue the interest of the shareholders then the allocation of the resources will be efficient. But with flawed markets this broad objective can potentially make all stakeholders better than focusing on the shareholder's interests only.⁵⁵ In the following paragraphs different definitions of corporate governance are examined as given by different authors.

The *Cadbury Report* defines corporate governance 'as the system by which companies are directed and controlled'.⁵⁶ The Cadbury Report's views on corporate governance focused on the internal structure of the corporation and the decision making body of the company.⁵⁷ It focus on how the board and management are controlled for the interest of the company and other stakeholders. It incorporates issues such as director's duties, shareholder protection, risk management, financial accounting and reporting.⁵⁸ In most countries this narrower definition has been adopted in discussing corporate governance.⁵⁹

The OECD Task Force defined corporate governance as:

'a set of relationships between a company's management, its board, its shareholders and other stakeholders. It also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of

⁵⁴ See Allen F (2005) 165.

⁵⁵ For instance where there are externalities such as pollution then maximizing the value of the firm is well known to cause misallocation of resources. If the firm were to use the broader view above they would change their behaviour and produce the social optimal level of pollution.

⁵⁶ See Cadbury Report (1992) para 2.5.

⁵⁷ Salacuse JW 'Corporate Governance in the New Century' (2004) *The Company Lawyer* 72.

⁵⁸ Du Plessis JJ 'Corporate Governance and the Cadbury Report' (1994) 6 *South African Mercantile Law Journal* 81-82.

⁵⁹ Salacuse JW *Corporate governance in the UNECE region* (2002) 8.

the company and shareholders and should facilitate effective monitoring, thereby encouraging firms to use resources more efficiently.’⁶⁰

From the above definition, corporate governance seeks to ensure that the rights of shareholders are protected, there is equitable treatment of shareholders, the role of stakeholders are considered in corporate business, there is disclosure and transparency as well as the board of directors is responsible and accountable.⁶¹

Gabrielle O’Donovan defines corporate governance as:

‘[A]n internal system encompassing policies, processes and people, which serves the needs of shareholders and other stakeholders, by directing and controlling management activities with good business savvy, objectivity, accountability and integrity. Sound corporate governance is reliant on external marketplace commitment and legislation, plus a healthy board culture which safeguards policies and processes.’⁶²

According to O’Donovan corporate governance is concerned with the way the company management is controlled in order to achieve the long term strategies of the company by considering interests of both shareholders and other stakeholders for the sustainability of the corporation.

The postulation which can be derived from the above definition is that corporate governance is meant for big public companies whose shares are listed in the stock markets. The challenges of economic survival can rebut this assumption because implementation of appropriate control measures, managing business risk and planning is essential for all type of companies for long term existence.⁶³

⁶⁰OECD Principles of Corporate Governance, (OECD, April 1999) available at <http://www.oecd.org/dataoecd/32/18/31557724.pdf> (accessed 20 June 2009).

⁶¹ The American Law Institute’s *Principles of Corporate Governance: Analysis and Recommendations* (1994) *St Paul Minn.* American Law Institute Publishers takes a similarly restricted view of the subject’s scope.

⁶² O’Donovan G ‘A board culture of Corporate Governance’ (2003) 6(3) *Corporate Governance International Journal* 22-23.

⁶³ Naidoo R (2002) ch 4.

A more inclusive definition of corporate governance that has been proffered is the one that creates a governance system which considers stakeholders welfare together with corporate needs and relationship with all stakeholders. It is concerned with creating a balance between economic and social goals; and between individual and communal goals. The efficient use of resources, accountability and stewardship are likely to align the interests of individuals, corporations and society.⁶⁴ It is submitted therefore, the broader definition of corporate governance should be adopted because corporations do not operate in isolation of other stakeholders. Therefore the interest of all stakeholders has to be addressed in conducting a firm's businesses.

2.4 OVERVIEW OF EVOLUTION OF CORPORATE GOVERNANCE

Corporate governance became an issue attracting international concern and debate from the early 1980s through to 1990s and continued into the twenty-first century. The phenomenon of corporate governance is not new; it has existed since the incorporation of enterprises began.⁶⁵ The recent concern and debate on corporate governance reflects the recognition of the centrality of major enterprises in allocating resources in the economy.⁶⁶ The separation of ownership and control of corporations that Berle and Means⁶⁷ highlighted lies at the heart of the debate on corporate governance.⁶⁸

Pressure on governance and on business in the corporate sector to improve corporate governance arrangement has arisen often in the context of the failure of large companies and particularly the corporate scandals taking place since the beginning of last two decades. The spectacular collapse of Enron and WorldCom

⁶⁴ The Kenyan Private Sector Initiative for Corporate Governance, 2009.

⁶⁵ Vinten G 'Enronitis- Dispelling the Disease' (2003) *Managerial Auditing Journal* 449.

⁶⁶ Lazonick W & O'Sullivan M 'Maximising Shareholder Value: A new Ideology for Corporate Governance (2000) *Economy and Society* 29.

⁶⁷ Berle A & Means G *The Modern Corporation and Private Property* (1932) as cited in Tricker RI (ed) *History of Management thought: Corporate Governance* (2000) ch 3. See also discussion in 2.5.1.

⁶⁸ Stiles P & Taylor B (2002) 51.

in the US and other companies in other countries had led to pressure and also action to change corporate governance practices.⁶⁹

The collapse of a number of large corporations and hostile takeovers particularly in the United Kingdom (UK) culminated in the Cadbury Report on the financial aspects of corporate governance in 1992.⁷⁰ Other Reports were the Greenbury Report on director remuneration in 1995, and the Hampel Report in 1998 that underlines the role of the board in enhancing the prosperity of the corporation.⁷¹

In 1998 the Cadbury and Greenbury Reports were brought together and updated in the form of the Combined Code. In 1999 the Turnbull guidance was issued to provide directors with guidance on how to develop an effective system of internal control. The Combined Code was updated (in 2003) to incorporate recommendations from reports on the role of non-executive directors (the Higgs Report) and the role of the audit committee (the Smith Report).⁷² In the same year, the UK Government appointed the Financial Reporting Council (FRC) to assume responsibility for publishing and maintaining the Code.

As a result of the Enron and WorldCom scandals in the US, there were many new corporate governance requirements enshrined in legislation. The Sarbanes-Oxley Act⁷³ as well as other regulatory mechanisms for instance the New York Stock Exchange (NYSE) rules and the requirements of corporate governance ratings agencies were reviewed.⁷⁴

⁶⁹ McConvill JA (2005) 1778.

⁷⁰ The fall of the Bank of Credit and Commerce International (BCCI) and the Maxwell raid on pension funds of the Mirror Group of newspapers in UK have had a significant impact on subsequent developments in corporate governance worldwide.

⁷¹ World Bank *Corporate governance: A framework for Implementation* (2000) (A report).

⁷² Financial Reporting Council, *The United Kingdom Approach to Corporate Governance* (2006) available at <http://www.frc.org.uk/documents/pagemanager/frc/FRC%20The%20UK%20Approach%20to%20Corporate%20Governance%20final.pdf> (accessed 10 November 2009).

⁷³ Public Company Accounting Reform and Investor Protection Act of 2002. The application of this Act is mandatory and failure to comply with it attracts penalty.

⁷⁴ The NYSE Rules on corporate governance, which were approved by the Senate in November 2003 (with amendments made in 2004), see section 303A of the NYSE *Listed Company Manual*. The main corporate governance rules introduced by the NYSE were that: Listed companies must (i) have a majority of independent directors; (ii) nominating/corporate governance committee

More and more countries have embarked on corporate governance reforms in order to protect the interests of investors. The King's Committee Report and Code of Corporate Governance in South Africa were published for the first time in 1994. The new Code on Corporate Governance (King III) came into force March 2010. It is among the initiatives which stimulate corporate governance in Africa.⁷⁵ The World Bank and the Common Wealth Secretariat in order to raise technical awareness provides training to various African countries such as Botswana, Senegal, Tunisia, Mali, Mauritania, Cameroon, Gambia, Mozambique, Mauritius, Sierra Leone and Zambia to help them put in place appropriate mechanisms to promote good corporate governance.⁷⁶ In East Africa there were regional conferences conducted in order to create awareness and promote regional co-operation in matters of corporate governance.⁷⁷

Corporate governance continues to be an area of focus for most companies, regardless of whether they are involved in global operations or not. There are many questions and issues that firms still struggle with: What is good corporate governance and why is it so important? Why are so many firms and governments promoting improved techniques in corporate governance? What are those techniques and best practices and is there evidence that these reforms and policies are useful for firms in promoting transparency, sustainability and the confidence of global markets and investors?

composed entirely of independent directors; (iii) must have internal audit function; (iv) must adopt and disclose corporate governance guidelines; (v) Each listed company CEO must certify to the NYSE each year that he or she is not aware of any violation by the company of NYSE corporate governance listing standards, qualifying the certification to the extent necessary.

⁷⁵ Rossouw G 'Business Ethics and Corporate Governance in Africa' (2000) *Business and Society* 95-97.

⁷⁶ Private Sector Initiative for Corporate Governance *Principles for Corporate Governance in Kenya and a Sample Code for best Practice for Corporate Governance* (2009).

⁷⁷ See the Kenyan Private Sector Initiative for Corporate Governance (2009.) Regional conference was held in Kampala, Uganda, in June 1998 and September 1999. At the June 1998 Conference, it was resolved that each member state of East Africa be encouraged to develop both a framework and a code of best practice, to promote corporate governance. Kenya developed its Code of best practice in 1999. Steering committee on corporate governance and the capital market and securities authority of Tanzania also established the guidelines to be adopted by listed companies.

The answers to the above issues are important in order to promote good business practices, good decision-making and opportunities for investors to ensure the reliability of their investment. The importance of good corporate governance is therefore elaborated upon in the discussion below so that both companies and policy-makers should ensure that good corporate governance is adopted widely and is effectively institutionalized throughout the firm.⁷⁸

2.5 IMPORTANCE OF CORPORATE GOVERNANCE

2.5.1 Efficient management

The nature of the debate on corporate governance is influenced by the way in which corporations are viewed. The early conceptualisations of corporations treated them as the property of equity capital providers (shareholders) for the pursuance of their economic interests. However, an essential characteristic of a corporation is its ability to have a separate existence apart from those who own it.⁷⁹

When a corporation has acquired its own separate existence, the issue of control arises. Historically,⁸⁰ control of a corporation was exercised by its owners either directly or through control of management. However, when ownership and management are separated, as when ownership becomes fragmented, control of the corporation presents a significant challenge. The issue of the separation of management from ownership, which results in the transfer of control of corporations from owners to professional managers,⁸¹ received greater emphasis

⁷⁸ King III emphasised on the transparency and responsibility to those who manage the business of the company for the interests of its shareholders and other stakeholders.

⁷⁹ Clarke T & Clegg S (1998) 107.

⁸⁰ Mintzberg H 'Who should Control the Corporation?' (1984) as cited in Tricker RI (ed.) *History of Management Thought: Corporate Governance* (2000) ch 6.

⁸¹ Scott J *Corporate Business and Capitalist Classes* (1997).

since early 20th century following the Berle and Means article: The Modern Corporation and Private Property⁸² in which they observed that:

‘...[I]n the modern corporation, these two attributes of ownership (control and economic rights) no longer attach to the same individual or group. The stockholder has surrendered control over his wealth. He has become a supplier of capital, and a risk taker pure and simple, while ultimate responsibility and authority of ownership is attached to the stock ownership, the other attribute is attached to corporate control. Must we not, therefore recognise that we are no longer dealing with property in the old sense? Does the traditional logic of property still apply? Because an owner who also exercises control over his wealth is protected in the full receipt of the advantages derived from it, must it necessarily follow that an owner who has surrendered control of his wealth should likewise be protected to the full?’

The main concern is who should control the corporation, and for the pursuit of which goals? As ownership of corporations became dispersed, owner-control weakened and corporations came under the implicit control of their managers.⁸³

Good corporate governance acts as a bridge for the board and management of the corporation in attaining long term strategies for the continued existence of the company. Therefore, there is a need for a system which checks their power for the endurance of the company.⁸⁴ Professor Robert Tricker once said that ‘whilst management processes have been widely explored, relatively little attention has been paid to the processes by which companies are governed. If management is about running business, governance is about seeing that they are run properly.’⁸⁵

Good corporate governance will therefore ensure that the board is independent, accountable, efficient, transparent, and execute their duties fairly for the interest of all stakeholders. In managing the business of the company personal interests of

⁸² Berle AA & Means GC ‘The Modern corporation and private property’ (1932) as cited in Tricker RI (ed) *History of Management thought: Corporate Governance* (2000) ch 3.

⁸³ Mintzberg H *Who Should Control the Corporation?* (1984) as cited in Tricker RI (ed) *History of Management thought: Corporate Governance* (2000) ch 6.

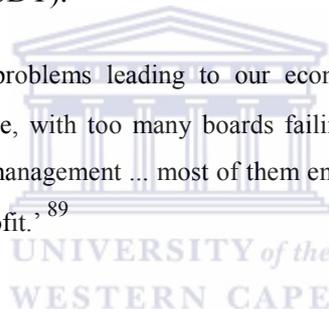
⁸⁴ Former Chief Financial Officer of Tyco Mark Swartz was paid severance package of USD 44.8 million in cash the amount which was paid during his investigation of the grand fraud. The amount paid was never disclosed to the shareholders.

⁸⁵ Tricker RI *History of Management Thought: Corporate Governance* (2000) ch 1.

directors should not prejudice interests of the company. It has been emphasised that the independent board is the one where the position of the CEO and chairman of the board are not occupied by the same person.⁸⁶

Following the popular fraudulent corporate scandals such as Enron and WorldCom, the perception of executives and management has become too negative.⁸⁷ This can be evidenced through the initiatives taken in ensuring good corporate governance internationally. It is through good corporate governance that the integrity of the board and management can be measured and controlled.⁸⁸ It is worth noting that the Vice-President of Tanzania Dr Mohammed Gharib Bilal made the following observation when he was launching the Institute of Directors of Tanzania (IoDT).

‘...[M]any of the problems leading to our economic crises can be linked to poor corporate governance, with too many boards failing to meet their primary function of closely overseeing management ... most of them ended up by making decisions focusing on the short term profit.’⁸⁹



Research shows that responsible management of environmental, social and governance issues creates a business culture and environment that builds both a company's integrity within the society and the trust of its shareholders.⁹⁰ Hence corporate governance has implication for company behaviour not only to the shareholders but also to the employees, customers, credit providers, and the community in which the business operates.

⁸⁶ Coyle B (2003) 8-10.

⁸⁷ Solomon *Corporate Governance and Accountability* 2ed (2005) 8.

⁸⁸ Cassim FHI et al (2012) 473.

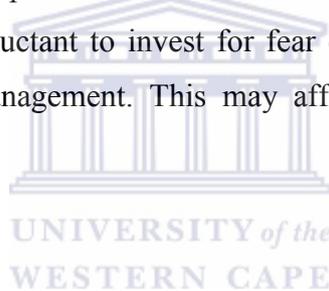
⁸⁹ Sylvester D 'Institute urged to draw up Corporate Governance Code' *The Guardian* 11th May 2012.

⁹⁰ United Nation Global Compact *Corporate Governance: the foundation for Corporate Citizenship and Sustainable business* available at www.unglobalcompact.org (accessed 15 December 2012).

2.5.2 Investors confidence

The collapse of Enron and other corporate scams which culminated in the global financial crisis have attracted public concern around the question of corporate governance. The main issue has been focused on how to develop systems, rules and institutions that will induce corporate executives to manage corporate assets in the interests of the shareholders, rather than running it for their own interests.

The global financial crisis of 2007-2008 also had implications on the investors' confidence in investing their capital in the markets. Many commentators argued that the financial crisis was a regulatory failure, but corporate governance played a significant role.⁹¹ It is possible also that due to the recent corporate disasters, the investors will be reluctant to invest for fear of their capital being stolen or misused by the top management. This may affect the flow of capital in the market.



The effect of financial crisis although this happened in the developed economies, spread all over the world. The emerging and developing economies also experienced it. The financial crisis seemed to create the risk from increase in funding costs hence tighter lending conditions that will affect economic activity. Furthermore, the dampened investors' appetite might also affect capital flows to the developing economies.⁹²

It is apparent that the issue of corporate governance is fundamental in the restoration of the confidence of investors in order to guarantee the continued existence of corporations. Through corporate governance principles the corporate

⁹¹Wade R 'From Global Imbalance to Global Solution' (2009) *Cambridge Journal of Economics* 539.

⁹² Tanzania Financial Report September 2010.

elites' powers can be limited for the interest of the shareholders, for the industrial system and for society as a whole.⁹³

The launching of the IoDT in 2012 is evidence that corporate governance is a fundamental for any country's economy regardless of the level of economic development. IoDT has initiated training in Certificate of Directorship (CiDir) programme for about 100 directors and senior executives from various organizations in Tanzania to ensure that they get better management expertise to improve the business environment.

More generally, the ability of countries to attract foreign capital is affected by their systems of corporate governance and the degree to which corporate management is compelled to respect the legal rights of lenders, bondholders, and non-controlling shareowners.⁹⁴ It is worth noting that James D. Wolfensohn, former President of the World Bank, stated that 'the proper governance of companies will become as crucial to the world economy as the proper governance of countries'.⁹⁵

The global financial crisis is an example of how the failure of boards and executives to understand and manage risks led to governance failures with very serious consequences, not only for financial firms and banks, but for individuals and national economies around the world.⁹⁶

There is a possibility of investors to refrain from providing capital or demand high risk premium for their capital. Therefore countries with effective systems of

⁹³ Keasey K, Thomson S & Wright M (1997) 7.

⁹⁴ OECD Principles of Corporate Governance, Preamble: 'If countries are to reap the full benefits of the global capital market, and if they are to attract long-term "patient" capital, corporate governance arrangements must be credible and well understood across borders' note 3 at p.12.

⁹⁵ As quoted in Gatamah K 'Corporate Governance and Ethics' (2004) The Fourth Annual Conference of BEN-Africa.

⁹⁶ Frenkel R & Rappeti M 'A Developing Country View of the Current Global Crisis: What Should Not be Forgotten and What Should be done' (2009) 33 *Cambridge Journal of Economics* 689.

corporate governance are in a better position of getting investors than those with poor corporate governance standards.⁹⁷ It has been urged that because of its role in capital formation, corporate governance has important consequences for economic efficiency and growth.⁹⁸

For example, Rwanda is the leading country in the EAC region with better investor protection measures followed by Burundi, Kenya and Tanzania.⁹⁹ In 2013, the World Bank has ranked Rwanda 52nd out of 185 countries worldwide for having good environment for investments. Generally, Rwanda is currently the best performing country in the East African region and is ranked at the 3rd position as easiest place to do business in sub-Saharan Africa. On the other hand, South Africa is ranked at 2nd in sub-Saharan Africa and is ranked 39th globally. Mauritius is ranked as the first in sub-Saharan Africa and 19th globally whereas Tanzania is ranked 97th and 127 respectively.¹⁰⁰ Criteria used by the World Bank in evaluating these economies are based on the ease of obtaining construction permit, paying taxes, protecting investors and resolving insolvency.

The World Bank used the following criteria in evaluating to what extent the country protect investors: transparency of related-party transactions (extent of disclosure index), liability for self-dealing (extent of director liability index) and shareholders' ability to sue officers and directors for misconduct and the shareholders' ability to access corporate information before and during litigation (ease of shareholder suits index).¹⁰¹

⁹⁷ In a survey conducted in 2000 by McKinsey & Company, Investor Opinion Survey on Corporate Governance it revealed that investors stated that all other things being equal they would be willing to pay more for a company that is well governed as opposed to one less well governed.

⁹⁸ OECD Principles of Corporate Governance, Preamble: 'One key element in improving economic efficiency is corporate governance.'

⁹⁹ The World Bank & the International Finance Corporation (IFC) Doing business in East African Community (2012) 58 available at www.doingbusiness.org (accessed 4 April 2013).

¹⁰⁰ The World Bank & the International Finance Corporation (IFC) Doing business in Tanzania (2012) available at www.doingbusiness.org (accessed 4 April 2013).

¹⁰¹ The World Bank & the International Finance Corporation (IFC) Doing business in East African Community (2012) 58 available at www.doingbusiness.org (accessed 4 April 2013).

Globally, Mauritius stands at 13 in the ranking of 185 economies on the strength of investor protection. While the most recent doing business data reflect how well regulations in Mauritius protect minority investors; overtime the data shows that it has been the best performer in Sub-Saharan region in protecting minority investors.¹⁰²

South Africa has reformed its corporate governance regime in order to attract more investors and this country has undertaken major reforms in the past two decades in this aspect. Among them were the establishment of corporate governance code (King Reports) whose final version came into force in 2010 (King III Report), enactment of new Companies Act of 2008 and Securities Services Act of 2004.

The new Rwandan Companies Act¹⁰³ requires shareholders' approval of transactions between interested parties. Directors and shareholders with conflicting interests cannot participate in the approval process. Furthermore, it mandated greater disclosure of such transactions to the board of directors and to a general meeting of shareholders. It also required an external review before such transactions are approved and detailed disclosure in the annual reports once approved. The law established as well a clear regime of liability for directors if transactions with interested parties cause damage to the company.

It can be concluded that for any country to remain viable, sustainable and competitive in the global market it needs well-governed and managed business enterprises that can attract investment, create jobs and wealth hence good corporate governance became a prerequisite for attracting investors.

¹⁰² From 2006-2013 the investor's protection index shows that the protection of investors has been strengthening over time and they are above minimum required regional level. See Doing Business in Mauritius available at www.doingbusiness.org (accessed 4 April 2013).

¹⁰³ Companies Act no. 7 of 2009.

2.5.3 Stability of Stock Markets

Deeper and more liquid international financial markets and new instruments have served to heighten awareness among policy makers on the need to continually update and review microeconomic structures including arrangements regarding transparency and disclosure.¹⁰⁴ In the last few decades the individual equity ownership has continued to decrease in terms of the total percentage of equity owned. For instance between the 1980's and the 1990's the individual ownership of equity in UK companies decreased from 54 per cent in 1963 to less than 18 per cent in 1993.¹⁰⁵

The decrease of individual shareholders resulted in the increasing dominance of institutional shareholders such as pension funds, insurance funds, and private retirement saving schemes and long term life insurance or assurance companies. Hence developing economies need institutional investors in order to solve the problem of illiquidity. At the same time application of good corporate governance is needed to govern those companies because it is difficult for institutions to control them. Due to complexity and controlling nature of these companies by the institutional shareholders, Cadbury Report noted that:

‘[B]ecause of their collective stake, we look forward to the institutions in particular, with the backing of institutional shareholder’s committee, to use their influence as owners to insure that the companies in which they have invested comply with the code.’¹⁰⁶

The institutional funds belong to the beneficiaries whose interests are represented by fund managers; there are possibilities for managers responsible for investment

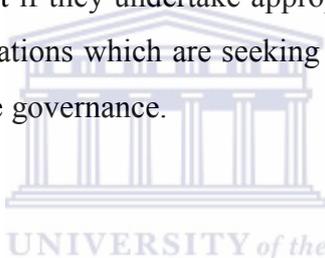
¹⁰⁴ Tedesco E ‘Shareholder Right to File an Item on the Agenda of a General Meeting: Comparative Study of Western European Countries’ (2002) *Hermes Discussion Paper*.

¹⁰⁵ Keasey K & Short H ‘Institutional Shareholders & Corporate Governance in UK’ in Keasey et al (eds) *Corporate Governance* (1997) 19.

¹⁰⁶ Cadbury Report (1992) para 6.16.

of those funds to act in their own interest.¹⁰⁷ In order to solve this problem of misappropriation of beneficiaries' funds those trusted with it should adhere to the principles of good corporate governance.

Corporate governance has a great impact on the efficiency of stock markets. For example, in the Asian crisis of 1997, it was alleged that poor corporate governance influenced the stock markets' inefficiency to a large extent.¹⁰⁸ Stability of stock prices is one of the important factors for the investors to predict the future performance of a company or organisation. It is through good corporate governance that listed companies can attract investors and embrace stability of the prices. Stock price stability shows the level of risk for investment.¹⁰⁹ Investors will only invest if they undertake appropriate risk for their investment. Therefore, those organizations which are seeking new funds for businesses must guarantee good corporate governance.



Developing countries in order to attract FDI have to improve market confidence by laying down rules and regulations to govern operations in the Stock Exchange. Developed stock exchanges act as a source of capital for the industry and government. Briston observed that:

‘[I]t is clear that stock exchange developed in order to meet two demands. First, the increase of the securities of a long-term or permanent nature required a market for purchase and sale of these securities, so that their holder could liquidate their investment in a short-term. Also the expansion of the industry during the nineteenth century necessitated the discovery of the new sources of finance.’¹¹⁰

¹⁰⁷ Keasey K & Short H (1997) 19.

¹⁰⁸ Sabri NR *Stability of the International Stock Markets* (2007).

¹⁰⁹ Maher M & Andersson T ‘Corporate Governance: Effects on Firm Performance and Economic Growth’ (1999) 11 at para 35 *A paper presented at the Tilburg University Law and Economics Conference on “Convergence and Diversity in Corporate Governance Regimes and Capital Markets”*, Eindhoven, the Netherlands.

¹¹⁰ Briston RJ *The Stock Exchange and Investment Analysis* (1973) 34-35.

He further opined that ‘one of the main such source was the stock exchange. Thus its major functions are the provision of a market for the purchase and sale of the securities and the provision of capital for the purpose of industry and government, both central and local.’¹¹¹

Most of the stock exchanges in developing countries were established during the privatisation process. The privatisation of state owned enterprises was meant to enable the government and industry to raise capital and provide a secondary market where existing investors can sell and where prospective investors can buy.¹¹²

The International Finance Corporation (IFC) identified a number of goals for the privatisation process in the developing countries. It observed that:

‘[O]ne goal is maximum economic efficiency of the resulting enterprises. A second goal may be to raise revenue for the state to address deficits. Another goal in the case of the newly open economic system is to permit the people of the nation to participate in the ownership. A fourth goal is to establish an active secondary market for securities...’¹¹³

The above observation reveals the need for efficient governance of the privatised enterprises to attain those goals.

Good corporate governance principles such as disclosure should be adhered to and must be sufficient and adequate in order to win investors’ confidence. Disclosure is the most important aspect in the capital market as it is the only information that the market can rely on. At the same time, out-dated laws and cumbersome licensing, and complicated entry which impede efficient operation, should be discouraged. For instance, the underdeveloped stock market in

¹¹¹ Briston RJ (1973) 35.

¹¹² Briston RJ (1973) 35.

¹¹³ International Finance Corporation (IFC) *Privatisation Principles and Practices: Lessons of Experience Series* (1995).

Tanzania was predominantly caused by inter alia out dated laws and cumbersome procedures especially with regard to foreign investors.¹¹⁴

It is not only potential investors that are constrained in their investment choices when corporations and countries have inadequate corporate governance laws and practices, the opportunities for partnerships and mergers and acquisitions are also limited. Many companies will be less interested in partnering with firms whose corporate governance is inadequate or not properly disclosed since this could expose the partnering companies to legal liability in their home jurisdiction if something were to go wrong.¹¹⁵

2.6 CONCLUSION

From the literature review it can be concluded that corporate governance is important in every country in order to ensure careful resource management and attraction of investors. Good corporate management can generally contribute to the stock market growth and economic growth of the country. Countries with good corporate governance are in a position to attract more investors compared to those with poor corporate governance practices.¹¹⁶ Directors must work in the interest of both shareholders and other stakeholders for the endurance of the company.

¹¹⁴ See detailed discussion in chapter 3 para 3.4.2 and chapter 4.

¹¹⁵ Maher M & Anderson T (1999)17-19 at para 45-52.

¹¹⁶ See La Porta R et al (1997) 1135.

CHAPTER THREE

CORPORATE GOVERNANCE IN TANZANIA

3.1 EVOLUTION OF CORPORATE GOVERNANCE IN TANZANIA

Tanzania is a developing country located in the Eastern African region, positioned around 5° south of the Equator and 45° east, and covers 945,087 sq km. It is bordered to the North and North East by Uganda and Kenya and to the North West and West by Rwanda, Burundi and the Democratic Republic of Congo. To the South and Southwest lie Mozambique and Zambia respectively, and the Indian Ocean lies to the East. Tanzania is made up of Tanganyika and Zanzibar. Tanganyika regained its independence in 1961 from the British, and became a republic in 1962. Zanzibar regained its independence from the Arab Sultanate in 1964. The two joined to form the current union – called the United Republic of Tanzania (URT) - in April 1964. Tanzania was a single party state from 1965 to 1991. In 1992 a multiparty political system was re-introduced.¹¹⁷ Tanzania is viewed as having been one of the most politically stable countries in Africa since independence. The transition towards a multiparty political system has also been peaceful. This stable environment is viewed as providing a base for rapid economic growth.¹¹⁸

Tanzania, in terms of economic potential, is endowed with a rich natural resource base and easy access for international trade. 46% of its land is suitable for agriculture (with only 6.7% of it being cultivated), it also has a large hydropower potential, a wide range of mineral deposits including gold, diamonds, tin, iron, uranium, phosphate, gemstones, and nickel, and also natural gas. Other resources include exotic varieties of wildlife and a number of tourist attractions.¹¹⁹

¹¹⁷ The multiparty political system was re-established following the recommendations of the Nyalali Commission despite the fact that this Commission found 77.2% of the people interviewed were in favour of single party system.

¹¹⁸ President's office, Planning and Privatisation Commission (1999) *Development Vision*, 2025.

¹¹⁹ World Bank Report. (2000).

Despite this potential and rich resource endowment, Tanzania remains one of the least developed countries in the world; poverty remains pervasive and deep. About half of Tanzanian citizens are poor, 32 per cent illiterate and the infant mortality rate stands at 99 per 1000 live births.¹²⁰ This suggests that the resources are not sufficiently utilised to bring about social and economic development.

The law governing corporations after independence were common law and the Companies Ordinance which originated from the British statute of 1932.¹²¹ The Companies Ordinance operated until 2002 when it was replaced by the new Companies Act of 2002 which came into force in 2006. After Arusha Declaration the Public Corporation Act of 1967 was enacted in order to govern and control the state owned corporations which were nationalised. This Act was amended in 1993 by Public Corporations (Amendment) Act No. 16 and further amended by Public Corporations (Amendment) Act No. 17 of 1999.

There is very little literature on corporate governance in Tanzania immediately after independence as it took almost seven years before the state nationalised all means of production including corporations. After the Arusha Declaration of 1967 the debate in the context of state ownership of corporations started.

The economy experienced a severe crisis in the 1980s. However, recently, changes have been taking place with positive growth being registered. In comparative terms, the economy of Tanzania has been showing positive growth since the mid-1990s.

Following the government's agreement with the International Monetary Fund (IMF) and the World Bank in 1986, a market-oriented system of economic coordination modelled on the classical/neoclassical perspective was re-

¹²⁰ World Bank Report (2000).

¹²¹ See the United Kingdom Companies Act of 1844.

introduced.¹²² This development reflected the worldwide victory of classical liberalism which advocates market coordination of economic activities.¹²³

The economic reforms that have been implemented in Tanzania have combined both liberalisation and privatisation initiatives. Liberalisation generally refers to a reduction in government control in order to open up the economy to competitive pressures.¹²⁴ In line with the IMF/World Bank conditions, state withdrawal from direct involvement in business activities is being achieved through the divestiture of state owned corporations.¹²⁵ A Presidential Commission on parastatal sector reform (PSRC) was established in 1993. Privatisation, which has been the major approach to divesting state-owned corporations, refers to the ownership and control of assets once owned by the state by various private shareholders and corporations.¹²⁶

The arguments for privatisation include the improvement in efficiency of allocating of resources, since this is encouraged by the market. This will, in turn, lead to an increased contribution to the government's finances through taxation. Broadening the ownership of corporations has also been cited as a motivating factor for privatisation.¹²⁷

The privatisation initiatives of the 1990s and beyond reversed the nationalisation policies of the 1960s and 1970s. In a similar way, the leadership code introduced by the Arusha Declaration was reversed in 1991 through what has come to be

¹²² Bagachwa et al (eds.) *Market Reforms and Parastatal Restructuring in Tanzania* (1992) ch 2.

¹²³ Keat R 'The Moral Boundaries of the Market' in Crouch C & Marquand D (eds) *Ethics and Markets: Co-operation and Competition within Capitalist Economies* (1993) ch 4.

¹²⁴ Starr P 'The meaning of privatization' (1988) retrieved from <http://www.princeton.edu>, (accessed on 12th October 2012).

¹²⁵ Wangwe SM 'Nature and extent of Parastatal Restructuring: the case of Industrial Parastatals in Tanzania' in Bagachwa et al (eds) *Market reforms and parastatal restructuring in Tanzania* (1992) ch 3.

¹²⁶ Scott C 'Privatisation, control and accountability' in McCahery J, Piccioto S & Scott C (eds) *Corporate Control and Accountability* (1993) ch 5.

¹²⁷ Ngowi HP 'Institutional Reforms to Attract Foreign Direct Investments (FDIs) as a Strategy for Economic Growth' (2005) *5 A Paper Presented during the in the 26th Annual Roundtable Conference for, African Association for Public Administration and Management (AAPAM)* Mombasa, Kenya.

called the Zanzibar Declaration.¹²⁸ The adoption of the Zanzibar Declaration is viewed as a move to realise individual rights in a liberal economy, including the right to own property. This resolution is mainly relevant to senior civil servants since it allows them to now own rentable property, shares in privately-owned companies and accept directorship appointments in privately-owned companies.

The economic reforms in Tanzania include attempts to evolve local sources of capital for firms, to replace the government which prior to these reforms provided capital for state-owned enterprises. In this respect, the Capital Markets and Securities Authority (CMSA) was established in 1994 to regulate securities business in Tanzania, promote a securities market and establish the stock exchange. The DSE was established in 1996 and began operations in 1997.

3.2 CORPORATE GOVERNANCE OF THE STATE OWNED CORPORATIONS



The state owned corporation was the dominant form of corporation during the socialism era in Tanzania. Socialism philosophy of ‘Ujamaa na kujitegemea’ paved the way for the nationalization of major means of production and put them under the control of the government.¹²⁹ The way in which the state owned corporations were governed is stated in the Public Corporations Act of 1969 and in different individual Acts which established that corporation.¹³⁰ The Public Corporation Act of 1969 was amended in 1976 and applied until 1992 when the current Public Corporation Act was enacted.

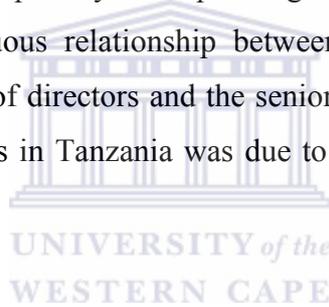
¹²⁸ Tripp AM *Changing the Rules: The politics of Liberalisation and the Urban Informal Economy in Tanzania* (1997) ch 2.

¹²⁹ Bagachwa et al (eds.) (1992) ch 2.

¹³⁰ There are corporations which was established under certain acts like the Tanzania Posts and Telecommunication Corporation Act No. 17 of 1977 as amended time to time give the minister responsible for matters relating to posts and telecommunication to direct and control the corporation.

The main features of corporate governance in state owned corporations were corruption (embezzlement and nepotism), managerial incompetency, political interference and government subsidisation of failing corporations. Corporations were shielded from the discipline of the market,¹³¹ control and accountability became the prime causality of these corporations. The lack of accountability and effective control of these corporations left the managers with unfettered powers¹³² which lead to misappropriation of corporate properties that were owned by the state

The problem of control and accountability in state owned enterprises is not the problem of Tanzania only as it was also largely experienced by other countries in Sub-Saharan Africa. The paucity of corporate governance in Sub-Saharan Africa arises from the ambiguous relationship between the state (the owner of the corporation), the board of directors and the senior management. Failure of many state owned corporations in Tanzania was due to the lack of effective corporate governance.¹³³



3.2.1 Control by central coordination

Corporate governance of the state owned corporations in Tanzania was done by a centrally-coordinated system which involved the people, the ruling party and the government. Tanzanian people through their government controlled these corporations directly and indirectly. Direct governance involved the use of social pressure on the managers of the corporation. For example, complaints about the conduct of managers that were reported in the media constituted one of the

¹³¹ Bagachwa et al (eds.) (1992) ch 2.

¹³² Bagachwa et al (eds.) (1992) ch 2.

¹³³ Wangwe SM (1992) ch 3.

deterrents to the abuse of the power vested on them.¹³⁴ Social pressure is recognised as one of the mechanisms by which corporations can be controlled.¹³⁵

The ruling party also governed these corporations through its directives and by appointment of the party representatives who were placed in corporation offices.¹³⁶ These representatives reported directly to the National party organs such as National Executive Committee (NEC) on the performance of the corporation. Such reporting system gave representatives significant influence in the management of the state owned corporation. Managers feared the disciplinary action that could be taken against them if they were reported to the NEC.

3.2.2 Parliamentary Control

Parliamentary control was and is still another way of exercising control over state owned corporations. In 1978, the parliament established a Parastatal Organisation Account Committee which serves as an important control mechanism. The duty of this committee was to verify whether funds were utilised legally, appropriately and on approved project or services. The committee employed the services of controller and auditor general (CAG) and Tanzania Audit Corporation to check the budget overruns and the reasons thereof. It also checked if there is extravagant spending of public funds.¹³⁷

¹³⁴ Mwapachu JV *Management of Public Enterprises in Developing Countries: The Tanzania Experience* (1983) 18-22.

¹³⁵ Demb A& Neubauer FF *The Corporate Board: Confronting the Paradoxes* (1992) as cited in Tricker RI (ed) *History of management thought: Corporate Governance* (2000) ch 5.

¹³⁶ Party representatives were individuals appointed by the ruling party to promote the party's policies at the place of work.

¹³⁷ Mwapachu JV (1983) 28.

3.2.3 Presidential and ministerial control

Presidential/ministerial control over the state owned corporations was both formal and informal. The formal control applied to those corporations established by Acts which provides that they should report direct to the president or minister of the respective sector. Informal control was done through appointment of the chief executives/ chairman of the holding corporation. According to the 1969 and 1992 Public Corporation Acts and the amendment done in 1993 and 1999,¹³⁸ the appointments have to be based on the recommendations by the sector ministries. The borrowing powers of such a corporation are also vested in the president or minister of that sector.¹³⁹

The 1992 Act¹⁴⁰ (as amended) still requires the responsible minister to give directives to corporations. Section 6 of the Act states:

‘[W]here the government is the sole shareholder, the minister responsible may in writing under his hand give the board of directors of the public corporation direction of a general or specific character as to the performance of their functions.’

When directors are the appointee of the minister the board provides the link between the minister and the management of the corporation.

3.2.4 Central control

Another way of governing state owned corporations was through central control. For instance, the Bank of Tanzania (BOT) is empowered to control banks and financial institutions through the Government Loan Guarantee and Grants Act of

¹³⁸ Public Corporation (Amendment Act No. 16 and 17 respectively).

¹³⁹ In Tanzania president appoint all ministers. He requires only approval of parliament with the prime minister. Ministerial control can be considered as indirectly presidential control.

¹⁴⁰ Public Corporation (Amendment Act) Act no. 16 of 1993.

1975; the Tanzania Audit Corporation; the National Price Commission and the Standing Committee for Parastatal Organisations.

The treasury registrar was established for the purpose of controlling and allocating the resources of the government.¹⁴¹ The ministry of finance is empowered to acquire, hold and manage investments of the government through a finance and credit plan under the central control.

3.3 CURRENT CORPORATE GOVERNANCE REGIME IN TANZANIA

The economic crisis of the 1980's in Tanzania was mainly caused by the paucity of corporate governance of the state owned corporations.¹⁴² (For instance directors were not running the corporations for the interests of the state but for their own interests).¹⁴³ Because of shortage of local capital to run the public corporations, the Tanzanian government reformed her policies into the privatisation of the state owned corporations. President Nyerere observed that:

‘...[W]hen we benefit (through private capital) by increasing employment opportunities; by increasing government revenue; by the wealth produced locally and so on, then we should welcome private enterprises...this is one of the matter about which we must start with the world as we find it. To be truly revolutionary we must be absolutely realistic and use what opportunities the world provides.’¹⁴⁴

¹⁴¹ For the first time the post of treasury registrar was established by the colonial government. The post-colonial government adopted the same mode. See Treasury Registrar Act 1959, 1980.

¹⁴² Chachage SLC ‘Going beyond Rhetoric: Why is Tanzania Still Poor 40 Years after Independence’ (2003) 3 *A keynote address to the Annual Convocation Symposium of the University of Dare-es-Salaam.*

¹⁴³ Expropriation done by the managers lead to the collapse of many state owned corporations in 1980's such as Sungura textile manufacturing industries; city of Dar es Salaam transportation company (UDA).

¹⁴⁴ Quoted in Hartmann J ‘The Rise of Private Capital’ in O’Neill N & Mustafa K (eds.) *Capitalism, Socialism and the Development Crisis in Tanzania* (1990)38.

The method used for privatising state owned corporations was through ‘strategic investors.’¹⁴⁵ This has effect on corporate governance as it provides an opportunity to a number of individuals to acquire significant holdings in the privatised corporation and hence concentration of ownership in a corporation.¹⁴⁶ The research done in five companies listed on the DSE revealed that the controlling shareholders in those companies own more than 50% of shares which provides them with controlling rights and incentives to exercise control.¹⁴⁷

Corporate governance in Tanzania as in other developing economies has adopted a mixture of aspects of the corporate governance structures found in developed markets.¹⁴⁸ This is usually facilitated by legal systems which tend to reflect the legacy of the linked colonial past between developing countries and developed western market economies.¹⁴⁹ Tanzania being a member of the commonwealth its legal system is highly affected by British laws. The Companies Ordinance and the new Companies Act of 2002 (cap 212) contain some principles which were applied in England in the 17th century.¹⁵⁰

The mode of corporate governance applied in Tanzania is the Anglo-Saxon model which reflects the liberalist approach to corporate governance. This model applies to the US, the UK, Australia, New Zealand and Canada, South Africa and other members of the Commonwealth.¹⁵¹ Under this model, shareholders interest

¹⁴⁵ A strategic investor is one who acquires a significant number of shares in a corporation in order to become either a controlling shareholder entitling him to significant control rights.

¹⁴⁶ Parastatal Sector Reform Commission annual report for 2002-2003 indicates that the majority of the privatized corporations have single controlling shareholders.

¹⁴⁷ Melyoki LL. 'Determinants of Effective Corporate Governance in Tanzania' (published PhD Thesis University of Twente, Enschede, Netherlands 2005). The findings were that: The 52.8% shares of Tanzania Breweries Limited (TBL) which is subsidiary company of the SABMiller limited of South Africa is owned by controlling shareholder who is SABMiller limited. The 75% shares of Tanzania Cigarette Company (TCC) are owned by the controlling shareholder who is Japan Tobacco International (JTI); and the 74.14% shares Tanzania Oxygen Limited are owned by controlling shareholder who is the government of the United Republic of Tanzania.

¹⁴⁸ Tam OK *The Development of Corporate Governance in China* (1999) 166.

¹⁴⁹ La Porta R et al 'Investor Protection and Corporate Valuation' (2000) *Journal of Financial Economics* 1158.

¹⁵⁰ See the UK Companies Act of 1844. The mode like that recognises the people who subscribe their names in the memorandum and articles of association became its shareholders.

¹⁵¹ Bradley M et al 'The Purposes and Accountability of the Corporation in Contemporary Society: Corporate Governance at Crossroads' (1999) available at <http://www.law.duke.edu/> (accessed 7 February 2013).

and their power in decision making are emphasised. The fact that shareholders have invested their capital in the company gives them power over other stakeholders in managerial decision making.¹⁵²

The role of donor countries and the international financial institutions with respect to the development of corporate governance practices in developing countries cannot be underestimated. The influence of the IMF and the World Bank may result in a system which does not reflect socio economic and local requirements for an effective corporate governance system. It has been contended that the preparation of the Companies Act No. 12 of 2002 relied heavily on foreign consultants and did not provide local stakeholders with the opportunity to contribute to the development of the Act.¹⁵³

The control and governance of corporations in Tanzania is done by both internal and external mechanism. The internal mechanism is through the memorandum and articles of association (MEMARTS) which contains rules for the organisation to be followed by its directors and managers. The external mechanism includes legal rules and regulatory framework.

3.4 LEGAL AND REGULATORY FRAMEWORK

The legal and regulatory framework is the basic mechanism outside the firm. It refers to the laws and regulations that govern the establishment and cessation of firms and their operations in a country.¹⁵⁴ The function of laws and regulations with respect to corporate governance is to provide a framework within which various

¹⁵² Scott J 'Corporate Business: Comparative Perspectives' (1996) available at <http://privatwww.essex.ac.uk/> (accessed August 2012).

¹⁵³ Mndolwa EB, Binamungu CS &Kashonda MA 'The Companies Act No 12 of 2002 and the People's Expectations: The Mismatch and Missed Opportunities; Accounting, Liquidation and Governance Aspects of the Law' (2002) *The Accountant* 23.

¹⁵⁴Denise KD & McConnell JJ 'International Corporate Governance' (2003) *Working Paper* No 05/2003. <http://www.ecgi.org/wp> (accessed September 2012).

organisations can relate to one another. They describe the relationship that must exist between management and various stakeholders.¹⁵⁵

They also encourage managers to pursue shareholder interests. In situations where effective legal protections are lacking, investors are likely to be extremely reluctant to give up resources in exchange for a promise because if such promise is violated there is no clear penalty they can impose.¹⁵⁶ La Porta concluded that countries with strong legal systems are likely to get many more investors than their counter parts.¹⁵⁷ The legislative measures can encourage self-regulations by directors and managers.¹⁵⁸

The OECD principles of effective corporate governance have emphasised the need to develop a corporate governance legal and regulatory framework and include issues that should be addressed including the rights of shareholders, and the equitable treatment of shareholders and other stakeholders. These principles also encourage countries to enforce relevant laws and regulations.¹⁵⁹

The legal and regulatory framework also influences the effectiveness of other mechanisms and in particular the way they evolve.¹⁶⁰ For example, the legal and regulatory framework influences ownership structure of corporations in Tanzania to a large extent.

Legal and regulatory framework for corporate governance in Tanzania is divided into two broad categories:

¹⁵⁵ Scott J (1997) 167.

¹⁵⁶ Dyck A 'Ownership Structure, Legal Protections, and Corporate Governance' (2001) in Pleskovic B & Stern N (eds.) *Annual World Bank Conference on Development Economics* (2000) Washington: The international Bank for Reconstruction and Development/the World Bank.

¹⁵⁷ La Porta R et al (1997) 1135.

¹⁵⁸ For example, the King III Report made recommendations with which listed companies in the South Africa are encouraged to apply, and they are required to provide explanations if they do not apply them. The implementation of these recommendations encourages managers to make decisions that lead to the maximization of shareholder wealth

¹⁵⁹ OECD *The OECD principles of corporate governance* (2004) available at <http://www.oecd.org> (accessed October 2012).

¹⁶⁰ Berlof E & Claessens S 'Enforcement and Corporate Governance' (2004) The Global Corporate Governance Forum Discussion Paper No 4, available at <http://www.gcgf.org> (accessed 7 February 2013) 15-17; they posit that the ownership structure is a response to the effectiveness of the legal and regulatory framework.

- i) Legal rules and regulations (including quasi-legal regulations)
- ii) Guidelines for corporate governance (in particular the Capital Markets and securities Authority (CMSA) guidelines and the Steering Committee guidelines.)

The legal regulation for corporate governance in Tanzania is underpinned by the corporate laws and securities laws and regulations. Corporate laws include the Companies Act no. 12 of 2002 (Cap 212 of the laws of Tanzania) which came into force in March 2006 and the Public Corporations Act 1992 (as discussed in 3.2 above). Securities law is covered by the Capital Markets and Securities Act (CMSA) No. 5 of 1994, guidelines for corporate governance established under CMSA to be used by listed companies in DSE and Steering Committee.

3.4.1 Companies Act No.12 of 2002

The Companies Act No. 12 of 2002 was assented to by the President on 27 June 2002 and came into effect from 1 March 2006. The new law repealed the Companies Ordinance of 1932, an archaic piece of legislation based on the English Companies Act of 1929. The new act aimed to put in place a relevant and modern legal framework. The legal system of Tanzania is affected by its predecessor colonial master, the British legal system. The framework of corporate governance under the Companies Act is to promote a moderate shareholder-oriented system of governance; however the ownership structure of companies may fetter the achievement of this goal.¹⁶¹

Chapter VII of the Act provides duties and liabilities of the Directors. The Act partially codifies these duties. This has increased accountability of directors by amplifying their duties and clearly documenting them. Previously, directors' duties were primarily covered by the common law. The purpose of partial codification is to make the law clear and more accessible, particularly to

¹⁶¹ Ownership of the majority of the listed companies in DSE is concentrated into few hands hence the dominant shareholders have more opportunity to control management compared to their counterpart minority shareholders.

directors. In particular, the Act requires directors to exercise their power for proper purpose,¹⁶² to act honestly and in good faith for the best interest of the company.¹⁶³

Directors are also required to consider the interests of employees when performing their duties.¹⁶⁴ The implementation of such requirement can be problematic both conceptually and in practice. Conceptually, shareholder interests and those of employees tend to conflict. For example, employees desire stable employment and higher salaries, while shareholders require a greater return on their investments in the form of dividends and capital gains. The questions arise here about the criteria for resolving these conflicting interests. In practice, the implementation of this provision is problematic because directors are appointed or elected by shareholders.

Directors owe their positions and hence allegiance to the company and not to the employees. It is submitted that there is a possibility of the directors to act on the interest of the dominant/large shareholders due to the corporate ownership existing in Tanzania unless an inclusive approach is adopted which address as the interest of other shareholders as recommended by the King III Report of South Africa. The inclusive approach is also recommended by the Commonwealth Association for Corporate Governance (CACG).¹⁶⁵

The fiduciary duties of directors are of greater importance because the Companies Act confers on the board of directors a statutory power and duty to manage the business and the affairs of the company subject to the company's

¹⁶² See s184 of the Act.

¹⁶³ See s182.

¹⁶⁴ Section 183 (1) the matters to which the directors of the company are to have regard in the performance of their functions includes, in addition to the interests of the members, the interests of the company's employees.

(2) The duty imposed by this section on the directors is owed by them to the company (and the company alone) and is enforceable in the same way as any other fiduciary duty owed to a company by its directors.

¹⁶⁵ See CACG *Principles for Corporate Governance in the Commonwealth: Towards Global Competitiveness and Economic Accountability* (1999) 3. See also discussion in chapter 4.5 with regard to stakeholders' rights.

memorandum of incorporation.¹⁶⁶ However, their effectiveness in the control function varies from company to company. The effectiveness is conditioned by the ownership structure and the extent of shareholder control. Where shareholder control is significant, the board of directors tends to be less involved in control, and becomes a mere legal requirement or at best an advisory committee. The director can be removed by an ordinary shareholders resolution notwithstanding provisions to the contrary in the memorandum and articles or in any agreement with him.¹⁶⁷ This is evidence that the controlling shareholders have a significant control of the company.

It is compulsory to appoint the first company secretary before registration. However there is no formal qualification requirement prescribed.¹⁶⁸ The Act also provides for protection of third parties dealing with a company in good faith. These people are not required to review the company's memorandum and articles to check on the powers of the directors. The doctrine of constructive notice and doctrine of ultra-vires are no longer applicable in such cases.¹⁶⁹

There are significant information and power asymmetries between controlling and minority shareholders in the Tanzanian context. In the current set-up, minority shareholders cannot effectively influence the decision-making process and they generally lack representation on the decision-making boards of directors of companies.¹⁷⁰ In annual general meetings, which they rely on for information on the performance of the corporations, they do not have an adequate voice which makes them vulnerable.

However, in order to protect minority interests any member of a company can make an application to the court for its intervention or for permission to start a

¹⁶⁶ Section 181 of the Act provides that 'Subject to any modifications, exceptions, or limitations contained in this Act or in the company's articles, the directors of a company have all the powers necessary for managing, and for directing and supervising the management of, the business and affairs of a company'.

¹⁶⁷ Section 193.

¹⁶⁸ Sections 14&187.

¹⁶⁹ Sections 35-38.

¹⁷⁰ Melyoki LL (2005) ch 6 pp 204-224.

derivative action on behalf of the company if the affairs of the company are being conducted in a manner which is unfairly prejudicial to the interests of the members in general or the minority in particular.¹⁷¹

In managing finances of the company, books of account are required to be preserved for six years from the date on which they are made up.¹⁷² Directors are required to prepare individual company accounts as well as consolidated group accounts, both of which will show a true and fair view in accordance with the generally accepted accounting practices by National Board of Accountants and Auditors (NBAA) regulations.¹⁷³

The auditor's report should cover each component of individual accounts as well as group accounts (balance sheet, profit and loss account and cash flow statement). Auditors are also required to report whether the contents of the directors' report are consistent with those in the accounts.¹⁷⁴ The Act prohibits directors to be remunerated tax free and no loan from the company should be provided to a director or any other person connected to him.¹⁷⁵

The power of shareholders to influence decision-making is exercised at the annual general meeting. Among the key decisions made by shareholders during these meetings is the election of directors and auditors. Directors' remuneration is also decided upon during these meetings. In practice, directors propose remuneration to shareholders at the annual general meeting, who then debate and approve them. Directors are empowered to propose auditors and determine the auditors' fees.¹⁷⁶

The board system applied in Tanzania reflects the British one-tier board, in which board, management and control roles are combined. As in other countries, the

¹⁷¹ Sections 233,234.

¹⁷² Section 151.

¹⁷³ Section 154.

¹⁷⁴ Section 161.

¹⁷⁵ Section 199-200.

¹⁷⁶ See s170(5) & (8).

management of the company is vested by law in the board of directors.¹⁷⁷ In practice, the board of directors appoints a chief executive officer to whom it delegates the responsibility for the management of the day-to-day affairs of the company and retains for itself the decision control role. The CEO is therefore accountable to the board of directors. The Act is silent on the issue of having executive and non-executive directors in the board. Although the CMSA and Steering Committee guidelines recommend it, compliance is not guaranteed due to the compliance nature of the guidelines. It should be noted that the guidelines applied only to the listed companies. The Act also does not provide for the separation of the post of the CEO and chairman of the board which is among the main principles advocated internationally in order to have an independent board.¹⁷⁸

3.4.2 Capital Markets and Securities Act No. 5 of 1994

Reflecting the characteristics of developing countries with regard to their underdeveloped equity markets, the importance of the stock exchange in the economy of Tanzania is currently low. The stock market was introduced in 1996, and DSE was established in 1997 but currently only seventeen companies are listed on the DSE - Tanzania Breweries Limited, Tanzania Cigarette Company, Tanga Cement, Swiss port Tanzania Limited, Tanzania Oxygen Limited, Tanzania Tea Packers , Kenya Airways Limited, Kenya Commercial Bank Limited, Tanzania Portland Cement Company Limited, East Africa Breweries Limited, Jubilee Holdings Limited, CRDB Bank Plc, National Media Group Limited, African Barrick Gold Plc, Precision Air Services Plc, Dar es Salaam Community Bank and National Microfinance Bank Plc.¹⁷⁹

¹⁷⁷ Section 183.

¹⁷⁸ See generally the OECD principles of Corporate governance, King report III and discussion in chapter 4.3.

¹⁷⁹ This information was retrieved from the Capital markets and Securities Authority website <http://cmsa-tz.org> (accessed 7 September 2012).

Until 2003, merger and acquisition was not allowed on shares listed on the DSE. Following the enactments of the Fair Competition Act of 2003 and the introduction of relevant regulations, these restrictions have been eased.¹⁸⁰ However, some restrictions still remain; for example, foreigners (corporate and individuals) are not allowed to hold shares in a corporation that exceeds 60% of the equity of that company. The initiative to allow foreigners and foreign firms to transact and to list at the exchange is an attempt to improve the liquidity and depth¹⁸¹ of the stock market.

This position of law led to the underdeveloped capital markets because the indigenous investors were not able to buy shares in the privatised companies. On the other hand, Kenya which is the counterpart member of EAC, put a limit as to what extent the foreign investors can own shares in Kenyan companies since 2002. The 75 per cent¹⁸² was left free float for all classes of investors, with no restriction on the amount held by a foreign investor.¹⁸³ Recently, the legal threshold of foreign ownership of a public listed company in Kenya has been reduced from 75 per cent to 60 per cent.¹⁸⁴

An active market for corporate control is currently non-existent in Tanzania. There have been no hostile takeovers reported in Tanzania since the listing of corporations was introduced in 1997. Apart from disclosures required by regulatory authorities, i.e. the CMSA and DSE, there are no legal restrictions that prevent takeovers or mergers. Transferability of shares is also permitted by the Companies Act¹⁸⁵ as well as by the listing regulations.

¹⁸⁰ Capital Markets and Securities (Substantial Acquisitions, Takeovers and Mergers) Regulations 2006.

¹⁸¹ Liquidity refers to the rate at which shares and securities are bought and sold. Depth refers to the number and type of shares and securities traded at the stock exchange (i.e. bought and sold).

¹⁸² Legal Notice 134 of 2002 referring to para 3(1) first set the limits at 75%.

¹⁸³ Nairobi Stock Exchange Ltd (NSE), Market Fact File 2007.

¹⁸⁴ Legal Notice 98 of 2007 referring to para.3(a) published on June 14, 2007.

¹⁸⁵ See s74 of Cap. 212.

Provisions under Part IX¹⁸⁶ of the Capital Markets and Securities Act prohibit conduct like creating false trading and market rigging activities and market manipulation. The use of fictitious transactions or devices to maintain, inflate or depress or cause fluctuation in the market price of any securities is also prohibited.¹⁸⁷ Any person violating Part IX is liable to a fine of not less than five million Tanzanian Shillings or imprisonment for a period not less than five years or both such fine and imprisonment.¹⁸⁸ He is also liable to pay compensation of the loss sustained by the person claiming compensation.¹⁸⁹

3.5 CORPORATE GOVERNANCE GUIDELINES IN TANZANIA

3.5.1 The Steering Committee Guidelines on Corporate Governance of 2000

These guidelines generally reflect an explicit recognition of the economic and social responsibilities expected from corporations by Tanzanian society, and these concern the creation of wealth, the provision of employment and ensuring the long-term survival of corporations.¹⁹⁰ In executing these responsibilities, directors are called upon to recognize the legitimate rights of the corporations' stakeholders including investors, suppliers, creditors, employees and society at large.¹⁹¹

Under principle 8 the guidelines appear to underpin the consideration of stakeholders in corporate governance. It reflects a belief that, in the long-term, corporations can address economic and social responsibilities only if the legitimate rights and interests of the stakeholders are taken into account in decision-making processes. These guidelines do not provide for the representation of stakeholders other than shareholders in the organisational decision-making organs such as boards of directors. In this respect, they are in

¹⁸⁶ See ss46-53.

¹⁸⁷ Section 106 of CMSA.

¹⁸⁸ Section 113.

¹⁸⁹ Section 113 (1)(2) &(3).

¹⁹⁰ See the introductory part of the guidelines.

¹⁹¹ Principle 8.

line with the shareholder instrumental view of the firm and therefore remain within the legal framework which recognises shareholders as the only organizational constituency represented in a company's decision-making board.

Corporate decision-makers are also called upon in the guidelines to institute codes of ethics which should explain the values of the corporation and set the framework for the corporation's policy and behaviour as a key component of effective corporate governance.¹⁹² In this respect, the guidelines are underpinned by the belief that ethics and corporate governance should be developed together. The guidelines require directors and managers to monitor the social responsibilities of corporations and disseminate policies which reflect the legitimate interests and acceptable business practices of the corporate entities.¹⁹³

The notions of "fairness" and "equity" are emphasised as guiding principles in the decision-making process involving employment, the protection of the environment, gender interests, children's rights and the rights of vulnerable groups in society. The guidelines are not explicit as to what should be done in practice to meet the requirement of "fairness and equity". In this regard, managers and directors are left to apply their discretion.¹⁹⁴

The recommended guidelines address issues of corporate governance in both state-owned and privately-owned corporations. The issues discussed include the function of the directors and the factors that determine the effectiveness of the boards of directors with respect to the control function.¹⁹⁵

In addition to the guidelines that apply to the corporations in general, the guidelines address issues specific to privately-owned companies. This is because of the increasing importance of privately owned corporations to the economy of

¹⁹² Principle 1.

¹⁹³ See principle 1 also principle 8.

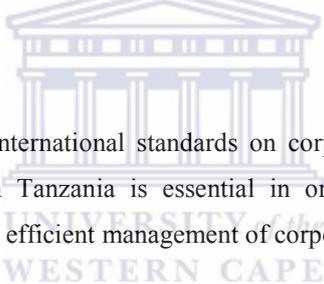
¹⁹⁴ Principle 5.

¹⁹⁵ Principles 1&9 among other thing it require the separation of position of the CEO and the chairman of the board.

Tanzania. Issues of shareholder rights and control, board control activities and determinants of board effectiveness with respect to control are addressed.¹⁹⁶

3.5.2 Capital Markets and Securities Authority (CMSA's) Guidelines of 2002

The CMSA has developed and recommended its own set of guidelines on corporate governance to be adopted by public listed companies in Tanzania which came into operation in 2002. The initiative by CMSA reflects the current international trend with respect to corporate governance since this involves the development of guidelines (principles) for effective corporate governance. The CMSA acknowledges the influence of the principles for effective corporate governance developed by the OECD.¹⁹⁷ The CMSA recommended guidelines take a shareholder instrumental view of organisations. It states in its introduction that:



‘[T]he adoption of international standards on corporate governance best practices for public companies in Tanzania is essential in order to maximise shareholder value through effective and efficient management of corporate resources.’¹⁹⁸

The guidelines have addressed in detail various aspects of shareholder rights and control, board control activities, and determinants of board effectiveness with respect to the control function.¹⁹⁹ Directors are expected to perform a number of activities to protect and further the interests of shareholders and other stakeholders of the company.²⁰⁰

The Board is required to establish relevant committees and delegate specific mandates to such committees as may be necessary. The CMSA pointed out that companies should establish audit and nominating committees.²⁰¹ The guidelines

¹⁹⁶ Generally see Part II.

¹⁹⁷ See introductory part of the CMSA para 1.2.

¹⁹⁸ Paragraph 1.1.

¹⁹⁹ See para 3.1, 3.2 and 3.3.

²⁰⁰ See para 4.1.1 (i)-(viii).

²⁰¹ Paragraph 3.1.1 (i) and (ii).

further specify the way in which such a committee should be constituted and led. Compliance with this recommendation may fall short because of the lack of legal power to enforce it.

The approach adopted in these guidelines is viewed as being prescriptive as well as descriptive. This means that companies are required to adopt certain aspects of the guidelines but have the option to implement or not.²⁰² However, no clear strategy has been put in place to encourage companies to implement these guidelines. The guideline is prescriptive as it has been developed for public listed companies and any other issuers of securities through the capital markets including issuers of debt instruments in Tanzania's capital market. Companies in the private sector are encouraged to practice good corporate governance but they are not bound to apply it. This should be addressed in order to attract more investors in Tanzania.



3.6 THE EFFECTIVENESS OF LEGAL AND REGULATORY FRAMEWORK OF CORPORATE GOVERNANCE IN TANZANIA

Various economic reforms undertaken by the government aimed to put in place laws and policies that will facilitate a favourable investment environment for local and foreign projects. During the mid-1990's the government initiated and enacted a number of investment related laws and policies in recognition of the important role towards creating an enabling environment for the development of a private sector. Some of them are: Tanzania Investment Act No. 26 of 1997 aimed at guiding investment activities in Tanzania except for the mining and oil exploration projects; Banking and Financial Institutions Act No.12 of 1991 which intends to harmonise the operations of all financial institutions in Tanzania and to regulate credit operations and to provide for other related matters; Mining Act No. 5 of 1998 which provides for mineral mining, trading and any other related matters; Capital Markets and Securities Act No.5 of 1995 which provides for the

²⁰² Paragraph 1.6. Listed companies are encouraged to comply with the guidelines and they have to disclose in their annual report the extent of compliance.

establishment of the CMSA for the purpose of promoting and facilitating the development of capital markets and securities in Tanzania and the establishment of the DSE.

Despite all these initiatives, the capital market is still underdeveloped.²⁰³ The evaluation by the World Bank in 2012 in East Africa region with regards to investors protection ranked Tanzania at the 4th position while Rwanda is the leading followed by Burundi, Kenya and Uganda.²⁰⁴

The provisions of the laws which govern corporate governance in Tanzania attempt to protect the investors but they are not adequate to fit all types of business in the modern world. The securities laws and the stock exchange which were established for the purpose of privatisation cannot fit market requirements for companies which are not listed for privatisation purposes.

Although the influence of laws and regulations is recognised, their effectiveness in encouraging managers to make decisions that maximise shareholder wealth is contestable. Jensen points out that the legal and regulatory framework 'is far more blunt an instrument to handle problems of wasteful managerial behaviour effectively as courts do not as a matter of practice question the judgment of management.'²⁰⁵

The US has been regarded as having strong legal and regulatory framework²⁰⁶ but yet it failed to prevent the conflict of interest between shareholders and managers. The collapse of Enron and other corporate scams is the evidence that the legal and regulatory framework alone cannot prevent the managers from pursuing their own interest to the detriment of shareholders and other stakeholders. The US

²⁰³ See discussion under ch 3.

²⁰⁴ Doing business in EAC 2012.

²⁰⁵ Jensen MC 'The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems' (1993) *Journal of Finance* 839.

²⁰⁶ La Porta R et al (1997) 1131-39.

government enacted the Sarbanes-Oxley Act (SOX) in 2002 whose application is mandatory to all corporations. It was established in order to strengthen the legal and regulatory framework and make it effective. Despite the existence and application of the SOX legislation, the US experienced the global financial crisis of 2007-2008 which has shaken the world's economy.

Despite the existence of legal framework for corporate governance in Tanzania, the level of flow of investment in a country is still small and Tanzania is still considered among the poorest countries in the world. The Companies Act falls short in promoting and protecting investors due to the fact that the large shareholders are the ones who are highly protected compared to minorities. Such situation can be a barrier to both local and foreign investors who are interested to invest in the listed companies with controlling shareholders.²⁰⁷

The guidelines recommended by both CMSA and Steering Committee are robust but the framework that exists in the corporate regime does not give way for their application especially to those companies with controlling shareholders. This is due to a lack of legal rules to back up the recommended guidelines as well as the weak enforcement mechanisms that exist in the country.

The former corporate governance system of state owned corporations in Tanzania was a complex system which faced a number of problems with respect to control and accountability. At the level of the people and the party, it can be argued that, when ownership is so fragmented, free rider problems occur which lead to an absence of monitoring.²⁰⁸ It cannot be expected that people would have the ability to monitor the management effectively. At the level of presidential and ministerial control level there is a problem for the lack of checks as the minister

²⁰⁷ World Bank Report on Doing Business in Tanzania (2012) 58 available at www.doingbusiness.org (accessed 4 April 2013).

²⁰⁸ See Hart O 'Corporate Governance: Some Theory and Implications' (1995) *Economic Journal* 678. Free rider problems refer to owners of a corporation who individually hold only a small number of shares and who thus individually lack an incentive to monitor management and take corrective action.

or president can be misled by his subordinates on the performance of a board of executive officers.

The ineffectiveness of the corporate governance of state-owned corporations contributed to their poor performance. Gregory and Simms suggest that the effectiveness of corporate governance will be reflected in a firm's performance.²⁰⁹ By the late 1980s, the public corporations were regarded as such a burden on the state²¹⁰ that they had to be divested.

The legal and regulatory framework of corporate governance in state owned corporations is generally considered weak because of the inefficient enforcement of the law and regulations.²¹¹ The system does not provide a plausible warning that violation of promises will be efficiently punished in such contexts.

Business entities are growing and becoming more and more interdependent. The rise of business transactions necessarily entails also a rise in commercial disputes, whose resolutions form an essential component to a thriving and vibrant business environment, and hence the relevance of a formal system for resolving commercial disputes. Despite the fact that Tanzania is ranked by the World Bank to be the top performer in enforcing contracts in the East Africa region,²¹² there are still many challenges facing the Commercial Court Division. Such challenges are: case-delays; backlogs of cases; limited access to justice; lack of transparency and predictability in court decisions; shortage of financial, physical and other resources; and weak public confidence in the judicial system.²¹³

²⁰⁹ Monks R & Minow N (eds) *Corporate Governance* 2ed (2002) ch 3.

²¹⁰ A study conducted by the Ministry of Finance in 1974 of 24 parastatals showed that, by the end of 1973, they had accumulated TAS 178 million (equivalent to US\$ 35.6 million at that time) in losses which accounted for 91% of the total capital allocated to these parastatals.

²¹¹ United Republic of Tanzania (URT) *Presidential Commission of Inquiry: Report on the State of Corruption in the country* (1996).

²¹² Tanzania is ranked at 36th position out of 185 economies evaluated by the World Bank in the Doing Business' program in 2012. For more information see www.doingbusiness.org (accessed 4 April 2013).

²¹³ Makaramba RV 'Ten Years of the Commercial Division of the High Court of Tanzania: Commercial Disputes Resolution in the wake of Global Economy Recession: Commercial Disputes Resolution in Tanzania: Challenges and Prospects (2009) 9 *A paper to be presented at the Roundtable Discussion* held at the Paradise City Hotel Benjamin Mkapa Towers.

Transparency and integrity is of most importance for the enforcement organs such as the judiciary. The problem of high levels of corruption is another thing which makes enforcement of corporate governance principles problematic in Tanzania to the extent that it cannot threaten managers to pursue the interest of the company.²¹⁴ The Presidential Commission in Tanzania, chaired by Justice Warioba, stated in the report on the 'State of Corruption in Tanzania' that:

[O]ur country has witnessed an alarming increase in incidences of corruption involving public servants on the one hand and the members of the public who are seeking public services on the other hand. Corruption has been fanned by the existence of loopholes inherent in procedures, temptations, greed for property, meagre incomes and erosion of ethics. Moreover state organs entrusted with the task of checking the proliferation of corruption has succumbed to this scourge leaving the public with no refuge.²¹⁵

The enforcement mechanisms in Tanzania can be fettered due to the lack of multiple enforcement organs. Apart from the commercial court which was established in 1999, other dispute resolution organs are the Tax Revenue Appeals Tribunal, which is established under the Tax Revenue Appeals Act²¹⁶ and the Fair Competition Tribunal which is established under the Fair Competition Act.²¹⁷ Hence, the reliance on judicial system may lead to long delays in dispute resolution on corporate issues. Tanzania needs to have alternative dispute resolution (ADR) established out of the limb of the commercial court in order to expedite commercial disputes and save time and costs for investors.

²¹⁴ United Republic of Tanzania (URT) *Presidential Commission of Inquiry: Report on the State of Corruption in the Country* (1996).

²¹⁵ Warioba JS *Remarks at the opening of the University of Dar es Salaam Annual Convocation Symposium*, Dar es Salaam. (2003). see also Chachage SLC (2003).

²¹⁶ Cap. 408 Revised Edition (R.E) 2002, in s8 (1) the Act establishes the Tax Revenue Appeals Tribunal (TRAT), whose chairman is a judge of the High Court.

²¹⁷ Cap.285 R.E 2002, in s4(1) the Act establishes the Fair Competition Tribunal (FCT) whose chairman is a person holding or is qualified to hold "high judicial office" which as per section 3(4) of the Act means the office of a Judge of the Court of Appeal or the High Court of the United Republic.

3.7 CONCLUSION

From above discussion, it can be acknowledged that policy makers and regulators in Tanzania have put a lot of effort in promoting good corporate governance so as to align the country with global standards by establishing guidelines for corporate governance.

The Tanzanian legal framework seems to be more robust compared to that of Kenya but still is suffering from low flow of FDI.²¹⁸ The problem is in the enforcement and compliance of the existing legal regulatory rules. There, however, remain a number of challenges the country has to attend to in order to achieve full compliance with corporate governance principles. The main challenges that Tanzania has encountered are, among others, lack of competent and committed human resources; poor regulatory oversight; lack of adherence to the regulatory framework, and inadequate transparency and disclosure; inadequate legal and judicial frameworks; corruption and ineffective compliance mechanisms.²¹⁹

Furthermore, many of the regulatory bodies that are meant to provide checks and balances within the system (including prosecuting systems) have insufficient resources, skills, infrastructure, and independence to enforce the laws and regulations.²²⁰ The failure of stringent requirements to achieve full corporate governance compliance shows that there is more to corporate governance than just laws and regulations. All players have to be committed to practice good corporate governance.

²¹⁸ See comparison in chapter 4.

²¹⁹ Cooper MS 'Corporate Governance In Developing Countries: Shortcomings, Challenges & Impact on Credit' *Paper presented at the Congress to celebrate the fortieth annual session of UNCITRAL* Vienna, 9-12 July 2007, available at www.uncitral.org/pdf/english/congress/Cooper_S_rev.pdf (accessed 20 July 2012).

²²⁰ Cooper MS (2007).

The corporate regime in Tanzania is positioned in such a way that it is for the companies with controlling shareholders. This is also a limitation because the development of the EAC and SADC Free Trade Area (FTA) encourages²²¹ cross boarder investment hence the legal framework has to accommodate the issue of minority shareholder rights.

Tanzanian legislature and policy makers therefore, still have a lot of work towards enhancing voluntary compliance, strengthening enforcement and prosecution mechanisms, encouraging sufficient disclosure and reporting, reducing corruption and encouraging shareholders participation especially minorities who are not well protected by the law as their counterpart controlling shareholders.



²²¹ The EAC FTA is operational and Tanzania is among of its members. At the same time The SADC FTA was launched since 2008 and custom union was to be launched by 2010 but to date they are working on how to harmonise tariff among member countries. The two regional blocs i.e. EAC and SADC want to form a tripartite FTA with Common Market for Eastern and Southern Africa (COMESA). This is the initiative of Africa Union to have a continental FTA.

CHAPTER FOUR

A COMPARISON OF CORPORATE GOVERNANCE LEGAL AND REGULATORY MECHANISMS OF TANZANIA, KENYA AND SOUTH AFRICA

4.1 INTRODUCTION

Corporate governance practices have undergone fundamental changes during the past few decades. The collapses of some big companies have motivated many countries to put in place advanced systems that promote higher standards of ethical conduct, accountability and transparency in companies and by directors.²²² A number of corporate governance misfortunes occurred in the financial sector, resulting in the collapse and absorption of a number of financial institutions.²²³ These collapses, among others, highlighted the risk of concentrating power and decision making in the hands of a few individuals which has led to a general consensus around the world that there is need for power balance in companies.²²⁴

In this regard, one of the major concerns of corporate governance has been the extent to which executive directors exercise their powers and whether such powers should be restricted.²²⁵ Other matters are financial management, shareholders rights and their role in corporate governance as well as the government role in putting in place good corporate governance regime. For the purpose of this chapter it is worth to outline the main source of corporate governance laws and regulations before embarking on making comparisons.

²²² Moloi STM ‘Assessment of Corporate Governance Reporting in the Annual Reports of South African Listed Companies’(published MSc Thesis, University of South Africa 2008) 1-3.

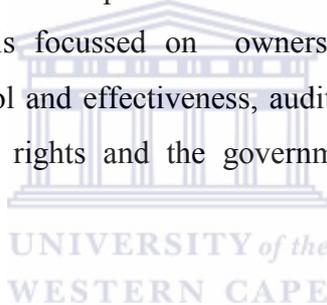
²²³ Smit P J, *Management Principles: A Contemporary Edition for Africa*, (2007) 15-18. Examples of financial institutions that collapsed are the Saambou Bank Limited and Regal Treasury Bank.

²²⁴ This is reflected by the number of corporate governance codes the world over which all provide for the need to separate powers between executive and non-executive directors and between the chairman and chief executive officer of a company.

²²⁵ Coyle B (2003) 44-51. This aspect of corporate governance is, *inter alia*, about the structure of board of directors, the role of independent non-executive directors and the powers of shareholders under company law.

The main sources of corporate governance in South Africa are the King Reports on Corporate Governance (which forms the basis of the debate on corporate governance in South Africa), Acts of Parliament, particularly the Companies Act 71 of 2008, JSE Listings Requirements and common law. This work will mostly focus on the King Reports, Companies Act, and JSE Listing Requirements with brief references to other selected Acts that positively impact on corporate governance. On the other hand, Kenyan corporate governance regime is exercised mainly from the Companies Act of 2009, common law and Capital Markets Authority (CMA) Guidelines. The Tanzania legal framework for corporate governance is based on the Companies Act 2002, common law, securities laws and corporate governance guidelines.²²⁶

The corporate governance comparisons in the three countries (South Africa, Kenya and Tanzania) is focussed on ownership structure and shareholder control; the board control and effectiveness, audit committee; shareholder rights and other stakeholder's rights and the government involvement in corporate governance.



4.2 OWNERSHIP STRUCTURE AND SHAREHOLDER CONTROL

The nature of the debate on corporate governance is influenced by the way in which corporations are viewed. The early conceptualisation of corporations tended to treat corporations as the property of equity capital providers (shareholders) for the pursuance of their economic interests. However, an essential characteristic of a corporation is its ability to have a separate existence apart from those who own it.²²⁷

²²⁶ See chapter 3 for detailed discussion on the Tanzania Legal framework for corporate governance.

²²⁷ Clarke T & Clegg S (1998) 105.

4.2.1 Tanzania

The Tanzania corporate ownership is characterized by concentrated ownership whereby many of the companies listed in the DSE have controlling shareholders holding more than 50% of the stock which provides them with controlling rights and incentives to exercise control.²²⁸ This reflects the privatisation strategy employed in divesting control of the state owned companies by selling of a large number of shares to strategic investors.

Shareholder control is exercised through participating in decision making process of these companies. The controlling shareholders are the ones who appoint directors,²²⁹ and set internal procedures and mechanisms which further ensure that management provides relevant information. Therefore, there is a possibility of the controlling shareholders to have more access to information than their counterparts who have to rely mainly on annual audited reports. The influence of these controlling shareholders is reflected in the annual general meeting of the company. When major decisions which require the shareholders' approval at these meetings, the vote of the controlling shareholders determines the outcome.

The concentration of ownership in Tanzania implies that separation of ownership from control has not really taken place in Tanzania. This supports the existing literature that, except for the US and the UK, in a large number of countries, ownership and control have not been separated.²³⁰

4.2.2 Kenya

Ownership of many listed companies on the NSE is concentrated in the hands of foreigners. For instance, 20 of the 58 companies listed on the NSE as of 1996 were available for foreign investment. In the last decade, the government of

²²⁸ See discussion in Chapter 3.

²²⁹ Section 192 (1).

²³⁰ Clarke T & Clegg S (1998)113.

Kenya in order to attract the flow of FDI, significantly reduced restrictions on foreign ownership in locally controlled companies from 20 per cent for investors and 25 per cent for single holdings to 40 per cent for investors and five per cent for single holdings in 1995.²³¹

Following these amendments, in 2002 the foreign investor regulations were amended to provide Kenyan citizens with a minimum ownership of 25 per cent while the balance of 75 per cent was left for investors.²³² The amendment done in 2007 reduced foreign ownership to 60 per cent.²³³ This confirms that there are some companies whose ownership is still concentrated in the hands of foreign investors as the case of Tanzania. However, there are also a good number of companies whose ownership is separated from control. Therefore, the minority shareholders rights in decision making are at risk in the companies with concentrated shareholdings. The majority shareholders also need to be protected in those companies where the ownership is separated from the control in order to protect their rights from abuse by the management.

The CMA guidelines for corporate governance in Kenya recommended the protection of both major and minority shareholders. The structure of the board should comprise with a number of directors, which fairly reflects the Company's shareholding structure. The composition of the board should also provide a mechanism for representation of the minority shareholders without undermining the collective responsibility of the directors.²³⁴ This however might be among the things which make the capital markets of Kenya more developed than that of Tanzania.

²³¹ Musikali LM 'The Law Affecting Corporate Governance in Kenya: A Need for Review' (2008) *International Company and Commercial Law Review (I.C.C.L.R)* 220.

²³² Legal Notice 134 of 2002 referring to para.3(1).

²³³ See Legal Notice 98 of 2007 referring to para.3 (a) published on June 14, 2007.

²³⁴ Paragraph 3.1.2 (iii) of the CMA guidelines.

4.2.3 South Africa

During the apartheid era the mode of ownership and control of many listed companies was concentrated in a few individuals and companies.²³⁵ By 2000 there were 608 companies listed in the main board of JSE whereby 390 of them had a shareholder with more than 30 per cent shareholding.²³⁶ This means that there was a substantial number of companies whose shares were concentrated in a few hands. This figure reflects almost two thirds of all listed companies. That means that the majority of the listed companies did not wield the legal control (by having more than 50% of shareholding). This ownership structure is different from that which exists in Tanzania whereby there are individuals and companies holding more than 50% of shares in a company. It can be concluded that South Africa has got both companies which have separation of management from ownership whereby single shareholders own not more than five percent of the companies share.²³⁷ Another category is those companies where there is a dominant shareholder who owns more than 50 per cent of shares, especially institutional investors.²³⁸ This dual system of ownership requires corporate governance standards which will strengthen the managerial accountability as well as protect the minority shareholders.

The separation of management from ownership which results in the transfer of control of corporations from owners to professional managers, poses a significant challenge in controlling the management so that they can pursue the interest of all shareholders.²³⁹

²³⁵ Mongalo T (2004) 111.

²³⁶ Profile's Stock Exchange Handbook January-June 2001 (Profile Media, Johannesburg) as cited in Mongalo T (2004) 112.

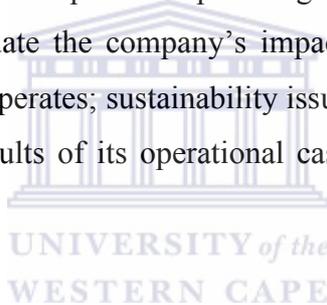
²³⁷ No individual is allowed to own more than 50 percent of the company's shares unless if it is institutional. See the Profile's Stock Exchange Handbook January-June 2001 (Profile Media, Johannesburg).

²³⁸ Mongalo T 'South Africanising Company Law for a Modern Competitive Global Economy' (2004) *SALJ* 111.

²³⁹ Scott J (1997) 167-168.\

King III Report having recognised the separation of ownership and control recommended the existence of a unitary board system. The board is supposed to consist of both executive and non-executive directors and in governing the business of the company allows committees to work side by side with the board.²⁴⁰ It also recommends the establishment of director's remuneration committee in order to reduce expenses on investors thereby protecting them.. The reason behind having this committee was that the directors may decide to pay themselves offensive remuneration packages as these directors are not necessarily shareholders or substantial shareholders, therefore they pursue their own interest rather than shareholders' interests.

The Report places great emphasis on leadership, sustainability and corporate citizenship. The King III Report has placed great emphasis on an integrated report, which will evaluate the company's impact on the economic life of the community in which it operates; sustainability issues pertinent to its business; the financial results; the results of its operational cash flow as well as many other matters.²⁴¹



The King III Report made many recommendations as to shareholders rights, audit committee, powers of directors and their duties,²⁴² corporate citizenship and the responsibility of the board of the company to operate within a triple faceted context i.e.: economic , social and environmental in order to make the managerial accountable. Companies have to adhere to social and ethical norms and the Report recommended for social and ethical committees²⁴³ which are also incorporated in the new Companies Act.²⁴⁴

²⁴⁰ The King III Report recommend for establishment of Committees such as nominating, audit and remuneration.

²⁴¹ See principle 9.1 para 5&6.

²⁴² See section 76 of the Act which partially codified the duties of directors.

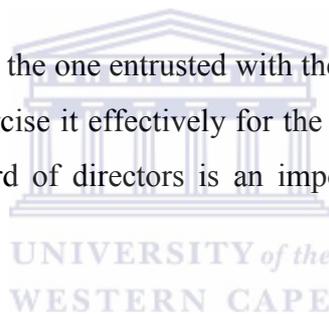
²⁴³ See principle 1.1 para 9.

²⁴⁴See s72 (4) of the South African Companies Act. See also s43 (3) of the Companies Act Regulations of 2011 which provides among other thing the functions of these committees.

4.3 BOARD CONTROL AND EFFECTIVENESS

Corporate governance begins with power. It is about those who hold the power in an organization, how it is delegated and exercised, its purpose, and what control mechanisms the power holders use. Those who have powers also have the responsibility of decision making, the right to choose, and the option to delegate. Power in a company is not absolute because it is always exercised within guidelines or constraints. In public corporations, the purpose of power is the creation of value, and the structure of shareholder owned corporations means that the value created must be shared. In this part I am going to compare and contrast board control and its effectiveness in the three countries, Tanzania, Kenya and South Africa.

The board of directors is the one entrusted with the power to control the company therefore they must exercise it effectively for the interest of those who entrusted them. An effective board of directors is an important determinant of effective corporate governance.²⁴⁵



4.3.1 Tanzania

The Companies Act provides that the business of the company will be controlled by the directors of the company.²⁴⁶ However it does not specify what activities constitute ‘managing of a company’. There is also a proviso to the effect that it will be subject to MEMARTS of incorporation. The nature of company control by the majority shareholders made the company’s directors to be less involved in control.²⁴⁷ They are left with the duty to discuss and approve the company’s strategies.

²⁴⁵ Berlof E & Claessens S (2004) 16-17.

²⁴⁶ Section 183 of the Companies Act 2002.

²⁴⁷ Roe MJ *Political Determinants of Corporate Governance: Political Context, Corporate Impact.* (2003) see also discussion in Chapter 3.

For those companies which have no controlling shareholders the directors perform all activities usually related to the control function of the board; making decisions about hiring and firing of the CEO; making the decision about the CEO and directors compensation and discuss and approve the company's strategies.

The Companies Act 2002 partially codified the common law duties of directors. These duties are to act in good faith and in the interest of the company and the duty of care. Under the duty of care, the court can use both objective and subjective tests. In the subjective test, the court looks at the skills and experiences of the directors whereas in an objective test it looks at how directors reach their decision. The objective test is just to test if a decision reached by a director would have been reached by another person in his capacity as a director.

The guidelines recommended by CMSA recognise that directors have a fiduciary responsibility to shareholders. Directors are expected to perform a number of activities to protect and further the interests of shareholders. It further recommends that the interests of the company's stakeholders should also be considered, especially in decision making. However, the interest of shareholders which is maximisation of wealth constitutes the key criterion in decision making.

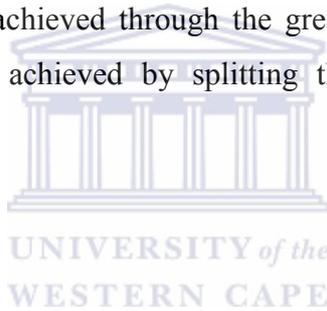
The CMSA guidelines recommended that, composition of the board of directors of listed companies should have at least one third of the board members as non-executive directors. The Companies Act does not make any provision regarding the existence of non-executive directors in the management of the company.

However, there is no provision regarding the separation of powers of the CEO and the chairman of the board. The statement below is the evidence to that effect:

[T]he directors may appoint one member to be the chairman of the board of directors and determine the period of which he is to hold office. Unless he is unwilling to do so, the director so appointed shall preside at every meeting of directors at which he is present. But if no such chairman is appointed, or if he is unwilling to preside, or if at any meeting the chairman is not present within five minutes after the time appointed for

holding the same, the directors present may choose one of their number to be chairman of the meeting.²⁴⁸

Therefore based on the above provision, there is a possibility of having companies whereby the posts of board chairman and executive director are separated and there exist scenarios whereby the two posts are combined and occupied by one person. By virtue of his position as a director, the chairman participates in decisions that are aimed at controlling his decisions. This reduces the extent to which other directors can be critical of his decisions. The continuing existence of the above paragraph fetters the application of the CMSA guidelines which recommend the separation of powers between the two posts.²⁴⁹ This implies that the board leadership is not considered to have any impact in governance of the companies. Donaldson and Davies opined that corporate performance would be achieved through the greater independence in decision-making that would be achieved by splitting the role of the CEO and the chairman.²⁵⁰



4.3.2 Kenya

Guidelines on corporate governance practices by public listed companies in Kenya provide that every public listed company should be headed by an effective board to offer strategic guidance, lead and control the company and be accountable to its shareholders.²⁵¹ However, the board of directors shall exercise all the powers of the company subject only to the limitations contained in the law and the memorandum and articles of incorporation. This is because the system of ownership reflects that of South Africa which contains both companies which have concentrated ownership and dispersed ownership. Therefore, for the company with a controlling shareholder the MEMARTS may provide otherwise regarding the powers of directors in the company's business.

²⁴⁸ Paragraph 45 of the schedule to Act.

²⁴⁹ See para 3.2.1 of the CMSA.

²⁵⁰ Donaldson L & Davies JH (1994) 2(3) 151.

²⁵¹ See the CMSA Guidelines at 2.1.

The manner in which directors are to exercise their powers in managing the company was not dealt with by the Companies Act 1962 nor the new Act of 2009, but by *Table A* of England's Companies Act 1948.²⁵² It is worth pointing out that *Table A* is optional and may not be part of the constitution of the company. The provisions of *Table A* are therefore discussed with the general assumption that they will be applicable to Kenyan companies.²⁵³ Article 101 of *Table A* provides that, 'the directors may elect a chairman to their meetings and determine the period for which he is to hold office.' This contravenes the CMA guideline which requires every public listed company should as a matter of best practice separate the role of the chairman and chief executive in order to ensure a balance of power and authority and provide for checks and balances. Chairmanship of a public listed company should be held by an independent and non-executive director.²⁵⁴

Although *Table A* is not mandatory, except where a company has adopted it into its constitution, the appointment of board chairman is likely to be based on it. When it is adopted by the company's constitution, it becomes a mandatory legislation upon which directors of companies can challenge the recommendations of the CMA Guidelines which are not mandatory. Therefore, it suppresses Kenya's quest towards adopting good corporate governance. There is a need to review Article 101 of *Table A* accordingly to prevent it from suppressing compliance with the requirement that the chairmanship of a public listed company should be held by an independent and non-executive director.

In Tanzania and Kenya strengthening managerial accountability may not be pressing because of the system of ownership and control which prevail. The system of management and control is referred to as insider or control oriented. The large companies listed in Tanzania and in many developing countries have concentrated shareholders who have a hand of control in the management. Hence the controlling shareholders can manage the company as they wish as they are the

²⁵² See s134 of the new Act of 2009.

²⁵³ Ogola JJ *Company Law* 2ed (2000) 219.

²⁵⁴ The CMA Guidelines at 3.2 (i) & (ii).

ones who decide the mode of governance. However, the issue remains with the protection of minority shareholders.

4.3.3 South Africa

The King III Report recommended that the Board should act as the focal point for Corporate Governance.²⁵⁵ This means that the board should direct, govern and control the company. The Board should provide effective Corporate Governance. The Board should as the link between the stakeholders and the company, exercise leadership, enterprise, integrity and judgment. It is the duty of the Board also to identify and take account of the legitimate expectations of stakeholders. Stakeholders should be engaged in such a manner that they have trust and confidence in the company.

Unlike the position in Tanzania where the interests of the controlling shareholders are well protected the ownership system applied in South Africa allows the directors to govern all the business of the company. This is because of the developments which have been achieved in South Africa whereby there is a separation of ownership and control in many listed companies. Therefore, in order to protect the majority shareholders, the management must be accountable.

Though the new Companies Act 71 of 2008 does not directly contemplate a board with separate executive and non-executive structures, it expressly permits *ex officio* members who hold 'some other office, title, designation or similar status with the company'.²⁵⁶ Furthermore the King III Report emphasised the unitary board structure²⁵⁷ whereby the board should consist of both executive directors and non-executive directors²⁵⁸ who will interact. The separation of position of the CEO and the chairman of the board is also among the recommendation of the

²⁵⁵ King III Report principle 1.1.

²⁵⁶ Section 66 (4) of the Companies Act 2008.

²⁵⁷ King III principle 1.17.

²⁵⁸ See King III Report principle 2.18:62.

King III Report.²⁵⁹ In addition to this the board should ensure that the company complies with all relevant laws, regulations and codes of business practices and communicate with its shareowners and relevant stakeholders.²⁶⁰

The new Companies Act which came into force in 2011 does partially codify the director's duties.²⁶¹ The new Act having regarded the development of the companies in the country and the need for a strong corporate regime; it gives the broader definition of not only *ex officio* directors but also other officers and committee members. This was done purposely because the duties of directors applied also to other prescribed officers.²⁶² The new Act does not provide for the qualification of directors. However, the Act provides for liability of directors, hence both subjective and objective test will be applied in determining whether they act with reasonable care and for the interest of the company.²⁶³

Section 67(3) of the new Act provides for both a subjective and objective test in examining the duty of care of directors depending on what type of skill the person has. This sub-section resolves the problem of lack of certain list of qualifications required for a person to be appointed as a director as one test of degree of care and skills cannot fit all.

Unlike the position in Tanzania and Kenya, the South African Companies Act 2008 provides for a business judgement rule.²⁶⁴ The Companies Act, by recognising the risks associated with businesses, such as economic crisis, exchange rates, environmental changes and many other social and economic risks, it provides for a shield in the form of this rule which may be used by directors to escape liability.

²⁵⁹ King III principle 2.16.

²⁶⁰ King III principle 2.4, see also principle 2.9.

²⁶¹ See section 76 which provides for the duties of the directors.

²⁶² Companies Act 2008, Section 76 (1) (2).

²⁶³ See section 77 of the Act.

²⁶⁴ Section 76(3).

A director who aims to rely on this defence should show that he acted in good faith and for a proper purpose; in the best interests of the company; and with the degree of care, skill and diligence that may reasonably be expected of a person carrying out the same functions in relation to the company as those carried out by that director; and having the general knowledge, skill and experience of that director.²⁶⁵

He is further required to satisfy that he has taken reasonably diligent steps to become informed about the matter; he had no material personal financial interest in the subject matter of the decision, and had no reasonable basis to know that any related person had a personal financial interest in the matter and he had a rational basis for believing, and did believe, that the decision he made or supported was in the best interests of the company.²⁶⁶ Hence the business judgement rule is the only way of protecting innocent directors otherwise people would be afraid to accept the position of directorship.

4.4 SHAREHOLDERS' RIGHTS AND THEIR INVOLVEMENT IN CORPORATE GOVERNANCE

In the modern economy, where there is separation of ownership from control, corporate governance is a balance in which shareholders limit their right to manage the company and leave it to the directors who provide for and oversee management of the company and owe duties and liabilities to the company and to the shareholders. The treatment of shareholders differs from country to country depending on the system of ownership in place.

4.4.1 Tanzania

As elaborated in earlier chapters the ownership system existing in Tanzania is dominated by the concentrated shareholder. The MEMARTS of incorporation is

²⁶⁵ Section 76 (4).

²⁶⁶ Section 76(4) (a) (i)-(iii).

the main internal rules of the company. In Tanzania, the law allows classes of shares to be issued hence there is variation of shareholder's rights.²⁶⁷

All shareholders have the right to participate in a general meeting. The Companies Act also gives the member the right to require an extraordinary meeting; however the member must own at least 10% of the shares in the company in the case of company limited with share and not less than one-tenth of the voting rights in the case of any other company at the time of requisition.²⁶⁸

Special resolution can only be passed by the majority votes of at least 75% of the members who are entitled to vote. In those companies with concentration of shareholding, the controlling shareholders have a bigger chance to pass a resolution than is the case with minority shareholders.

However, in order to protect minority interests any member of a company can make an application to the court for intervention or for permission to start a derivative action on behalf of the company if the affairs of the company are being conducted in a manner which is unfairly prejudicial to the interests of the members in general or the minority in particular.²⁶⁹ In the system where controlling shareholders hold more than 60 per cent of the shares it will be difficult for minority shareholders to secure a resolution for derivative action especially where they are complaining about abuse by the controlling shareholders.

4.4.2 Kenya

In Kenya as the case in Tanzania the controlling shareholders are more protected than the minority in the companies with concentrated ownership. The CMA Guidelines deal with the extent of foreign ownership and provide that, 'a board of a public listed company should ensure equitable terms of shareholders including

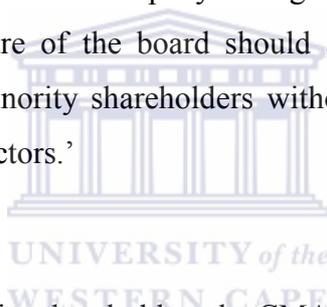
²⁶⁷ Section 73 provides for rights of holders of special classes of shares. The rights are therefore attached to class of shares hold by a shareholder.

²⁶⁸ See ss133 & 134 of the Companies Act 2002.

²⁶⁹ Sections 233, 234.

the minority and foreign shareholders'.²⁷⁰ This provision reiterates the fact that the interests of minority shareholders need to be taken into account. Other provisions in the CMA Guidelines however, contradict this end. At paragraph 3.3(iv) it states that, 'every shareholder shall have a right to participate and vote at the general shareholders meeting including the election of directors'. With foreign ownership in some companies exceeding 40 per cent, with a possibility of 60 per cent ownership,²⁷¹ it is doubtful whether minority shareholder votes will have any effect in securing the interests of minority shareholders. Research has shown that a majority of the top 20 companies listed in the Nairobi Stock Exchange are foreign controlled.²⁷²

CMA recognizes the risk which might be faced by minority shareholders in protecting their interest in the company. Paragraph 3.1.2(iii) of the Guidelines states that: 'The structure of the board should also provide a mechanism for representation of the minority shareholders without undermining the collective responsibility of the directors.'



In order to protect minority shareholders the CMA Guidelines require the structure of the board to reflect the Company's shareholding structure. The board composition should not be biased towards representation by a substantial shareholder but should reflect the Company's broad shareholding structure. The composition of the board should also provide a mechanism for representation of the minority shareholders without undermining the collective responsibility of the directors.²⁷³ Shareholder protection appears to only be possible if minority shareholders vote as a block.

²⁷⁰ The CMA Guidelines at 3.3 (i).

²⁷¹ Legal Notice 98 of 2007 referring to para.3 (a) published on June 14, 2007. The first limit set for the foreign ownership was 75%. See Legal Notice 134 of 2002 referring to para.3(1).

²⁷² Musikali LM (2008) 223.

²⁷³ The CMA Guidelines at para 3.1.2(iv); Substantial shareholder is the shareholder who holds not less than fifteen per cent of the voting shares of a listed company and has the ability to exercise a majority voting for the election of the directors.

Research in developed countries has shown that shareholders as a group have an incentive to monitor the actions of management.²⁷⁴ This highlights the need to protect the rights of minority shareholders in Kenya and Tanzania by reviewing the law affecting derivative actions to provide an efficient dispute resolution mechanism for minority shareholders.

4.4.3 South Africa

The Companies Act 71 of 2008 is more robust in providing shareholder protection than the Companies Acts of Tanzania and Kenya. The Act provides greater power and more forceful means of intervention to shareholders than would be found in the United States or United Kingdom.²⁷⁵

As in the case of Tanzania and Kenya, the Act provide for the right of the shareholder to participate in the annual general meeting. The Act goes further allowing shareholders to raise any matter at any time with or without advance notice to the company'.²⁷⁶

The Act also allows shareholder participation beyond the annual meeting. It does grant shareholders representing at least 10 per cent of the voting rights in a company the right to call a special meeting.²⁷⁷

The Act also allows any two shareholders of a company to propose a resolution concerning any matter of which they are each entitled to exercise voting rights.²⁷⁸

The scope of a permitted resolution is narrowed only in that it requires the

²⁷⁴ Grossman SJ& Hart OD 'Takeover Bids, the Free-rider Problem, and the Theory of the Corporation' (1980) 11(1) *Bell Journal of Economics* 42.

²⁷⁵ Olson J F 'South Africa Moves to a Global Model of Corporate Governance but with Important National Variations' (2009) 242 *Modern Company Law for A Competitive South African Economy* 219-247.

²⁷⁶ Section 61(8)(d).

²⁷⁷ Companies Act s 61(3) (b). However, the Act does allow any shareholder or company to apply to the court for an order setting aside a demand for meeting on the grounds that the demand is frivolous or is otherwise vexatious. The court is given many powers here to give their own judgment as to whether the meeting was dully called or not.

²⁷⁸ Companies Act s 65(3).

resolution to be clear and properly explained for the shareholders who have right to vote in the meeting to determine whether to participate in a meeting and to seek influence of the outcome of the vote on the resolution.²⁷⁹ Shareholders are also allowed to commence derivative proceedings.²⁸⁰ However, the resolution should be approved by the shareholders. The Act provides that for an ordinary resolution to be approved by shareholders, it must be supported by more than 50% of the voting rights exercised on the resolution except for an ordinary resolution for the removal of a director under section 71. For a special resolution to be approved by shareholders, it must be supported by at least 75% of the voting rights exercised on the resolution.²⁸¹

4.5 STAKEHOLDERS' RIGHTS

4.5.1 Tanzania and Kenya

As pointed out in chapter 3, corporate governance in Tanzania is confined to the boundaries drawn by Anglo-Saxon notions of property rights- that is, it is a shareholder-oriented system. The transplanted company ordinance and the current Companies Act represent the way in which this Anglo-Saxon notion has been reproduced in the Tanzanian context and reflects the linked colonial past.

Corporate governance that is focused on shareholder interests alone is increasingly being challenged. This is in particular on the basis of its narrow focus as well as its ethics or morality. Fort and Schipani²⁸² assert that: 'the comfortable and traditional characterization of corporations as profit maximisers within the limits of the law might be insufficient in today's world'. While the shareholder perspective is being challenged, an alternative perspective - the

²⁷⁹ These are requirements under s 65(4).

²⁸⁰ Companies Act s 165(2). This section provides four categories of persons who may serve a demand on the company to commence a derivative action.

²⁸¹ See s. 65(7) .(8) and (9).

²⁸² Fort TL & Schipani CA 'Corporate Governance, Stakeholder Accountability and Sustainable Peace' (2002) *VAND J TRANSNATIONAL LAW* 387.

communitarian perspective is increasingly receiving greater attention and is even being advocated by some as evidenced by the use of such words as ‘inclusive’ corporate governance.

In Tanzania, as pointed out in Chapter 3, the legal framework encourages some limited form of stake holding orientation in the governance of corporations. Under the companies Act 2002 the directors are supposed to protect the interests of the shareholders first. In addition to the interests of the members, the directors of the company have to give regard to the interests of the company's employees in the performance of their functions.²⁸³

Although the CMSA Guidelines recommend that the company should take into consideration the interest of other stakeholders; the implementation of it is fettered due to the lack of effective enforcement and lack of back up with legal rules. Also the CMSA Guidelines are essential for public companies in Tanzania in order to maximize shareholder value. The position in Kenya is not different from that of Tanzania. The Companies Acts are silent on protection of other stakeholders.

In Kenya the CMA Guidelines has been developed as a response to the recognition of the role of good governance in “maximisation of shareholders value as well as protection of investors' rights”. The focus of the Guidelines appears to be on shareholders rather than stakeholder interests. This is confirmed by paragraph 3 of the CMA Guidelines, which provides that:

‘... [T]he adoption of international standards in corporate governance best practice is essential for public companies in Kenya in order to maximize shareholders value’

As is the case in Tanzania, the corporate governance pursued in Kenya is shareholders oriented. The company should however take into consideration the interest of other stakeholders while pursuing shareholders’ welfare.²⁸⁴

²⁸³ Section 183.

²⁸⁴ The CMA Guidelines at para 1.2.

4.5.2 South Africa

South Africa has a robust legal system when it comes to the issue of stakeholder's rights other than shareholders. The King Committee's Report on corporate governance states in paragraph 37 that:

‘... [I]t is the King committee's unanimous view that the inclusive approach is fundamental to doing business in South Africa in order to ensure that companies succeed at balancing economic efficiency and society's broader objectives.’

An inclusive approach to corporate governance implies a system of governance of corporations in which the interests of non-shareholder constituencies are seriously taken into account in the decision making processes of corporations. The King III Report recommended a triple bottom-line or integrated report.²⁸⁵

The inclusive approach has however posed a tension on its practical implementation which was also recognised by the King Report. In paragraph 5.1 of the report it is noted that:

‘..... [T]he stakeholder concept of being accountable to all legitimate stakeholders must be rejected for this simple reason that to ask boards to be accountable to everyone would result in their being accountable to no one...’

Under the Companies Act, shareholders, directors, officers or trade unions representing employees of the company may initiate proceedings to restrain the company from doing anything inconsistent with the new Act.²⁸⁶ Employees, through trade unions, are also provided the opportunity to have a director declared delinquent²⁸⁷ and are given the authority to institute a derivative action to recover for losses to the corporation, a power held only by shareholders of a company in most jurisdictions.²⁸⁸ In addition to the broadened power given to employees under the Companies Act, employees are also provided with more

²⁸⁵ King III Report recommended that in preparing their financial statement companies should consider not only to the shareholders but also to other company's stakeholders. This is all about the concept of making company responsible to the community it operates.

²⁸⁶ Section 20(4).

²⁸⁷ Section 162 (2).

²⁸⁸Section 165(2)(c).

expansive access to information than is typically provided to non-shareholder stakeholders. The South African Companies Act requires that trade unions be given access to company financial statements for the purpose of initiating a business rescue process.²⁸⁹ Additionally, like shareholders, trade unions must be notified if the board provides financial assistance to any director.²⁹⁰

The new Act also provides that the Minister of Trade and Industry may require a social and ethics committee²⁹¹ or other committees such as director's nomination and remuneration committees. A committee may include non-director members, although those members may not vote on matters the committee decides.²⁹²

4.6 ENFORCEMENT OF COMPLIANCE

Tanzania, Kenya and South Africa have come up with a number of legal and regulatory provisions as a way of ensuring compliance with formalities and legal requirements. Further, in order to make sure that directors conduct their duties within the ambit of good corporate governance they must comply with legal rules and regulations of corporate governance. Standards of directors' behaviour are enforced through both criminal and civil sanctions as charges against a director who misappropriates property can be brought under both civil and criminal law. To enforce a director's duty of loyalty and therefore secure their duty of care and skill, criminal sanctions are the key to providing the necessary standard of deterrence under which directors can be expected to refrain from misappropriation of company assets.

²⁸⁹Section 31 (3) provides that: 'Trade unions must, through the Commission and under conditions as determined by the Commission, be given access to company financial statements for purposes of initiating a business rescue process'.

²⁹⁰ If the board provides financial assistance to a director or officer is must provide written notice to all shareholders and to any trade union representing its employees.' See s 45(5).

²⁹¹See s72(4).

²⁹² See s72 (2)(a).

The South African Companies Act contains a wide range of purely criminal provisions.²⁹³ Directors' liability is set out under the Act²⁹⁴ although in some cases one's liability is based entirely on his own conduct.²⁹⁵ Over and above this, the Companies Act provides for remedies in respect of common law.²⁹⁶ This means that the provisions of the common law can also be applied to a director or company for misconduct or any breach of the provisions of the Act.²⁹⁷

However, an examination of Kenya's companies' legislation reveals a comprehensive legal framework that is difficult to enforce owing to underlying weaknesses in the drafting of legislation governing director liability. Director's liability is dealt with under s.45 of the Companies Act. Section 45(1)(a) of the Companies Act provides that directors are personally liable for misstatements in company prospectus but avails directors with an array of defences in s.45(2). Section 45(2) provides that where a prospectus has been issued without his consent, where he withdrew his consent or relied on a public official document, a director is exempted from liability for misstatements in the company prospectus. Section 45 of the Companies Act consequently gives company directors no incentive to ensure that they exercise due diligence in the performance of their duties.

Shareholders are left vulnerable and unprotected by this provision, in that where a shareholder has relied on incorrect information in the company's prospectus, they can only be compensated if it can be shown that the director was aware of the misstatements in the prospectus or that the director consented to the issuing of the

²⁹³ Section 216 of the Companies Act 71 of 2008 provides that any director who is convicted of any offence referred to in the Act is liable to a fine and can be sentenced to a maximum period of ten years depending on the nature of the offence.

²⁹⁴ Section 77.

²⁹⁵ For example s 216(5) of the Companies Act, which makes it a criminal offence for a director to fail to notify the company of a change in personal particulars.

²⁹⁶ In support of this view, section 158 of Act 71 of 2008 provides that -when determining a matter brought before it in terms of this Act, or making an order contemplated in this Act a court must develop the common law as necessary to improve the realization and enjoyment of rights established by this Act.

²⁹⁷ For example, subsection (2) of section 77 provides that the section applies in addition to any rule of common law that is consistent with the section.

prospectus.²⁹⁸ The burden of proof here rests with the shareholder, who usually has access to little or no information on the activities of the company.

On the other hand, the Tanzania Companies Act provides for prohibition to the effect that the director can be held both civilly and criminally liable for misstatement in the offer document.²⁹⁹ The Companies Act Also provides for directors' personal liability.³⁰⁰

Under the Tanzania Companies Act³⁰¹ the member can only bring action against the director in the company name. Unlike countries like the United States, where an attorney can bring proceedings on behalf of minority shareholders without the consent of the directors of the company, in Kenya the decision to sue rests with the board of directors as it is only the board that can bring proceedings in the company's name.³⁰² An advocate in Kenya cannot bring proceedings against a company on behalf of the shareholder without the authority of the board.³⁰³ The position in South Africa is more robust as the representative of employees can move the court in case of any fault done by the board.³⁰⁴

The effectiveness of compliance is necessitated by the power given to enforcement organs. In all three countries courts are given certain powers with reference to corporate matters.³⁰⁵ In South Africa the new Companies Act provides the court with enormous power to override the corporate decision based on the 'judges own judgment.'³⁰⁶

The wide range of the enforcement mechanism also to some extent guarantees effective compliance. For example in South Africa as opposed to Tanzania and

²⁹⁸ Section 46(1) of the Kenyan Companies Act 1962.

²⁹⁹ Section 50&51 of the Companies Act 12 of 2002.

³⁰⁰ Section 198-200.

³⁰¹ Section 233,234.

³⁰² *Bugerere Coffee Growers Ltd v Sebaduka* [1970] E.A. 147.

³⁰³ *Bugerere Coffee Growers* [1970].

³⁰⁴ Section 162(2) of the Companies Act no. 71 of 2008.

³⁰⁵ In Tanzania for example court is empowered to give an order to convene annual general meeting, see section 134 of Companies Act 2002.

³⁰⁶ See s71.

Kenya there are other bodies than the court which are vested with powers to resolve corporate disputes. These bodies are: the alternative dispute resolution,³⁰⁷ companies' tribunal³⁰⁸ and filing complaints with the Takeover Panels in matters of change of control³⁰⁹ or with the companies and Intellectual Property Commission for any other matters³¹⁰ as well as applying to Court.³¹¹ The Minister of Trade and Industry is empowered to interfere in the internal affairs of the company for the public interest.³¹²

4.7 CONCLUSION

Some features appear to be common in all three countries' legal framework. This is because of colonial history which has resulted in their corporate governance being based on the UK model in a common law framework. The corporate governance Code of South Africa and the guidelines of corporate governance of Tanzania and Kenya make similar recommendations in matters such as: separation of position of chairman and the CEO, having non-executive directors in the board and protection of shareholders' interests. This is due to the international bodies which influenced these recommendations such as the OECD's principles.

Another area of similarity is between Tanzania and South Africa whereby the two countries have amended their company legislation to codify directors' duties³¹³ a move that is being internationally recognised and that is aimed at clarifying and making the duties easily accessible and predictable. Furthermore, the DSE and

³⁰⁷ See s166-167.

³⁰⁸ See s156 (b).

³⁰⁹ See s168 (a).

³¹⁰ See s168 (b).

³¹¹ Section 156 (c).

³¹² Section 72 (4).

³¹³ The only different is that in South Africa the directors are provided by a shield of business Judgment rule while in Tanzania there is non-existence of such shield.

NSE have to incorporate the guidelines of corporate governance into their listing requirements as incorporated by the JSE³¹⁴ in order to guarantee compliance.

The analysis in paragraph 3.6 and 4.6 above has also revealed that the legal framework of corporate governance in South Africa is in a good position to guarantee compliances with both legal rules and voluntary mechanisms than in Kenya and Tanzania. The partial codification of directors duties in the Companies Act, the establishment and application of the code of corporate governance (King III); the incorporation of the King III in the JSE Listing Rules and the powers given to court and other enforcement machineries seem to facilitate compliance with the principles of good corporate governance in South Africa.

Although all countries appear to be favouring more prescriptive rules and regulations, South Africa appears to promote self-regulation in corporate governance than in Tanzania and Kenya. This can be evidenced by the new Code of corporate governance which came into force in 2010 which apply to all type of companies.

³¹⁴ King III Report form part of the JSE listing rules hence all companies listed on JSE has to apply and in case failed to apply they have to explain the non-conformity.

CHAPTER FIVE

FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.1 FINDINGS OF THE RESEARCH

The main purpose of this work was to establish the legal and regulatory framework of corporate governance in Tanzania. The key findings of this research are analogous to most of other developing countries.³¹⁵ A number of corporate governance mechanisms have been identified such as the legal and regulatory framework, the ownership structure; control of the board and powers of directors; shareholders' and other stakeholders' rights. A legal and regulatory framework for corporate governance in Tanzania does exist but further improvements are required. The most challenging issue facing Tanzania and most of the developing countries is the poor enforcement of the laws and regulations.³¹⁶

In order to attract investors and develop capital markets in Tanzania, there is a need to have a strong legal system that protects the interests of the minority shareholders. This is due to the fact that the spread of ownership and the separation of ownership from control do not currently exist in Tanzania as is the case in many developing countries. Therefore, the enforcement of the existing laws and regulations needs to be developed in order to encourage the development of capital markets which is of significant importance to Tanzania.

Corporate governance in Tanzania currently reflects the legacy of the former policy of Ujamaa na Kujitegemea during which corporations were placed in the hands of the state. The same applied with the position where ownership is placed

³¹⁵ See the comparison with Kenya in chapter 4.

³¹⁶ Chapter 3 and 4.

in the hands of controlling shareholders. Besides, the state is still a major shareholder in some companies, for instance 74.14% of Tanzania Oxygen Limited shares are owned by a single controlling shareholder which is the government.³¹⁷ This gives the state the power to control management of these companies by appointing directors and other senior civil servants to such companies. This means that the decision making processes of government and those of some corporations are intertwined.

The government is the one that develops and enforces laws; but through control of the companies done by its senior civil servants, it will be difficult for the government to regulate the behaviour of business in the economy. The fact that it is part of corporate decision-making processes, allows the possibility of senior civil servants being used to protect corporate interests by influencing the type and content of laws and regulations, and its enforcement mechanisms.

The privatisation process which aimed at strategic investors resulted in the ownership of many of the privatised companies being under foreign control. This means that important decisions with implications for the Tanzanian economy are made abroad.³¹⁸ This poses a serious challenge to the long-term development of Tanzania, and the realisation of the 2025 development vision. Tanzania is expected to achieve, by the year 2025, a number of goals ‘... Tanzania of 2025 should be a nation imbued with five main attributes: high quality livelihood; peace, stability and unity; good governance; a well-educated and learning society; a competitive economy capable of generating sustainable growth’.³¹⁹ The realisation of the goals contained in this vision depends on involvement of majority of the people (an inclusive approach) in the decision-making processes that are central to the allocation of resources in the economy. Yet, the corporate governance arrangement in Tanzania, which is exclusively shareholder-oriented, does not reflect the objectives of this vision.

³¹⁷ See chapter 3 para 3.3.

³¹⁸ See chapter 3 and 4 for detailed discussion.

³¹⁹ United Republic of Tanzania (URT) *Development Vision, 2025*(1999). 5; President’s office, Planning and Privatisation Commission, Dar es Salaam.

Since important decisions are made outside Tanzania, there is a possibility that corporations will be driven solely by business interests (as this is the primary reason why they invest in Tanzania) and have little interest in the welfare of Tanzania beyond the profits they can make. This calls into question the relevance of the received shareholder model currently being encouraged. There is an urgent need for a debate to reconcile these conflicting interests for the benefit of both the foreign capital that is required to stimulate the economy and for the long-term benefit of the Tanzanian economy. The need to address the interests of stakeholders in corporate governance other than shareholders is of utmost importance for the continued existence of corporations and society.

5.2 CONCLUSION

*'The proper governance of companies will become as crucial to the world economy as the proper governance of countries'*³²⁰

In light of the previous discussion and the weighted importance of corporate governance in today's world; it is noted that a strong legal and regulatory system of governing companies is of utmost importance for the continued existence of corporations and attracting investors in a country. However, this does not mean that a good corporate regime in Tanzania is unattainable. In line with earlier submissions, it cannot be ignored that the present corporate governance regime in Tanzania poses a major threat to investors, both foreign and domestic, due to a lack of protection of minority shareholders. This requires urgent attention from both the government and private sector.

Importantly, it should be noted that, the developments in the eastern and southern Africa regions (the establishment of free trade areas in the EAC and in the

³²⁰ As stated by James D. Wolfensohn, former President of the World Bank and quoted in Gatamah K (2004) 3.

SADC), with Tanzania as a member of both regional trade agreements pose a challenge for Tanzania to improve its corporate governance regime in order to benefit from the flow of investments from these regions. The EAC for instance aims at having a customs union, common market, monetary union and eventually political federation.³²¹

The need to have a good corporate governance regime has been established as essential for the country to attract investors. No potential investor will be ready to take the risk of investing capital in a country whose legal regime is not protecting his interests. The existence of both strong legal and voluntary rules is one of the important factors that any investor examines before investing in any country.

Investors prefer larger as well as smaller markets as they enable them to take advantage of economies at various scale and scope. The increased size of the East African market that becomes available to entrepreneurs and multinational enterprises should provide excellent opportunities for investors to realize greater profits than they would in any of the smaller, single markets. Hence this is a challenge for countries in this region particularly for Tanzania to prepare a good foundation for these investors. Among the strategies is to have a good regime for corporate governance in order to attract FDI.

5.2.1 The Protection of Shareholders

A large number of listed companies in Tanzania are owned by single large and controlling shareholders. The existing legal system seems to protect these

³²¹ As stated under Article 5 (2) of the Treaty, ‘the Partner States undertake to establish among themselves and in accordance with the provisions of this Treaty, a Customs Union, a Common Market, subsequently a Monetary Union and ultimately a Political Federation in order to strengthen and regulate the industrial, commercial, infrastructural, cultural, social, political and other relations of the Partner States to the end that there shall be accelerated, harmonious and balanced development and sustained expansion of economic activities, the benefit of which shall be equitably shared’.

shareholders. It has been submitted that ‘large shareholders are the key determinant in the corporate governance in developing countries.’³²² This proposition to a large extent has been confirmed in this research and corroborates the findings because the ownership structure in these corporations seems to give the controlling shareholders a possibility to influence corporate decisions.

In situations where the ownership structure is under control of single large shareholders, there is a possibility of them having effective control in management hence posing a challenge with respect to the interests of minority shareholders. This creates a significant challenge as the controlling shareholders may use their position for their private benefits, i.e. benefits that are not available to other shareholders, and that has the consequence of reducing firm value. These large shareholders are thereby able to drain profits from the corporation to the detriment of minority shareholders.

This work has shown that there is significant information and power asymmetries between controlling and minority shareholders in the Tanzanian context. In the current set-up in Tanzania, minority shareholders cannot effectively influence the decision-making process and they generally lack representation on the decision-making boards of companies. In annual general meetings which they rely on for information on the performance of the corporations, the minority shareholders do not have an adequate voice.³²³

Although this research has not found conclusive evidence that such expropriation problems currently do exist in Tanzania, it reveals that the existing situation is fertile ground for this to occur. Hence there is a need to put in place initiatives to improve corporate governance by protecting minority shareholders.

³²² Oman C, Fries S & Buiter W *Corporate governance in developing, transition and emerging-market economies* (2003) OECD Development Centre, Policy Brief No.3.

³²³ See Chapter 4.

In order to protect minority shareholders, Tanzania needs to develop a strong system as suggested by La Porta et al who identify six legal principles which they referred to as anti-director rights. These include: allowing shareholders to mail their proxy vote to the firm; not requiring shareholders to deposit their shares prior to the general shareholders' meeting; cumulative voting; proportional representation of minorities on the board of directors; and the presence of a mechanism for oppressed minorities. The other element is allowing shareholders with a low percentage of equity capital to convene an extraordinary shareholders' meeting. The minimum shareholding should be less than or equal to ten per cent, and the pre-emptive rights of shareholders should be only waived by a shareholders' vote.³²⁴

The Tanzanian Companies Act 2002 also contains these anti director rights by allowing members of the company holding ten per cent (10%) of the paid up shares to require the directors of the company to convene an extra ordinary general meeting. Section 134 of the Act provides that:

[T]he directors of the company notwithstanding anything in its articles, shall, on the requisition of members of the company holding at the date of the deposit of the requisition not less than one-tenth of such of the paid-up capital of the company as at the date of the deposit carries the right of voting at general meetings of the company or, in the case of a company not having a share capital, members of the company representing not less than one-tenth of the total voting rights of all the members having at the said date a right to vote at general meetings of the company, forthwith proceed duly to convene an extraordinary general meeting of the company'.

The Act further provides that, if the directors failed to convene a meeting within twenty one days, the requisitionists or any of them representing more than one-half of the voting rights may convene a meeting.³²⁵ The purpose of this provision is to protect the interest of all shareholders; however in the situation like Tanzania where in many companies a single shareholder holds more than fifty

³²⁴La Porta R et al 'Investor Protection and Corporate Governance' (2000) *Journal of Financial Economics* 20.

³²⁵ Section 134 (4).

per cent of the shares in a company, this provision can be easily abused and used to the detriment of the minority ones.

The existence of this provision in the statute does not guarantee that it is enforceable. As mentioned earlier,³²⁶ the enforcement of laws and regulations is a key element of the sound foundations upon which effective corporate governance can be developed.

5.2.2 The ownership structure

The evidence from the study challenges the government's privatisation programme with respect to broadening ownership and the empowerment of Tanzanians. Privatisation through strategic investors leads to the emergence of large private shareholders who subsequently exclude large numbers of minority shareholders from important decision-making processes of corporations, including board deliberations, and this is contrary to the official objectives of the privatisation programme. However, large shareholders although effective in controlling incentive problems, also pose a challenge with respect to the interests of minority shareholders. This research found that a key corporate governance issue in Tanzania is the one of weak minority shareholders versus powerful controlling shareholders.

The research found that the ownership structure of corporations in Tanzania is under few strong/large shareholders. The power of these large shareholders in corporate decision-making processes points to a practical challenge in the approach being pursued by CMSA in its recommendations.

The recommendation of having independent non-executive directors does not work in corporations with concentrated ownership. This reflects that these

³²⁶ See chapter 3.

guidelines were borrowed from developed countries where there is separation of ownership from control. This suggests that developing countries need guidelines which fit their social-economic environment and not just ‘transplanting’ from developed countries. There is a need to ensure that the law keeps up with the needs of society. Lord Denning M.R. (as he then was) recognised this position in *Nyali Ltd v A.G. of Kenya*,³²⁷ where with reference to the common law he stated that one can take an oak tree from English soil and plant it on Kenyan soil, but one cannot guarantee that it will do equally well. He opined that:

‘This wise provision should, I think, be liberally construed. It is recognition that the common law cannot be applied in a foreign land without considerable qualification... It has many principles of manifest justice and good sense which can be applied with advantages to people of every race and colour all the world over. But it also has many refinements, subtleties and technicalities which are not suited to other folk. These offshoots must be cut away. In these far off lands the people must have a law which they understand and which they will respect. The common law cannot fulfil this role except with considerable qualifications. The task of making these qualifications is entrusted to the judges of these lands. It is a great task. I trust that they will not fail therein.’

Although Lord Denning's quote refers to common law as opposed to legislation, it encapsulates the difficulties that arise when laws are transplanted from one jurisdiction to another without reviewing them to reflect the economic conditions and political environment of the receiving jurisdiction. Clearly, an effort has to be made to review Tanzanian corporate governance laws and guidelines to fit the needs of Tanzanians today.

Requirements by international financial institutions, such as the International Monetary Fund and the World Bank that developing countries should implement structural adjustment programmes as a condition for awarding loans to developing countries have meant that developing countries like Tanzania and Kenya find themselves adopting a corporate governance system that is akin to the Anglo-American system of corporate governance. It is submitted that it is not

³²⁷ [1955] 1 All E.R. 646 at 653.

necessary to have one law which fits all; hence Tanzania should adopt a system which is compatible with its social-economic needs.

5.2.3 The Board of Directors / Board Control

As discussed in previous chapters, an effective board of directors is important in establishing effective corporate governance especially where single and large controlling shareholders do not address control aspects which are the domain of the board. It is submitted that when large shareholders become fully involved in control, boards of directors become mere advisory committees to management. The suggestion made by the Steering Committee on Corporate Governance and the CMSA on the separation of the chairman and CEO positions can be rendered futile due to the large shareholders who tend to render ineffective other corporate governance mechanisms. With controlling shareholder powers upon the board, such separation does not necessarily lead to an effective board in the control role.

Besides, the adherence to the principles of corporate governance that are being recommended in terms of board constitution, which are based on agency theory, does not necessarily lead to effective boards in the control function as would be expected. For example, the suggestion of having a large number of independent non-executive directors in a board who are helpful in controlling the company's businesses can only be attained in the absence of shareholders who closely monitor management.

The recommendation given by the CMSA and Steering committee of having a majority number of independent non-executive directors in a board poses a challenge to the implementation of the guidelines. In the situation with the controlling shareholders, a considerable amount of effort is needed in implementing these recommendations as it can be resisted by the controlling shareholders. There are no criteria for appointing directors in Tanzania as they are directly appointed by the shareholders. The Companies Act does not provide

any qualifications for directors. This suggests that such appointments may not be based on clearly defined needs. This research suggests that there is a need for more clear and explicit criteria for appointing directors.

5.3 RECOMMENDATIONS

5.3.1 Strengthening the legal and regulatory framework

On the basis of the above conclusions, it has been argued that the foundations for the development of effective corporate governance are currently weak in Tanzania and are required to be developed and reinforced. The key issue appears to be the enforcement of the existing laws. The research recommends that in order to improve the enforcement of laws and regulations, the strategies such as training, sensitisation and awareness of the lawmakers, (Members of Parliament) and law enforcers (judges and managers of regulatory organs) with respect to issues of corporate governance should be established. This will enable Members of Parliament to realize issues involved in corporate governance and enhance the prospects of developing appropriate laws for Tanzania as well as the prospect that these laws will be enforced in practice.

Tanzania needs to raise its corporate governance profile. There is little awareness of corporate governance issues in Tanzania. Media should be encouraged to report on corporate governance issues as it is the most effective way of raising people's awareness of what is happening in corporations. The current initiatives by the institute of directors of training directors cannot be undermined. However, a robust legal system plays a big role in corporate governance.

5.3.2 Protection of Minority Shareholders

The ownership structure of many corporations in Tanzania is concentrated in few hands. Where a small number of block holders holds either majority or de facto control they can manipulate the management as they are in a position to place their representatives on the controlled firm's board of directors hence rights of the minority shareholders are at risk. Tanzania needs to strengthen corporate governance to guarantee the protection of minority shareholders due to the fact that there is no separation of ownership from control.

This issue emerged in the research and it has an effect on the flow of investment into the country. The protections of minority shareholders mostly require the enforcement of laws and regulations be improved. However, it also requires parallel implementation of other strategies including providing greater access to information, reviewing the current laws and regulations, educating of minority shareholders, organising shareholder associations and enforcing the existing recommendations and guidelines.

As revealed by the research, there is unequal access of information between the controlling shareholders and minority ones. Greater access to information will enable minority shareholders to challenge the decisions of management and large shareholders hence prevent the possibility of diverting resources from the firm. This recommendation can be implemented by the CMSA through establishing institutions like stock brokerages, financial analysts and a reputable financial investigative press which will report the corporate issues and avail required information to the minority shareholders and community in general.

The reviewing of existing laws and regulations is recommended in order to protect minority shareholders. The current requirement of holding at least ten per cent (10%) of voting equity to convene an extraordinary general meeting should be reconsidered because it appears prohibitive in a country such as Tanzania where majority of people are poor. It is recommended that a lower shareholding

threshold be introduced to increase the possibility of minority shareholders making use of this protection.

Education of minority shareholders is also recommended in order to help them to know their rights. The CMSA and the Business Registration and Licensing Authority (BRELA) should encourage the companies to conduct seminars and educate minority shareholders about their rights. The shareholder associations can also do the same and also establish a body which will be lobbying for minority shareholders' rights.

Further, the implementation of the recommendation given by the CMSA and Steering Committee on corporate governance of separating the position of the chairman and the CEO will help to have an independent person managing company meetings. Such a person will endeavour to balance the interests of all shareholders away from the influence of the board. The CMSA have to incorporate this requirement into the DSE listing rules so that it will be mandatory for all listed companies.

5.3.3 Reviewing the guidelines of corporate governance

The evaluation of the current recommended guidelines has revealed that they do not address the existing corporate governance structure where there is imbalance of power that exists between the large and the minority shareholders. It is recommended that these guidelines be reviewed in the light of the findings of this research to address this important issue.

The Institute of Corporate Governance (TICG) in collaboration with the CMSA and other corporate governance stakeholders such as academicians, private sector, Tanzania Chamber of Commerce, Tanzania Investment Centre and lawyers should be involved in the review process and the CMSA should encourage the companies to implement them effectively. The CMSA should also

carry out periodic assessments to determine the extent the companies have complied with the guidelines.

Tanzania also needs to have a corporate governance code which will act as a pillar of the corporate governance regime. There is a need to have this code as it is not possible to legislate on everything hence companies should be encouraged to adhere voluntarily to the corporate governance principles. Investors always look on a company's profile to see whether it adheres to the corporate governance principles before they decide to invest in that company.

This research compared the legal and regulatory system of corporate governance in Tanzania with that of South Africa and Kenya. The study doesn't conclude that Tanzania should copy what is carried out in South Africa or Kenya but can use the South Africa corporate regime to evaluate the needs of the country with regard to corporate governance in order to meet socio economic needs. The King III Report of South Africa can be used as a reference in preparing a corporate governance code for Tanzania. Other international codes such as the OECD principles of corporate governance can be applied as a framework and would help to give further description and analysis of corporate governance in order to further understand the status of the various elements of this framework as applied to Tanzania.

5.3.4 Other Stakeholders' rights

Tanzania should adopt a model that takes into account its cultural context and represents the interests of stakeholders such as the employees and community in general through representation on the board. There is strong debate globally concerning the interests of stakeholders other than shareholders. As observed, the corporate regime in Tanzania is silent on the issue of other stakeholders. This research recommends that the review of the corporate governance guidelines and eventually establishment of corporate governance code should address this issue.

5.3.5 Board Control and Director's Independence

Director's independence

The director independence issue has been identified as a major problem in Tanzania. The ownership structure whereby controlling shareholders have power over the management is among the reasons for director's independence not being given the weight it deserves. There is a need to develop director's independence in the corporate governance regime of the country. In order to address this problem, this research supports the recommendations made by CMSA and the Steering Committee on Corporate Governance to be relevant and useful if companies could adhere to them.

The two sets of recommended guidelines require directors to make proposals to shareholders about potential candidates who can be elected or rejected by shareholders. Directors should be recruited from the market by applying a transparent mechanism of inviting applications from the public. This issue can be addressed by boards of directors.

Evaluation and Training of Directors

For Tanzania to improve the effectiveness of boards which is also emphasised by the international community, this research recommends the introduction of director evaluations and feedback. Evaluations should be performed on the board as a whole, and on the individual directors and the CEO.

Evaluation should reflect on the actual performance of the people being evaluated, and needs to be associated to the criteria for appointing directors. Boards of directors can implement this recommendation. The board of directors can be evaluated by reflecting on the decision making, adhering to corporate governance principles and the performance of the company.

In conjunction with evaluating them, the orientation of new directors is of utmost importance as recommended by the CMSA and Steering Committee of corporate governance. Additionally, companies have to conduct training on work for

directors in order to bring them up to date on global corporate governance issues and improve their corporate governance practices.

CMSA and BRELA should also encourage the directors to attend the training of directors which is currently offered by the Institute of Directors in order to equip themselves with the knowledge of running the business of the firm. It is recommended further that for a person to get directorship in a public company she/he should possess a certificate showing that he/she has attended the directorship course.

The board structure

The board structure of the company also plays a big role in the effectiveness of corporate governance of a firm. This research has identified that the position of the CEO and that of the chairman of the company is likely to be held by the same person. This is due to the fact that the Companies Act does not provide for its separation hence the companies may opt to separate it as recommend in the guidelines or refuse and rely on the Companies Act.³²⁸ It is recommended that companies should adopt a corporate structure which splits the position of CEO and chairman for effective and independent board as recommended by the CMSA and Steering Committee guidelines on Corporate Governance.

A company's board of directors, in collaboration with its shareholders, can address this issue. Also, the legislature should amend the provision of Paragraph 45 of the schedule to the Companies Act to make it compulsory that the CEO should not be the chairman of the board. This will remove the conflicting position currently existing between the Companies Act and the guidelines for corporate governance which legally allows the Companies Act position to prevail over the guidelines.

³²⁸ Paragraph 45 of the schedule to the Companies Act No. 12 of 2012. For detailed discussion see chapter 4 para 4.2.1.

5.4 MATTERS FOR FURTHER RESEARCH

This study has employed a qualitative approach where findings are based on literature review only. The research highlights general issues which to a certain extent are valid for companies listed on the Dar es Salaam stock exchange. Further research should involve a quantitative practical survey, particularly with respect to listed and non-listed firms to provide a strong base for generalisation over a wide range of companies and give a firm practical test.

The research can also be extended by practically surveying some companies' practices in Tanzania and others from developed countries and then compare the findings. This will generate additional knowledge on the general development of corporate governance in developing countries. Another area that requires further research is the accountability of the corporate business to society. The international community is emphasising corporate citizenship and corporate responsibility. The role that corporations play in the society they operate in is of utmost importance for their continued existence. Therefore the research in this area will provide insight into corporate governance practices and accountability in Tanzania.

The role of stakeholders other than shareholders is not widely discussed in this research. This is an area for further research as the Companies Act of 2002 introduces the notion of stakeholders to all companies by requiring directors to consider the interests of employees as one of their duties and to protect the employees in addition to shareholders. Despite this legal provision, employees are not represented on boards of directors. Research on the potential role of employees and other stakeholders in corporate governance will improve understanding of future corporate governance practices in Tanzania.

Good corporate governance is required for all type of corporations. Therefore, it should not be limited to the industrial corporations and listed /public companies only. Research on other sectors of the economy such as the financial sector, the

public sector, private sectors and executive agencies is also needed. This is expected to provide additional insights on corporate governance practices in Tanzania.



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