

REPORT ON THE STATE OF CORPORATE GOVERNANCE OF ISSUERS OF SECURITIES TO THE PUBLIC IN KENYA

2018

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ABBREVIATIONS

CMA	Capital Markets Authority
IFC	International Finance Corporation
MIMS	Main Investment Market Segment
AIMS	Alternative Investment Market Segment
GEMS	Growth Enterprise Market Segment
ICS	Institute of Certified Secretaries
LSK	Law Society of Kenya
ASEAN	Association of South East Asian Nations
PLC	Publicly Listed Company

1. FOREWARD

MESSAGE FROM THE CHIEF EXECUTIVE



**Mr. Paul Murithi Muthaura, MBS
CE, Capital Markets Authority, Kenya**

Research and practice have undoubtedly confirmed the importance, value, and contribution of good corporate governance to an organization's continued existence (sustainability), profitability, growth and business prospects. Indeed, numerous studies globally buttress the need for good governance. Though some work has been done locally to assess the value of good governance, this has not definitively been issuer-focused and evidence-based.

With the introduction of the [Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015](#), a case was made for determining how good governance contributes to an issuer's business prospects and sustainability. As a result, a [suite of corporate governance reference materials](#) were developed including the issuer's reporting template and the Authority's corporate governance scorecard together with the scorecard methodology.

The 2017/2018 findings suggest a fair status of 55.00% weighted overall score in the application of the Code of Corporate Governance Practices for Issuers of Securities to the Public. We take this to be a good starting point owing to the fact that it is the first time that issuers are being assessed on their application of corporate governance practices as espoused in the Code. It is important to note that the ASEAN Corporate Governance Scorecard country Reports and Assessments 2014 indicates that Indonesia, Malaysia, Philippines, Singapore, Thailand, and Viet Nam scored 43.29%, 62.29%, 48.90%, 55.67%, 67.66% and 28.42% respectively in the year 2012 when the PLCs of these countries were first assessed on their application of good corporate governance practices. The PLCs assessed under the ASEAN Corporate Governance initiative composed of the ASEAN Corporate Governance Scorecard, and assessment and ranking of ASEAN PLC's, have since shown significant improvement in adopting corporate governance best practices.

This report details the findings of the analysis of corporate governance practices for issuers as assessed using the scorecard for the year 2017/2018. The scorecard assessment of each issuer is based on information which is publicly available to shareholders and potential investors. The relevant information is that which an investor may use to decide whether to invest, divest or hold an investment. The scorecard does not therefore rely on information that is within the issuer's knowledge but not yet publicly disclosed.

This report was based on 56 issuers of securities to the public in Kenya. However, 10 issuers were excluded from the assessment as they failed to submit either the reporting template or the full set of annual reports for assessment purposes. The Authority is considering taking appropriate enforcement action against the aforementioned issuers for violating continuous reporting requirements.

I urge every issuer to consider the findings in this report and, together with its stakeholders, and with the support of the Authority, progressively enhance its governance practices. The Authority welcomes interactions with issuers on any content or finding in the report.

MESSAGE FROM THE DIRECTOR



Mr. Wycliffe Shamiah
Director, Market Operations, Capital Markets Authority, Kenya

One of the objectives of the Capital Market Authority's [2018-2023 Strategic Plan](#) is to 'enhance the responsiveness and enforceability of the policy and regulatory framework to improve investor experience'. The Code of Corporate Governance Practices for Issuers of Securities to the Public not only promotes the framework for corporate governance but also recognizes the significant role played by stakeholders. The Code introduced a self-reporting template for issuers while creating assessment criteria for the Authority to independently review and analyze governance reports submitted by issuers.

This Corporate Governance Scorecard provides a platform for issuers to interact with investors, other regulators, diverse professional, media and the public on their respective as well as market wide governance practices. This publication is intended to trigger the beginning of a journey towards continuous improvement of governance practices in Kenya.

While this is a generalized report, each issuer has received its own tailored feedback detailing its strengths and areas of improvement. The Authority is available to discuss any specific aspects of the scorecard with each issuer, with a focus on building a strong foundation of good governance embedded in every issuer's business dealings and culture culminating in sustainability and enhanced investor experience.

2. EXECUTIVE SUMMARY

This report is the first of its kind in Kenya and is a culmination of stakeholder engagement and the regulatory journey that was initiated in 2012, culminating in the 2015 Code of Corporate Governance Practices for Issuers of Securities to the Public (the Code).

The report sources its data from the Corporate Governance Scorecard, evaluates key areas and seeks to analyze performance based on issuer performance, specific sectors and the entire market at large. The Scorecard comprises of self-assessed metrics as well as validation of the assessment by the Authority on all the key focus areas that are the subject of this report. The key strengths and weaknesses observed from the analysis of the data collected from the Scorecard are outlined with detailed recommendations on areas of improvement.

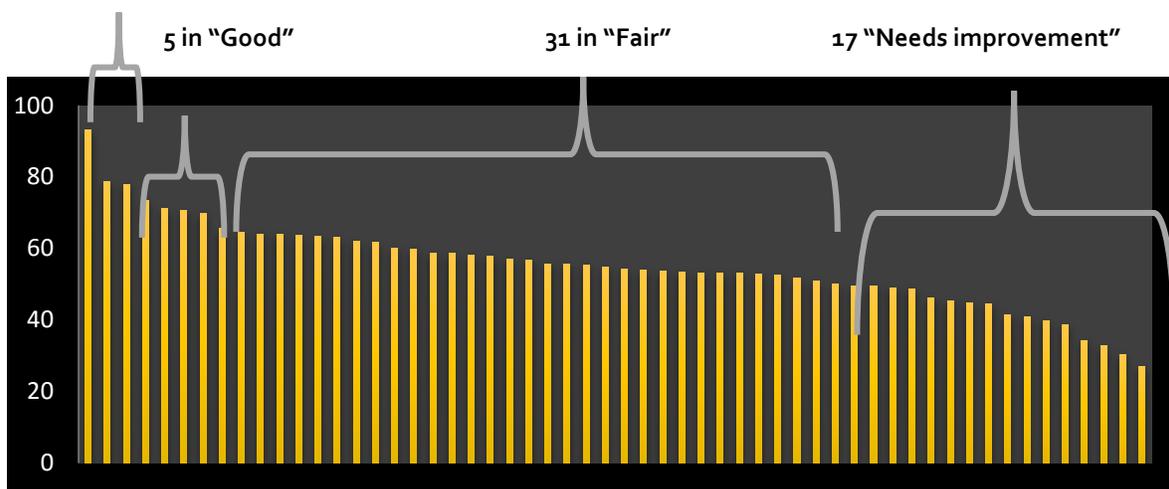
We note that there are 62 listed companies and 5 issuers of corporate bonds, making a total of 67 issuers.

Below is a summary of findings:

A snapshot of individual issuer overall weighted performance

The analysis highlighted the performance of individual issuers overall weighted performance and below is a snapshot of the findings.

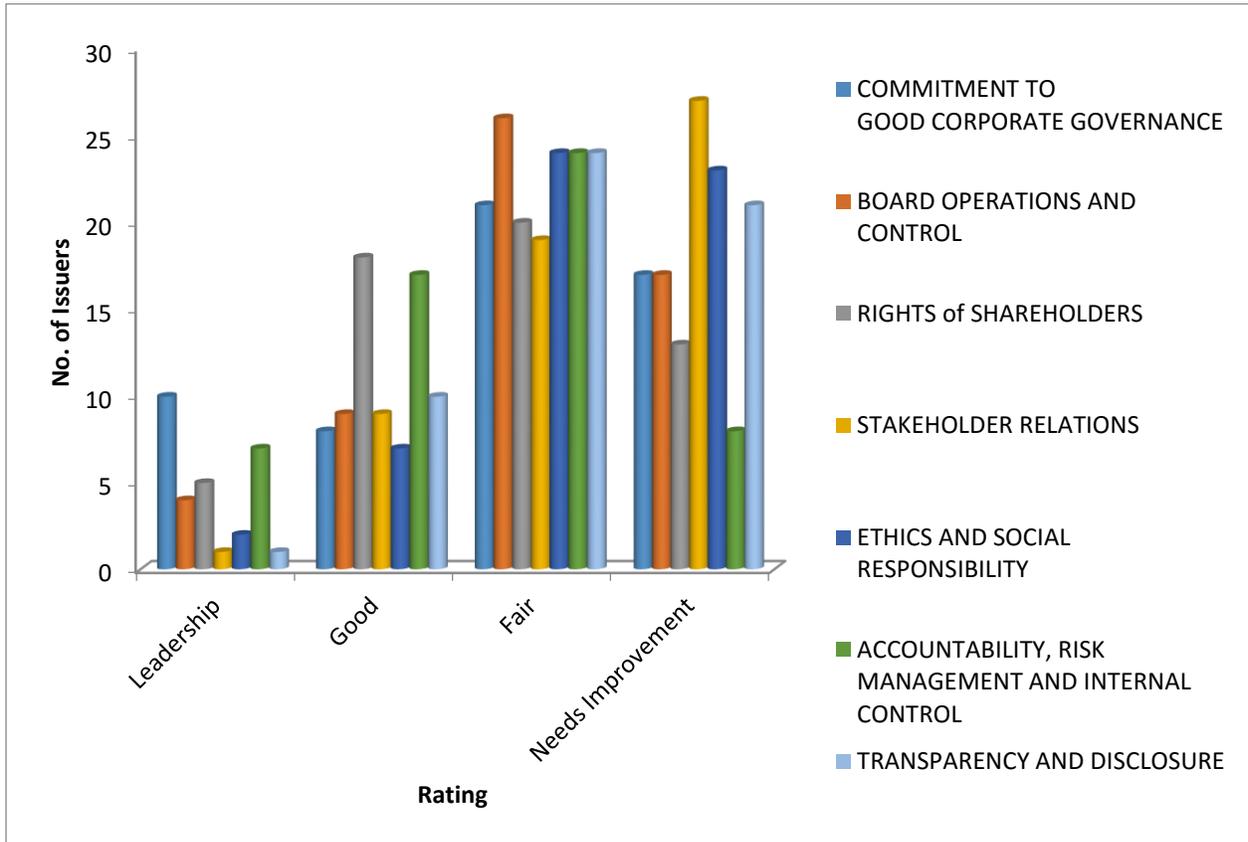
3 in "Leadership"



We note that 3 issuers in leadership were from the banking sector, the 5 issuers in good rating comprised of 2 from banking, 2 from commercial and services and 1 from manufacturing and allied sectors. Most issuers were on a fair rating with 17 assessed as being in need of improvement.

Snapshot on the performance of issuers on each principle

The analysis determined the performance of issuers on each principle and below is a snapshot of the findings.



A tabulation of the number of issuers that were rated in leadership, good, fair and need improvement categories on each principle.

Principle	Rating	No. of Issuers	Percentage
Commitment to good corporate governance	Leadership	10	17.86%
	Good	8	14.29%
	Fair	21	37.50%
	Need Improvement	17	30.36%
Board operations and control	Leadership	4	7.14%
	Good	9	16.07%
	Fair	26	46.43%
	Need Improvement	17	30.36%
Rights of shareholders	Leadership	5	8.93%
	Good	18	32.14%
	Fair	20	35.71%
	Need Improvement	13	23.21%
Stakeholder relations	Leadership	1	1.79%
	Good	9	16.07%
	Fair	19	33.93%
	Need Improvement	27	48.21%
Ethics and social responsibility	Leadership	2	3.57%
	Good	7	12.50%
	Fair	24	42.86%
	Need Improvement	23	41.07%
Accountability, risk management and internal control	Leadership	7	12.50%
	Good	17	30.36%
	Fair	24	42.86%
	Need Improvement	8	14.29%
Transparency and disclosure	Leadership	1	1.79%
	Good	10	17.86%
	Fair	24	42.86%
	Need Improvement	21	37.50%

- **Top 3 principles on leadership rating:** Commitment to good governance had 10 issuers on leadership rating, followed by accountability, risk management & internal control and rights to shareholders which had 7 and 5 issuers respectively;
- **Top 3 principles on good rating:** Rights of shareholders had 18 issuers on good rating, followed by accountability, risk management & internal control and transparency & disclosure which had 17 and 10 issuers respectively;
- **Top 3 principles on fair rating:** Ethics & social responsibility, accountability, risk management & internal control and transparency & disclosure each had 24 issuers on fair rating; and
- **Top 3 principles on need improvement rating:** Stakeholder relations had 27 issuers on need improvement rating, followed by ethics & social responsibility and transparency & disclosure which had 23 and 21 issuers respectively.

Snapshot on the overall weighted performance of issuers on each principle

The sectors with the highest overall scores did not necessarily perform well in all principles. Similarly, sectors with lower scores are not necessarily weak in all principles. All sectors were rated 'fair' in board operations and control principles while the commercial and services/telecommunications sector got a fair rating on all the principles.

The construction & allied sector scored leadership rating in the weighted score under the rights of shareholders and a good rating in the weighted score under commitment to good governance.

The investment/investment services and insurance sectors scored a good rating on rights of shareholder and in accountability, risk management and internal control respectively. Other good rating scores were observed in accountability, risk management & internal control for manufacturing & allied/automobile sector and rights of shareholders for the agricultural sector.

The banking sector needs improvement in stakeholder relations, accountability, risk management & internal control and transparency & disclosure principles whilst energy & petroleum sector need improvement in commitment to good corporate governance, stakeholder relations, ethical & social responsibility, and transparency & disclosure principles. Additionally, the agricultural sector needs improvement in stakeholder relations, ethical & social responsibility and transparency & disclosure principles. Insurance and manufacturing & allied/automobile sectors need improvement in transparency & disclosure and ethical & social responsibility principles respectively.

Overall weighted performance of all issuers

The 2017/2018 findings suggest a fair status of 55.00% weighted overall score in the application of corporate governance practices by Kenyan issuers of securities to the public.

The aim of this report is to encourage issuers of securities to become good and model corporate citizens by adopting and fully implementing the Code and related corporate governance laws, standards and practices.

3. INTRODUCTION

3.1. BACKGROUND

The Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015 (the Code) was developed based on a recognition that more needs to be done by issuers, investors, auditors and Capital Markets Authority, among other stakeholders, to foster a cultural shift in corporate governance in Kenya. The Guidelines on Corporate Governance for Listed Companies issued in 2002 represented the first step towards that objective. However, the Guideline was not sufficient in keeping pace with changing local and global governance dynamics.

The 2002 Guideline required that public listed companies should either “comply or explain”. This meant that publicly listed companies had to comply with the set rules or explain their reasons for non-compliance. The approach limited public listed companies from going beyond the provisions of the Guideline.

The 2002 Guideline was limited in scope in that the universe envisaged comprised of public listed companies only. This reflected the times when the predominant instrument in the capital markets in Kenya was equities. In the past two decades, we have witnessed issuances without listing, at the first instance, as well as increased appetite in corporate debt issuances by unlisted companies. Therefore, the Code expands the scope to include all the issuers of securities to the public, whether listed or not.

The promulgation of the Constitution in 2010 created a need for compliance with its letter and spirit as the supreme law in Kenya. Specifically, Articles 10 and 73 on the national values and principles of governance as well as responsibilities of leadership became apparent. It is in this spirit that the Capital Markets Authority introduced new regulations on corporate governance for market intermediaries (2011) for the first time.

To appropriately anchor corporate governance reforms applicable to issuers under the law, the Authority initiated amendments to the Capital Markets Act in 2013 leading to amendments vide the Capital Markets (Amendment) Act No. 48 of 2013 to give the Authority specific powers to:

- (i) Prescribe notices or guidelines on corporate governance of a company whose securities have been issued to the public or a section of the public {section 11(3)(v); and
- (ii) Require issuers to disclose material information to the Authority, shareholders and other stakeholders to enable them to appraise the financial position and the state of corporate governance of the issuer and its subsidiaries.

In December 2012, a nine-member Corporate Governance Steering Committee was appointed by the Board of the Capital Markets Authority with a mandate to propose reforms aimed at strengthening the corporate governance framework and practices applicable to issuers of securities to the public in Kenya. The membership cut across the public and private sectors and academia.

The thrust of the work done by the committee included identifying the evolving trends, regulatory provisions & practices, evaluating compliance by issuers and research on international best practices. Stakeholders were then engaged and contributed to the Committee not only identifying challenges in the framework that existed then but also through providing feedback on suggestions and recommendations were made on areas of improvement.

The reforms in corporate governance were necessitated by the need to:

- Align the corporate governance framework in Kenya to global best practice, putting into perspective the local circumstances in the country;
- Update the existing corporate governance framework for issuers to reflect market dynamics;
- Identify the legal framework and institutional strengthening requirements to promote corporate governance;
- Address prevailing weaknesses in the enforcement of the corporate governance Guideline; and
- In line with the Capital Markets Master Plan, to position Kenya as a competitive international financial center.

The Steering Committee conducted comprehensive benchmarking but was fully cognizant of the domestic environment in developing the Code. The various jurisdictions that were referenced included the King Code of Governance for South Africa (King III and IV), the Malaysian Code of Corporate Governance (2012), the UK Code of Corporate Governance (2012), the Brazilian Corporate Governance Code (IBGC 2010) and the Australian Stock Exchange Code (2010) as well as International Finance Corporation and World Bank Group research, findings and publications on the subject of corporate governance.

Upon gazettelement of the Code in March 2016, the 2002 Corporate Governance Guideline was revoked, and the Code became effective on March 4, 2017. The Code is principle-based rather than rule-based. This means that the provisions allow a great deal of flexibility including demonstrating the application of the spirit of the Code. There is a mix of mandatory and voluntary provisions and incentives given to issuers who do not fully comply to commit and move towards full application of the Code. This has shifted from the previous 'comply or explain' principle and now focuses on 'apply and explain' principle. Apply and Explain (A & E) requires the issuer to apply all the provisions of the Code, explain their basis for indicating they have applied the same and explain any non-application providing satisfactory reasons for such non-application as well as timelines to the full application of the Code.

It should be noted that the Code provides minimum standards required of the board of directors, shareholders, and management of an issuer to promote high standards of conduct. Issuers may and are encouraged to implement higher standards than those contained in the Code. However, there is no restriction on the exercise of proper judgment made by either the board or management of an issuer in the implementation of sound corporate governance practices.

Ultimate responsibility in the formulation of policies, procedures and guidelines lies with the board of directors of an issuer. Corporate governance is not only being promoted as a compliance measure but ideally as a component of culture and dealing being an integral part of any issuer's business. Within four months after the end of every financial year, each issuer is required to submit a report using a prescribed template on the status of application of the Code to the Authority and their investors.

This Scorecard is the outcome of the assessment process. This publication provides a consolidated analysis of the findings arising from a defined assessment methodology and independent review by the Authority

As the reforms in corporate governance were being initiated, the public sector was also experiencing this change and the result was enactment through Executive Order of the Mwongozo, A Code of Governance for Government Owned Entities. Mwongozo was highly aligned to the Code of Corporate Governance for Issuers of Securities to the Public.

The developments in corporate governance have been further reinforced by the enactment of the [Companies Act, 2015](#). Section 770 of the Act requires quoted (listed) companies to set out corporate governance principles, policies and strategies and annually assess the extent to which the company has observed the policies and strategies. This forms the basis of self-assessment by issuers and assessment by the Authority through this Scorecard.

3.2. Assessment methodology

3.2.1. Assessment tools

In collaboration with the International Finance Corporation (IFC) and in consultation with the issuers, the Authority developed offsite tools including the Corporate Governance Reporting Template and Corporate Governance Scorecard for reporting, measuring and monitoring the application of the Code. The reporting template, filled and submitted by issuers, serves to enhance adherence to governance requirements as well as disclosing the status of application of each requirement. On the other hand, the Corporate Governance Scorecard is assessed internally by the Authority to assess the level of implementation of the Code.

To comply with the Authority's continuous reporting requirements, all issuers are expected to submit the completed reporting template together with the complete annual report within four (4) months following the end of the financial year. Subsequently the same should be uploaded on the issuer's website. The Scorecard covers the following seven (7) areas of the Code:

- A. Introduction to the Code (focus on commitment to good governance);
- B. Board operations and control;
- C. Rights of shareholders;

- D. Stakeholder relations;
- E. Ethical and social responsibility;
- F. Accountability, risk management and internal control; and
- G. Transparency and disclosure.

3.2.2. Scorecard assessments

The assessments of corporate governance practices by issuers were based on publicly available and accessible information such as annual reports, issuer websites, notices, circulars, articles of association, minutes of shareholders’ meetings, Board Charter, media publications, codes of conduct, sustainability reports and other sources of public information as available.

The agreed weighting of scored areas/categories, summing to a total of 100%, are:

Section	Category	Number of Questions	Maximum points per section	% of total score
A	Introduction (including definitions)	7	21	5.0
B	Board operations and control	30	90	35.0
C	Rights of shareholders	5	15	5.0
D	Stakeholders relations	5	15	5.0
E	Ethics and social responsibility	9	27	10.0
F	Accountability, risk management and internal control	10	30	15.0
G	Transparency and disclosure	12	36	25.0
	Total	78	234	100

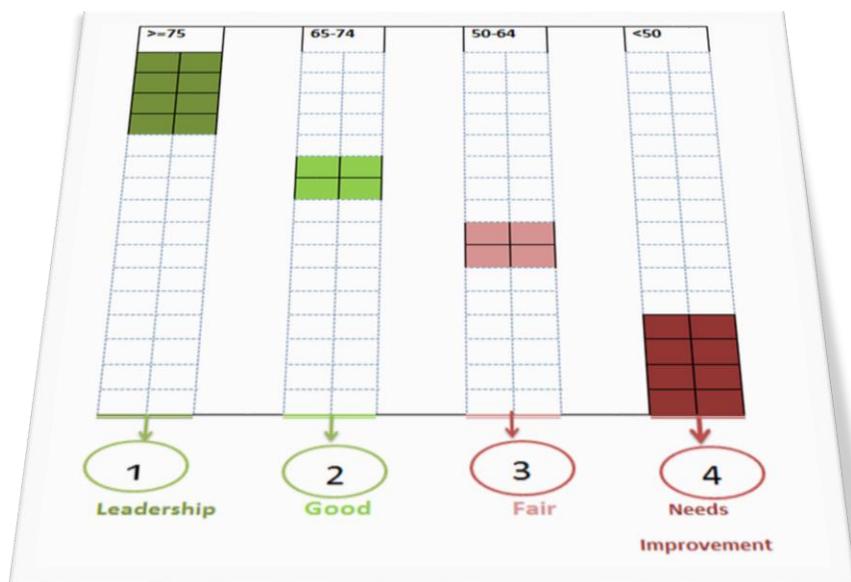
Table 1 weighting of score areas/categories

The number of questions and weighting generally was guided by the relative content and detailed guidance in the Code including emerging risks and new developments, taking into account the strengths and weakness of Kenya’s corporate governance practices.

In the Scorecard assessment, good corporate governance practices are ‘observed’ or ‘not observed’. If corporate governance practices are ‘observed’, they are allocated ratings in the following criteria ‘partially observed’, ‘good practice’ and ‘leadership’ and points are allocated according to the scale below:

- ‘Not observed’ (not observed, missing or non-compliant practices (the lowest level of CG practice) – 0 points;
- ‘Partially observed’ (some practice evident but deficient, or missing practices) – 1 point;
- ‘Good practice’ (good practices evident but not all good practices evident) – 2 points; and
- ‘Leadership’ (the highest level of CG practice observed) – 3 points.

Based on the final score, issuers will be grouped into the following buckets:



- Scores rating
- Leadership 75% & above
 - Good' 65% and 74%
 - Fair between 50% and 64%
 - Needs improvement below 50%.

Figure 1: Final Scoring Buckets

3.2.3. Scorecard analysis

The review process took into consideration the fact that some sectors like automobiles & accessories, telecommunications and investment services contained single entities. These were therefore consolidated with similar categories for analysis purposes. The result was that:

- (a) Automobiles & accessories was analyzed with manufacturing & allied;
- (b) Telecommunications was analyzed with commercial & services; and
- (c) Investment services was analyzed with investments.

A breakdown of the number of assessed issuers per sector:

	SECTORS	Number of issuers
1	Banking	14
2	Commercial & services/telecommunications	13
3	Automobiles & accessories/manufacturing & allied	7
4	Energy & petroleum	5
5	Insurance	5
6	Agricultural	4
7	Investment & investment services	4
8	Construction & allied	4

Table 2 Breakdown of issuers per sector

3.2.4. Peer review process

In order to minimize assessor subjectivity and to enhance accuracy and consistency in the review process, a check and balance methodology was applied through peer review.

4. RESULTS AND ANALYSIS OF EACH PRINCIPLE

4.1. COMMITMENT TO GOOD CORPORATE GOVERNANCE

This analysis focuses on aspects of commitment to good governance including development and publication of a board charter, awareness of the requirements of the Code and promotion of sustainability among others.

4.1.1. PERFORMANCE OF ISSUERS ON COMMITMENT TO GOOD GOVERNANCE

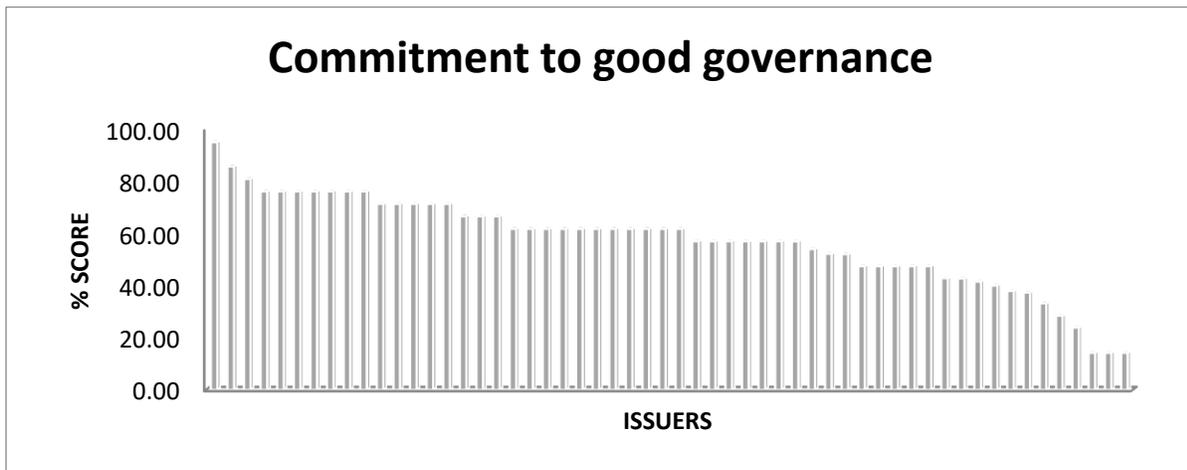


Table 3 Issuer performance on commitment to good governance

On commitment to good governance, the assessment reveals the following rating for issuers; 10 - leadership, 8 - good, 21 - fair and 17 - needs improvement.

Below is an illustration on how sectors performed in commitment to good governance.

4.1.2. OVERALL SECTORAL PERFORMANCE IN COMMITMENT TO GOOD GOVERNANCE

Below is an illustration on how sectors performed in commitment to good governance.

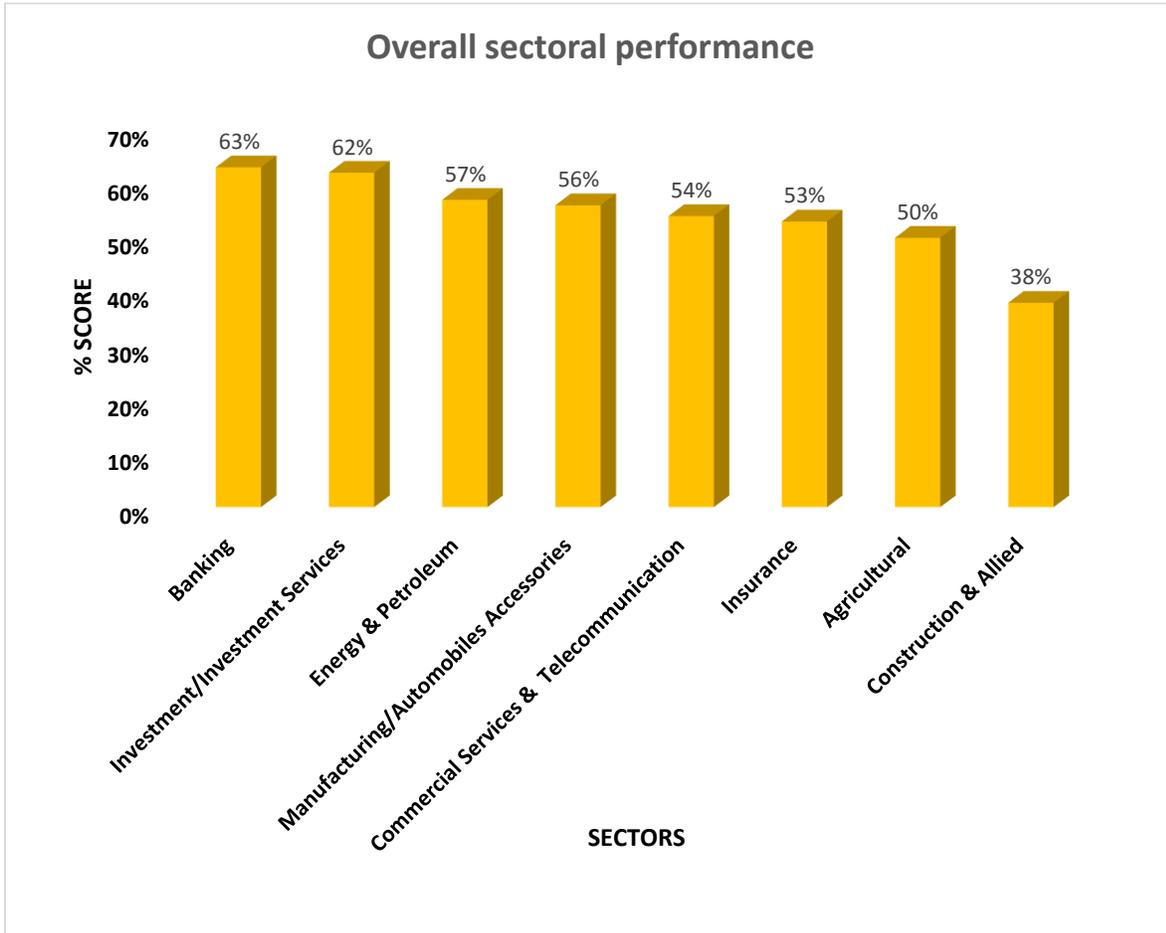


Table 4 Overall sectoral performance principle 1

All sectors performed fairly in commitment to good governance save for Construction & Allied which scored a 'needs improvement'.

4.1.3. OVERALL PERFORMANCE ON SPECIFIC ELEMENTS OF COMMITMENT TO GOOD GOVERNANCE

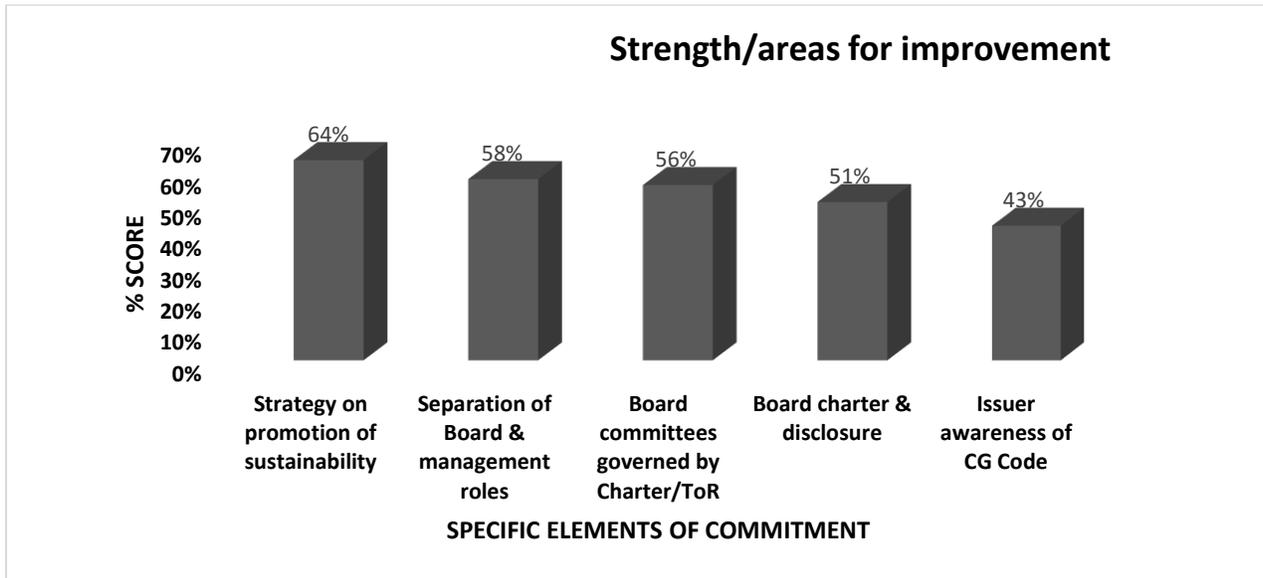


Table 5 Performance of specific elements on principle 1

The above graphical presentation shows that most issuers have prioritized setting strategies to promote sustainability. The graph also shows that there is a need for issuers to improve their level of awareness of the Code.

4.2. BOARD OPERATIONS AND CONTROL

This focuses on the establishment of board committees, independence of directors, separation of roles of chairperson & chief executive officer, management of conflicts of interest, legal and governance audits among others.

4.2.1. PERFORMANCE OF ISSUERS ON BOARD OPERATIONS AND CONTROL

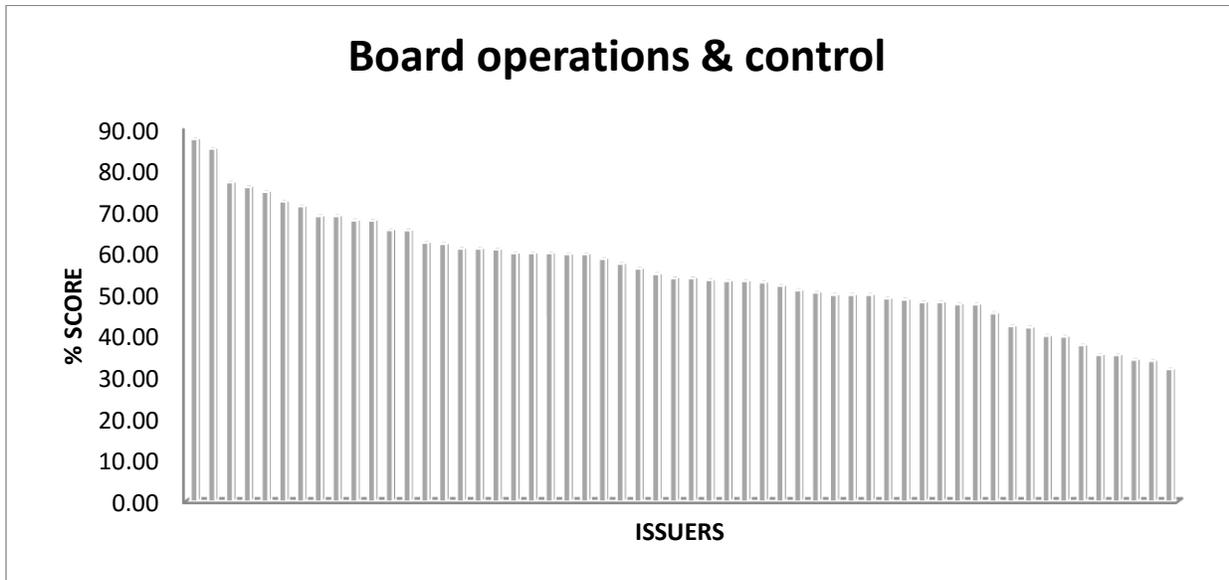


Table 6 Issuer performance on board operations and control

On board operations and control, the assessment reveals the following rating for issuers; 4 - leadership, 9 - good, 26 - fair and 17 - needs improvement.

4.2.2. OVERALL SECTORAL PERFORMANCE IN BOARD OPERATIONS AND CONTROL

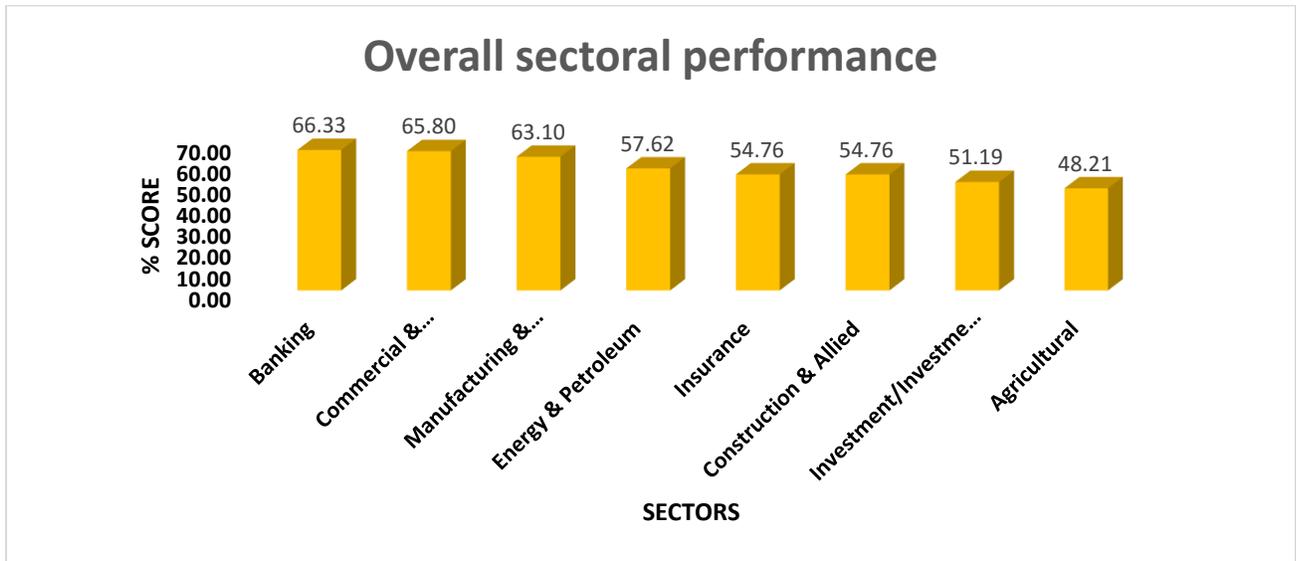


Table 7 Overall sectoral performance Principle 2

The Banking, Commercial Services/Telecommunications, sectors demonstrated a good level of application of Board Operations and Control.

The lowest level of application was observed in the in the Agricultural sector.

4.2.3. OVERALL PERFORMANCE ON SPECIFIC ELEMENTS OF BOARD OPERATIONS & CONTROL

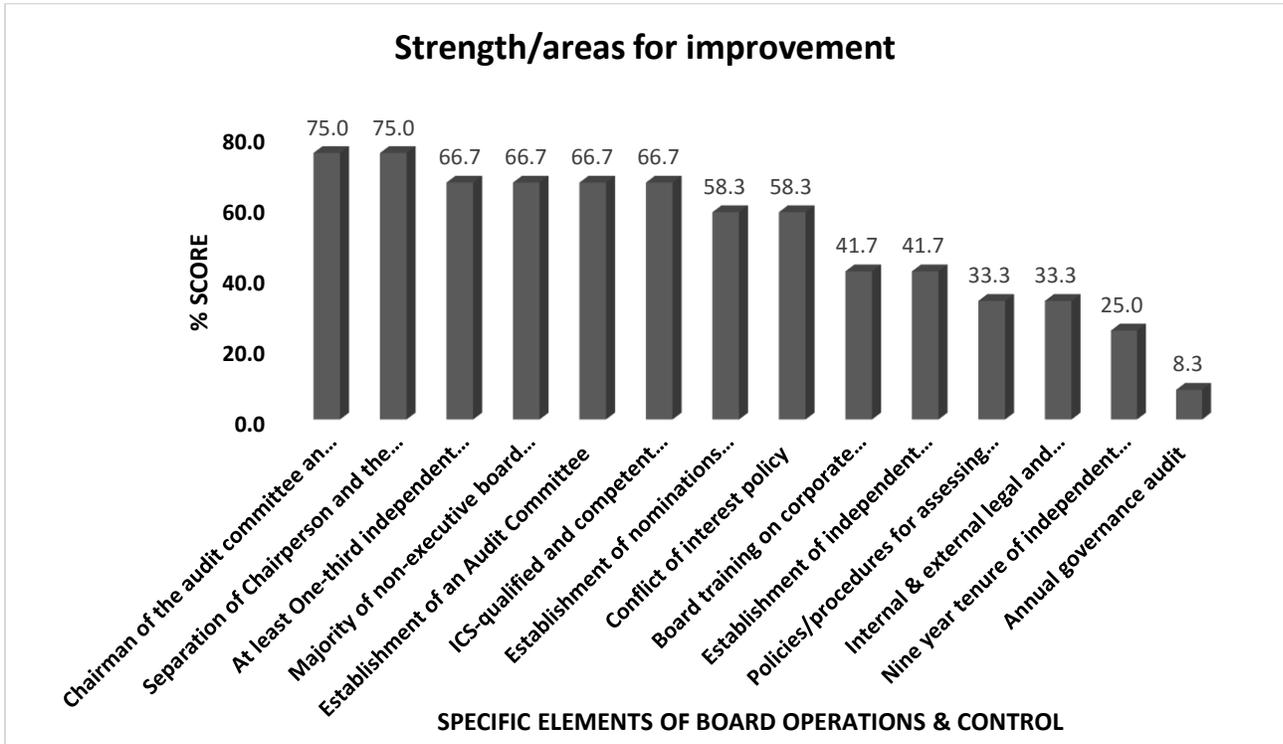


Table 8 Performance of specific elements on principle 2

Leadership rating was demonstrated in the requirement of the chairperson of the audit committee being independent and separation of the roles of the chairman and the CEO.

There were several areas of improvement with the weakest being the failure to conduct annual governance audits.

4.3. RIGHTS OF SHAREHOLDERS

The analysis on rights of shareholders focused on equitable treatment of all shareholders, board facilitation of shareholders' participation at the AGM and proactive provision of information to shareholders in a timely manner.

4.3.1. PERFORMANCE OF ISSUERS ON RIGHTS OF SHAREHOLDERS



Table 9 Issuer performance on rights of shareholders

On rights of shareholders, the assessment reveals the following rating for issuers; 5 - leadership, 18 - good, 20 - fair and 13 - needs improvement.

4.3.2. OVERALL PERFORMANCE IN RIGHTS OF SHAREHOLDERS

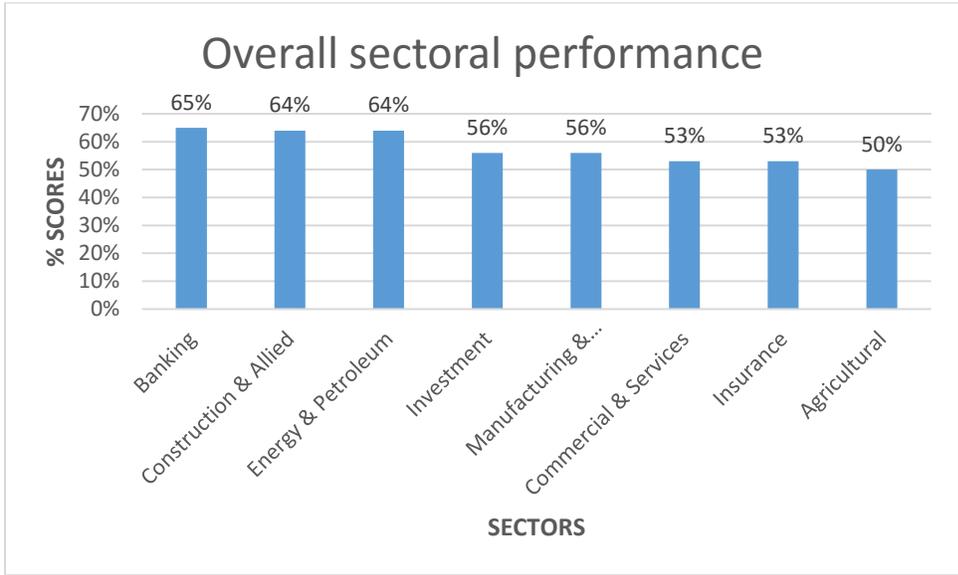


Table 10 Overall sectoral performance on principle 3

Construction & Allied and Energy & Petroleum sectors outperformed the rest. The overall performance of the sectors was a fair rating.

4.3.3. OVERALL PERFORMANCE OF SPECIFIC ELEMENTS OF RIGHTS OF SHAREHOLDERS

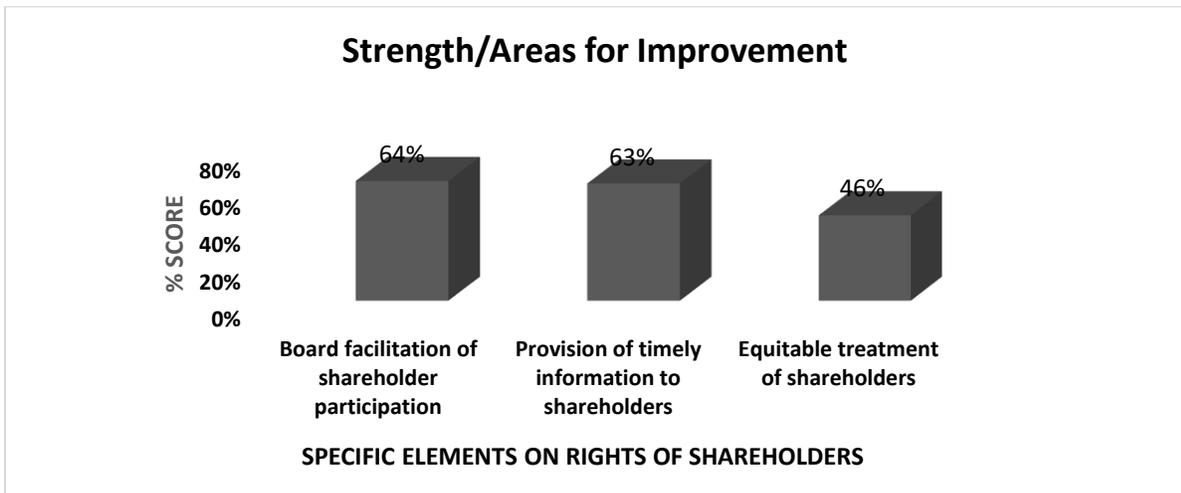


Table 11 Performance on specific elements on principle 3

General area of strength was demonstrated in the Board facilitating shareholders' participation at the AGM and ensuring the provision of timely information to shareholders and the media while issuers need to improve on equitable treatment of shareholders.

4.4. STAKEHOLDER RELATIONS

This area focused on management of relationships with stakeholders considering the interests of key stakeholders input in decision making. In addition to ensuring communication with stakeholders, the review also put into consideration the establishment of a formal dispute resolution process.

4.4.1. PERFORMANCE OF ISSUERS ON STAKEHOLDER RELATIONS

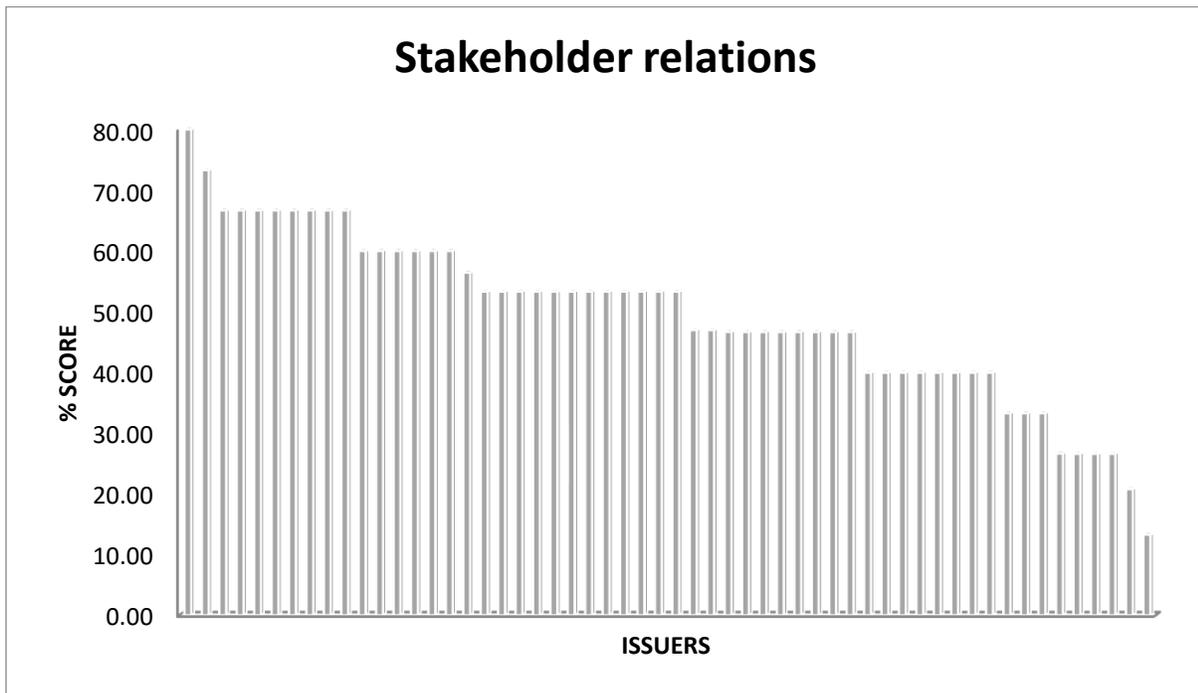


Table 12 Issuer performance on stakeholder relations

On stakeholder relations, the assessment reveals the following rating for issuers; 1 - leadership, 9 - good, 19 - fair and 27 - needs improvement.

4.4.2. OVERALL SECTORAL PERFORMANCE IN STAKEHOLDER RELATIONS

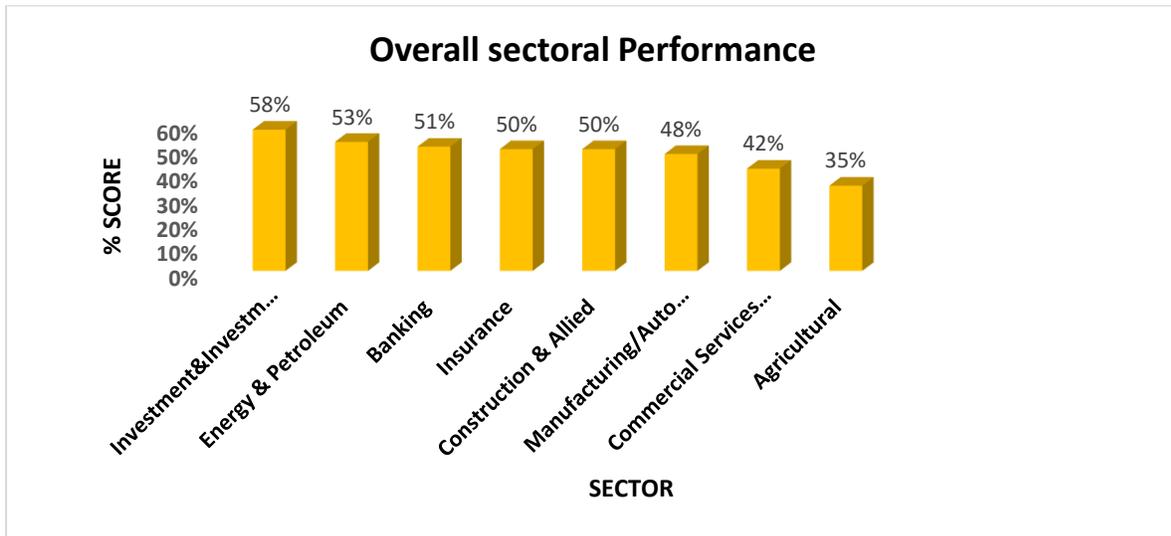


Table 13 Overall sectoral performance on principle 4

The performance in relation to stakeholder relations was average to poor across all the sectors. However, manufacturing and Allied, Commercial Services and Telecommunications and Agricultural sectors were the lowest with “a needs improvement” rating.

4.4.3. OVERALL PERFORMANCE ON SPECIFIC ELEMENTS OF STAKEHOLDER RELATIONS

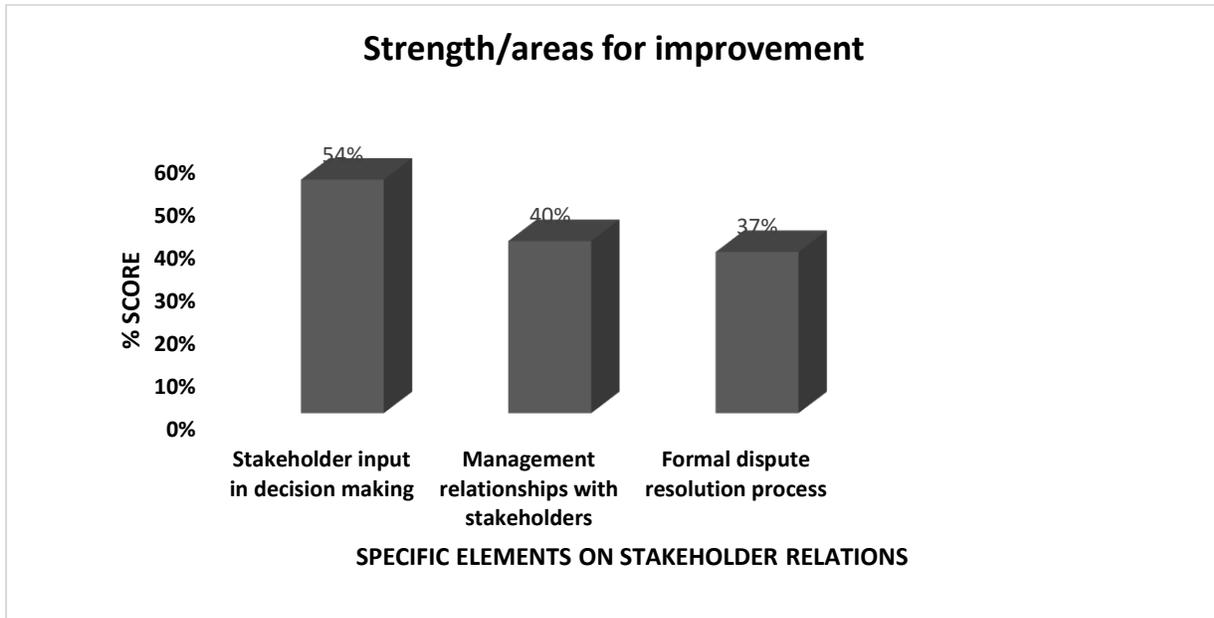


Table 14 Performance of specific elements on principle 4

There was a fair performance in ensuring stakeholder input is taken into consideration during decision making process. However, significant improvement is required in managing relationship with stakeholders and developing formal dispute resolution processes. In the overall, issuers should improve on their relationship with stakeholders and ensure that stakeholder input (outside the traditional shareholder considerations) is integrated into the issuer's decision-making framework.

4.5. ETHICS AND SOCIAL RESPONSIBILITY

This area focuses on the impact of company's operation on society and environment, monitoring and reporting of corporate citizenship and sustainability, code of ethics & conduct, implementation of whistle blowing policy and ethics and sustainability in risk management process among others.

4.5.1. PERFORMANCE OF ISSUERS ON ETHICS AND SOCIAL RESPONSIBILITY

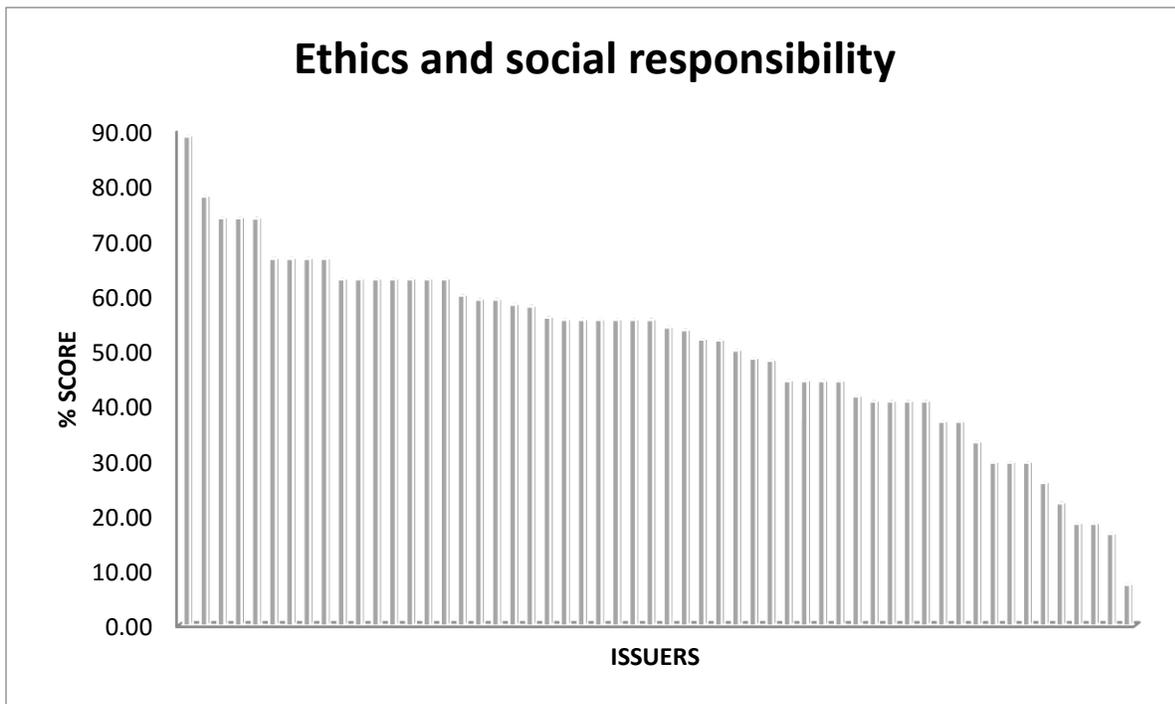


Table 15 Issuer performance on ethics and social responsibility

On ethics and social responsibility, the assessment reveals the following rating for issuers; 2 - leadership, 7 - good, 24 - fair and 23 - needs improvement.

4.5.2. OVERALL SECTORAL PERFORMANCE IN ETHICS & SOCIAL RESPONSIBILITY

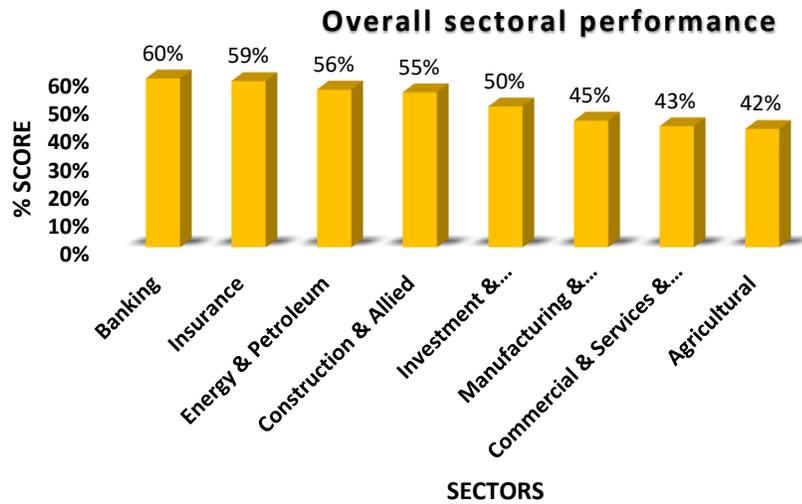


Table 16 Overall sectoral performance on principle 5

Generally, the performance of the sectors was fair with three sectors posting a needs improvement rating.

4.5.3. OVERALL PERFORMANCE ON SPECIFIC ELEMENTS OF ETHICS & SOCIAL RESPONSIBILITY

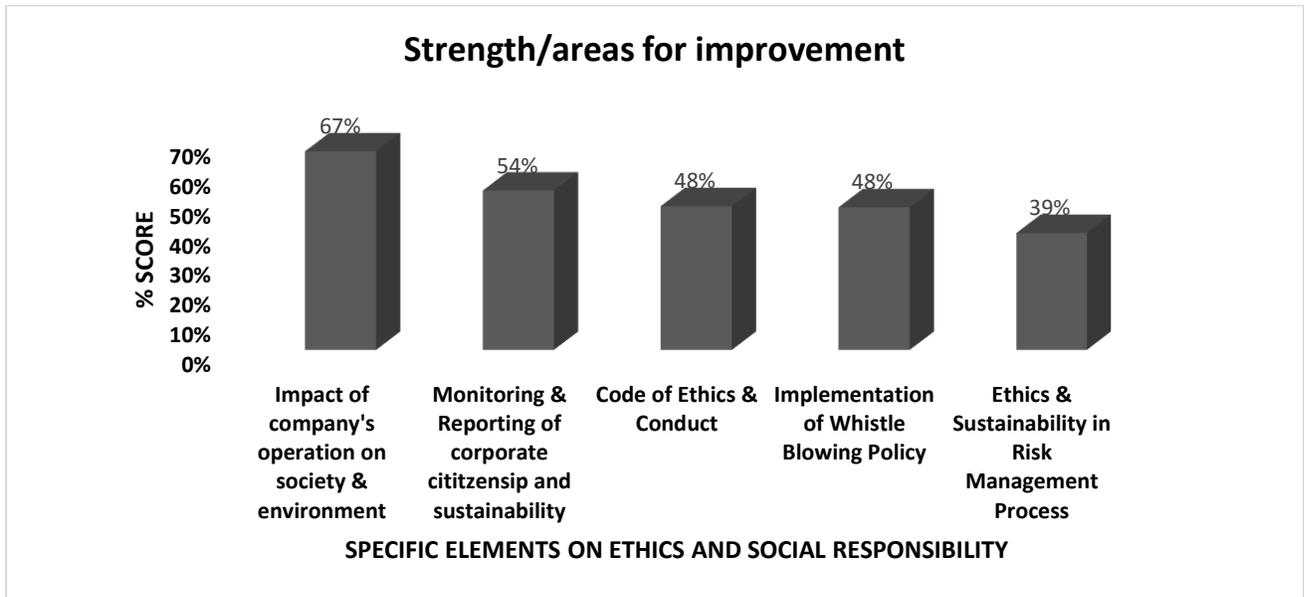


Table 17 Performance of specific elements on principle 5

Good performance was observed in considering not only financial performance but also the impact of the issuer's operations on society and the environment. Fair performance on monitoring and reporting activities on corporate citizenship and sustainability was observed while needs improvement was observed in development and publication of the code of ethics and conduct, incorporation of ethical and sustainability risks and opportunities and in development and implementation of a whistleblowing policy.

4.6. ACCOUNTABILITY, RISK MANAGEMENT AND INTERNAL CONTROL

This area covers the responsibilities of the board, audit committee and external auditors in preparation of financial statements, independence of external auditors, integrated reporting, risk management framework and internal audit function among others.

4.6.1. PERFORMANCE OF ISSUERS ON ACCOUNTABILITY, RISK MANAGEMENT AND INTERNAL CONTROL

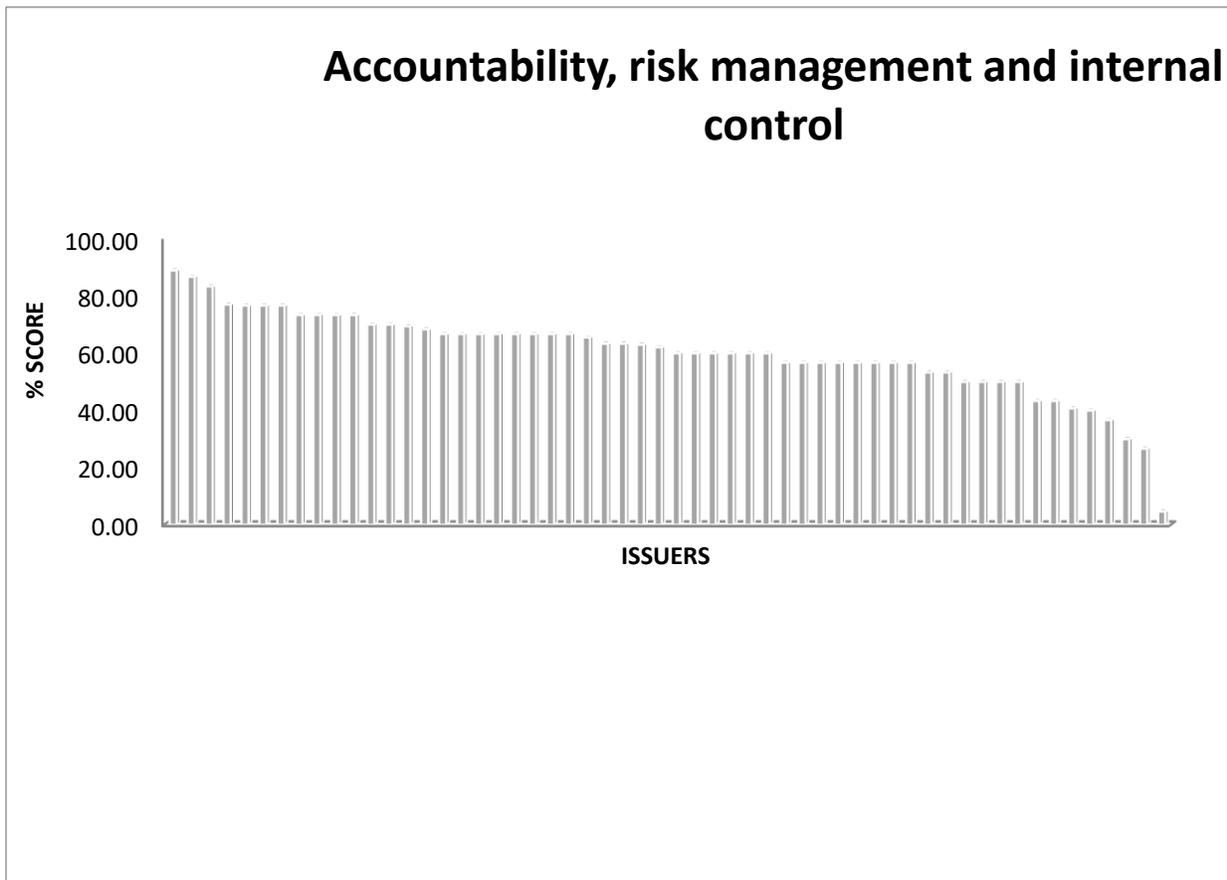


Table 18 Issuer performance on accountability, risk management and internal control

On accountability, risk management and internal control, the assessment reveals the following rating for issuers; 7 - leadership, 17 - good, 24 - fair and 8 - needs improvement.

4.6.2. OVERALL SECTORAL PERFORMANCE IN ACCOUNTABILITY, RISK MANAGEMENT AND INTERNAL CONTROL

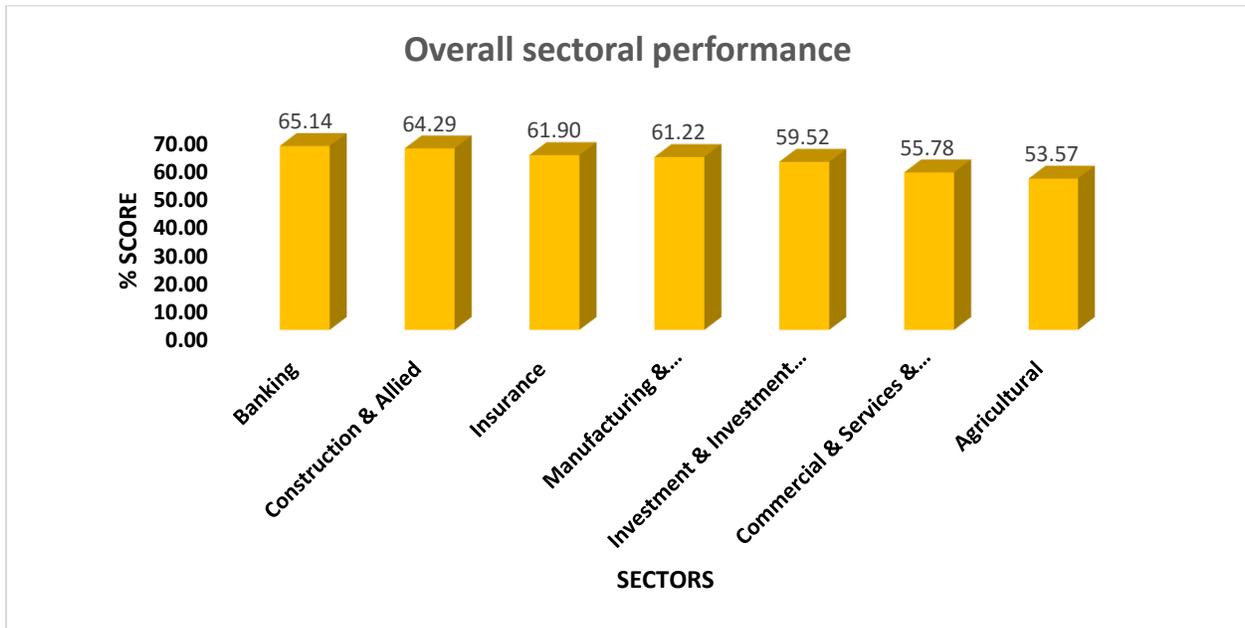


Table 19 Performance of specific elements on principle 6

Banking sector demonstrated a good rating while the rest of the sectors demonstrated a fair rating.

4.6.3. OVERALL PERFORMANCE ON SPECIFIC ELEMENTS OF ACCOUNTABILITY, RISK MANAGEMENT & INTERNAL CONTROL

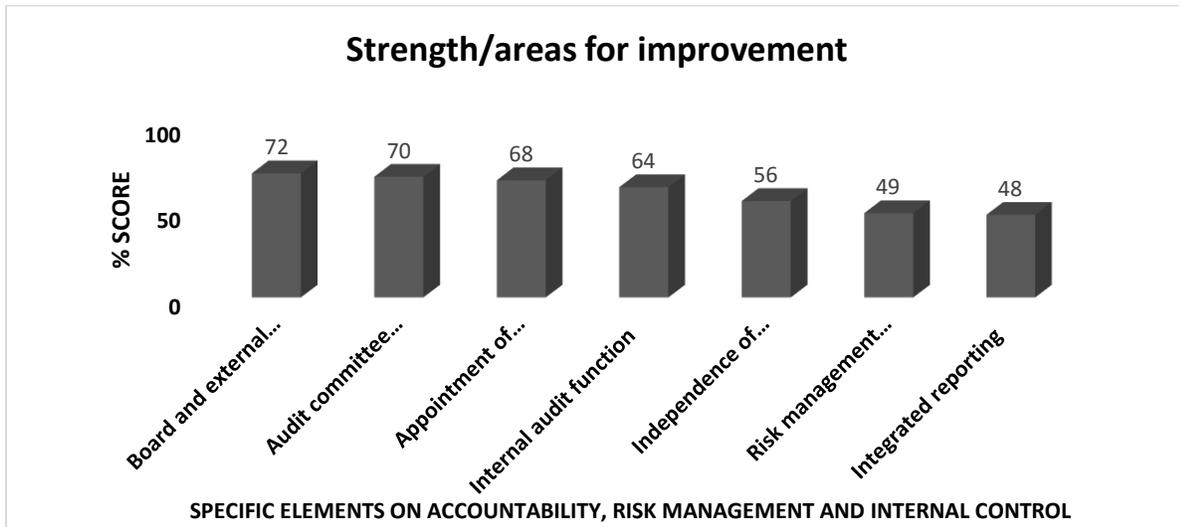


Table 20 Performance of specific elements on principle 6

A demonstration of good performance was observed in ensuring the board, audit committee and external auditor responsibilities are met on preparation of the financial statements. There is need for improvement in the establishment of a risk management framework and the introduction of integrated reporting.

4.7. TRANSPARENCY AND DISCLOSURE

This area covers disclosures on; remuneration on directors and senior management, board charter, whistleblowing policy, code of ethics and information on resignation of directors, management discussion and analysis, compliance with laws, ethical leadership, conflict of interest, corporate social responsibilities and citizenship, governance audit, risk management policy, procurement policy, insider dealings, related party transactions, information technology policy, corporate reporting, statement of policy on good governance and status of application of the Code among others.

4.7.1. PERFORMANCE OF ISSUERS ON TRANSPARENCY AND DISCLOSURE



Table 21 Issuer performance on transparency and disclosure

On transparency and disclosure, the assessment reveals the following rating for issuers; 1 - leadership, 10 - good, 24 - fair and 21 - needs improvement.

4.7.2. OVERALL SECTORAL PERFORMANCE IN TRANSPARENCY & DISCLOSURE

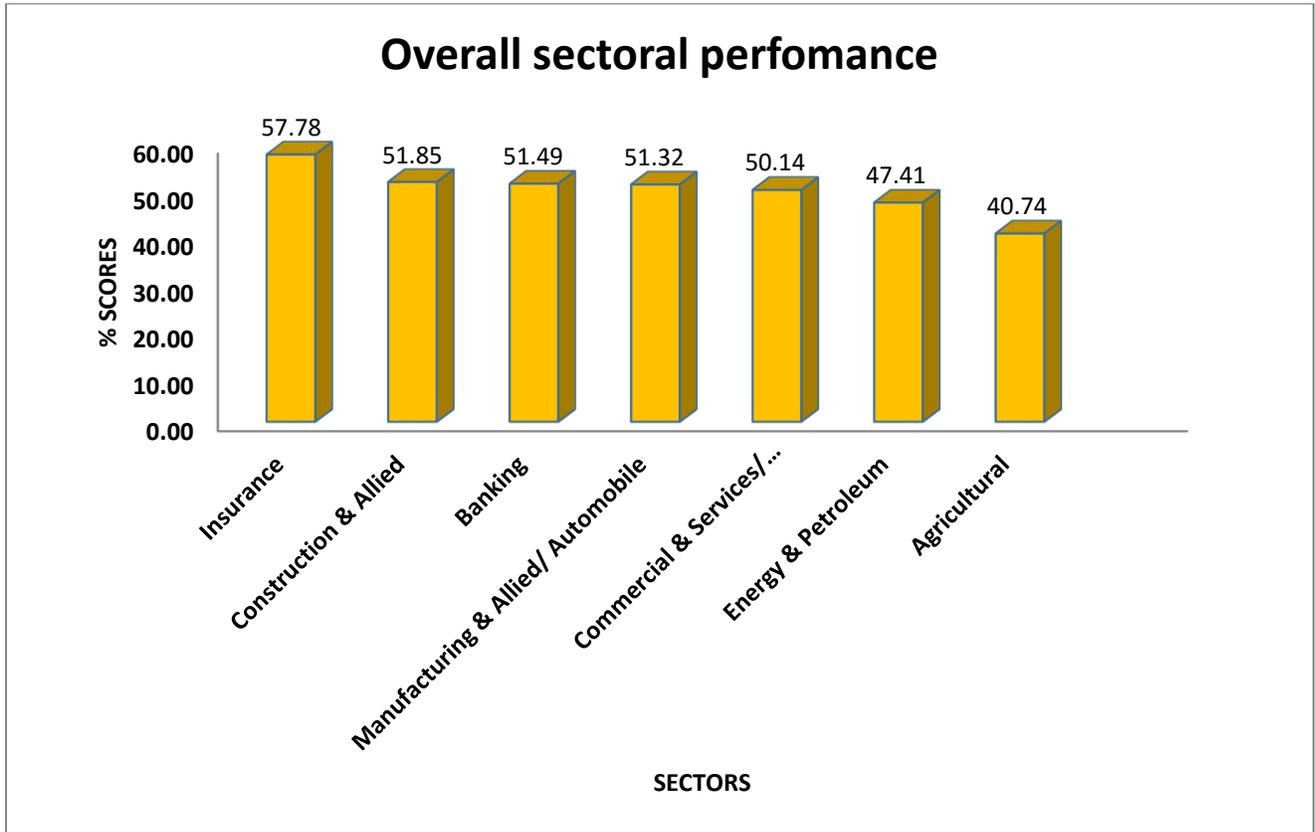


Table 22 Overall sectoral performance on principle 7

All the sectors performed fairly except Energy & Petroleum and Agriculture which recorded a needs improvement rating.

4.7.3. OVERALL PERFORMANCE ON SPECIFIC ELEMENTS OF TRANSPARENCY & DISCLOSURE

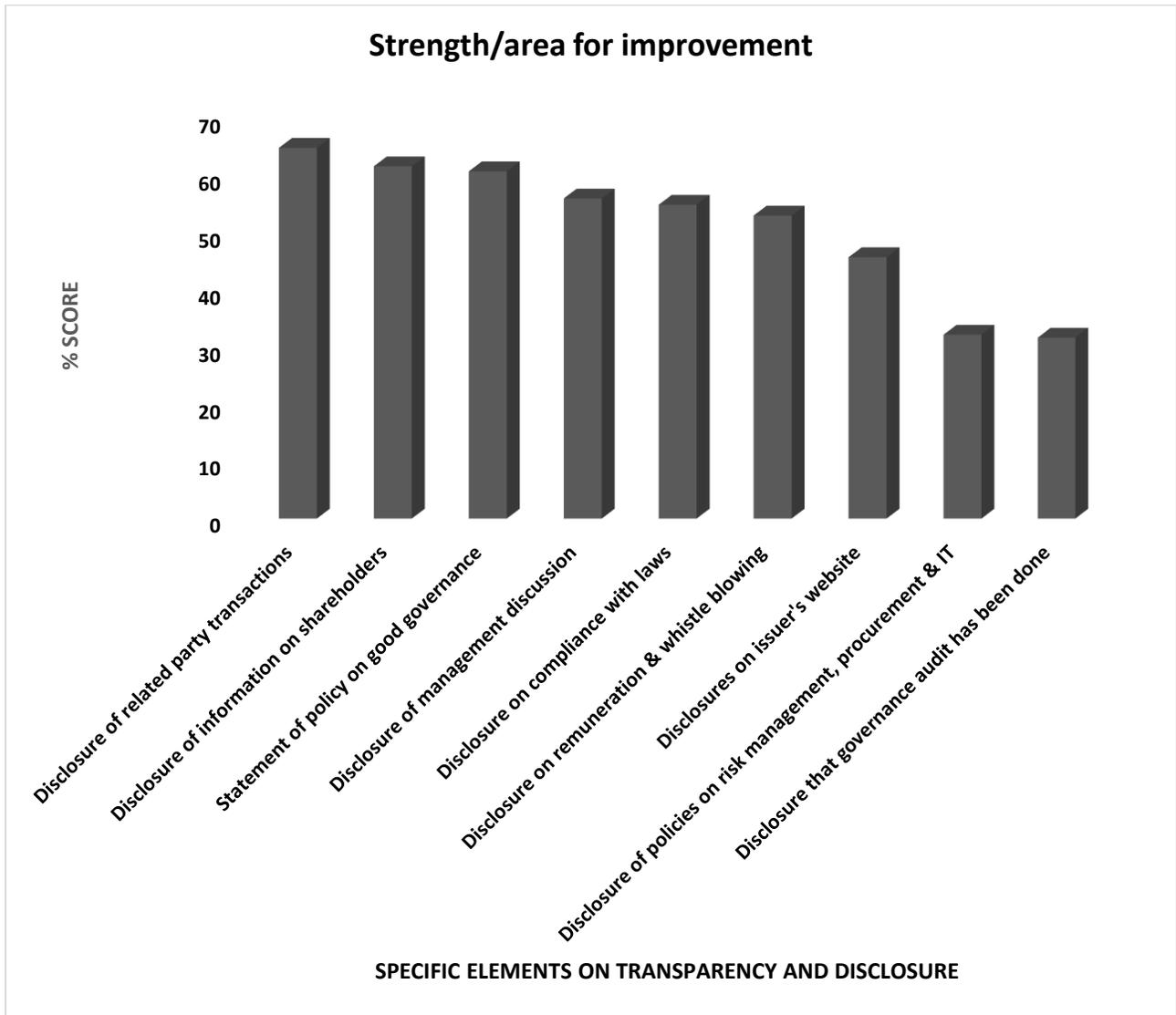


Table 23 Performance of specific elements on principle 7

The above table shows that most issuers fairly performed on disclosures. Necessary disclosures on respective issuer's website, the company's risk management policy, company procurement policy, information technology policy were ranked as needs improvement. In addition, areas requiring needs improvement were disclosure on whether governance audit has been conducted and if there were any known insider dealings needs.

5. OVERALL ASSESSMENT

5.1. INDIVIDUAL ISSUER PERFORMANCE

The graph below represents a general performance of all the issuers as assessed.

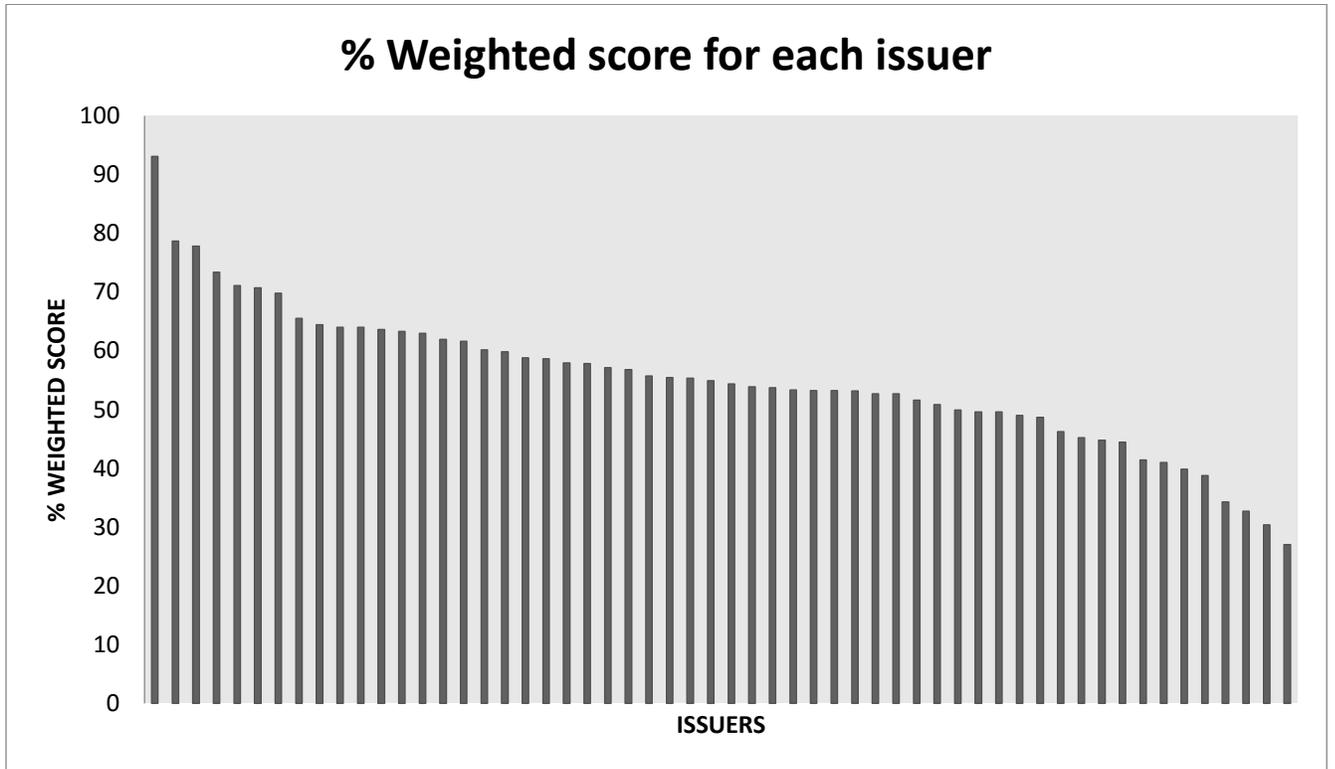


Figure 2 Weighted score for each issuer

Rating	No. of Issuers	Percentage
Leadership	3	5.36%
Good	5	8.93%
Fair	31	55.37%
Need Improvement	17	30.36%

5.2. OVERALL PERFORMANCE ON ALL PRINCIPLES

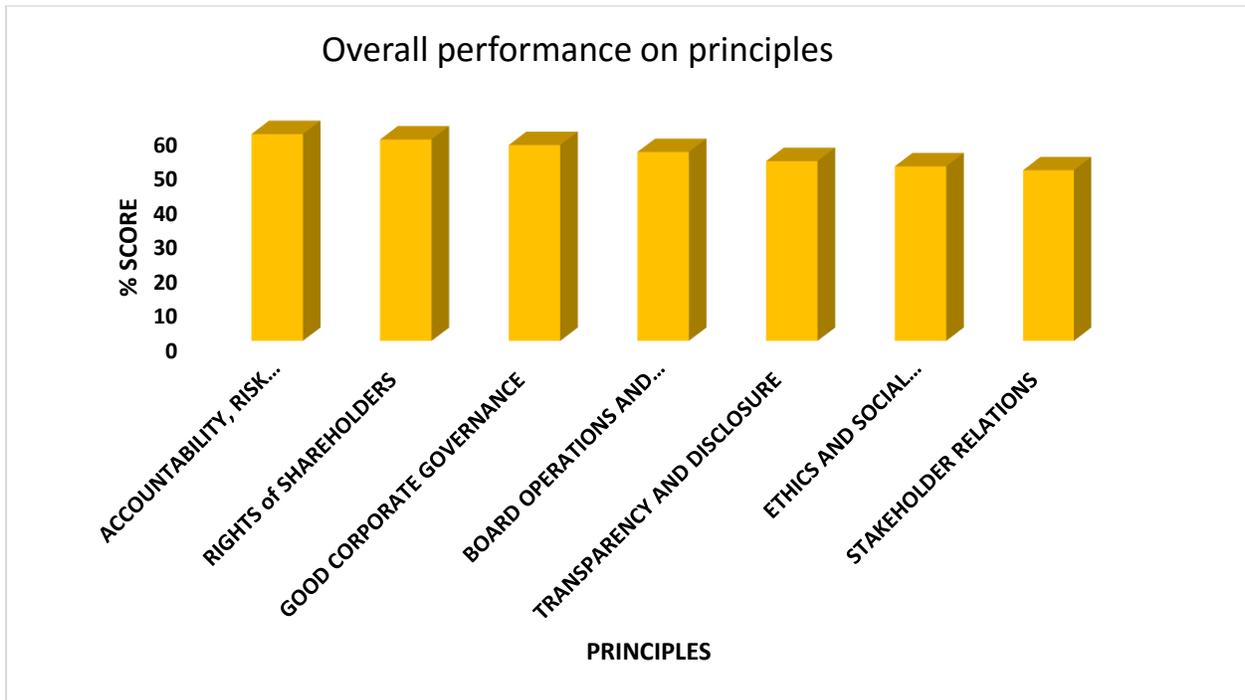


Table 24 Overall performance on principles

The above table shows that companies performed better on the principle of accountability, risk management & internal control and the principle of rights of the shareholders. The principle where performance was at the lowest was in relation to stakeholder relations.

5.3. SECTORAL PERFORMANCE

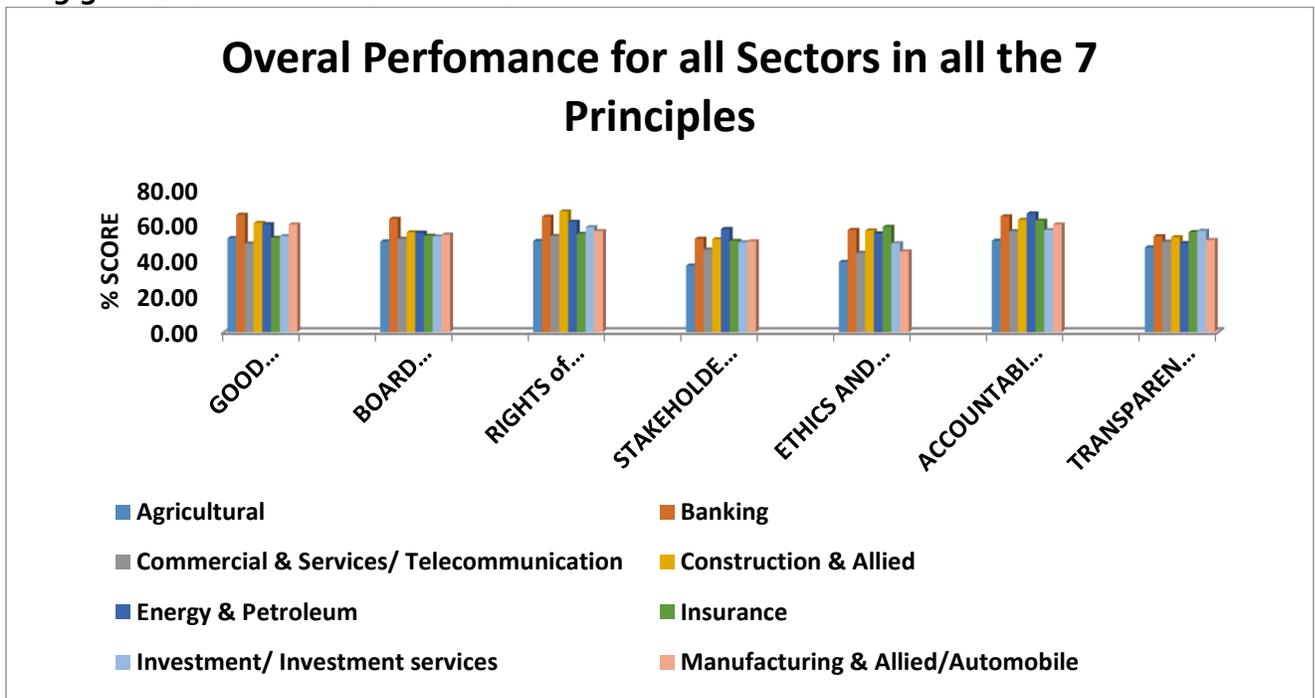


Table 25 Sectoral performance on principles

The above shows that the banking sector performed well on each principle leading on commitment to good corporate governance and in board operations and control. Construction and Allied sector lead on ensuring the rights of the shareholders are considered. The energy and petroleum sector led on ensuring the stakeholder relations are adhered to as per the requirements of the code. Most sectors performed fairly well on ethics and social responsibility but struggled to meet the stakeholder relations and on transparency and disclosures.

5.4. WEIGHTED PERFORMANCE ON EACH SECTOR

The graph below shows weighted performance on each sector.

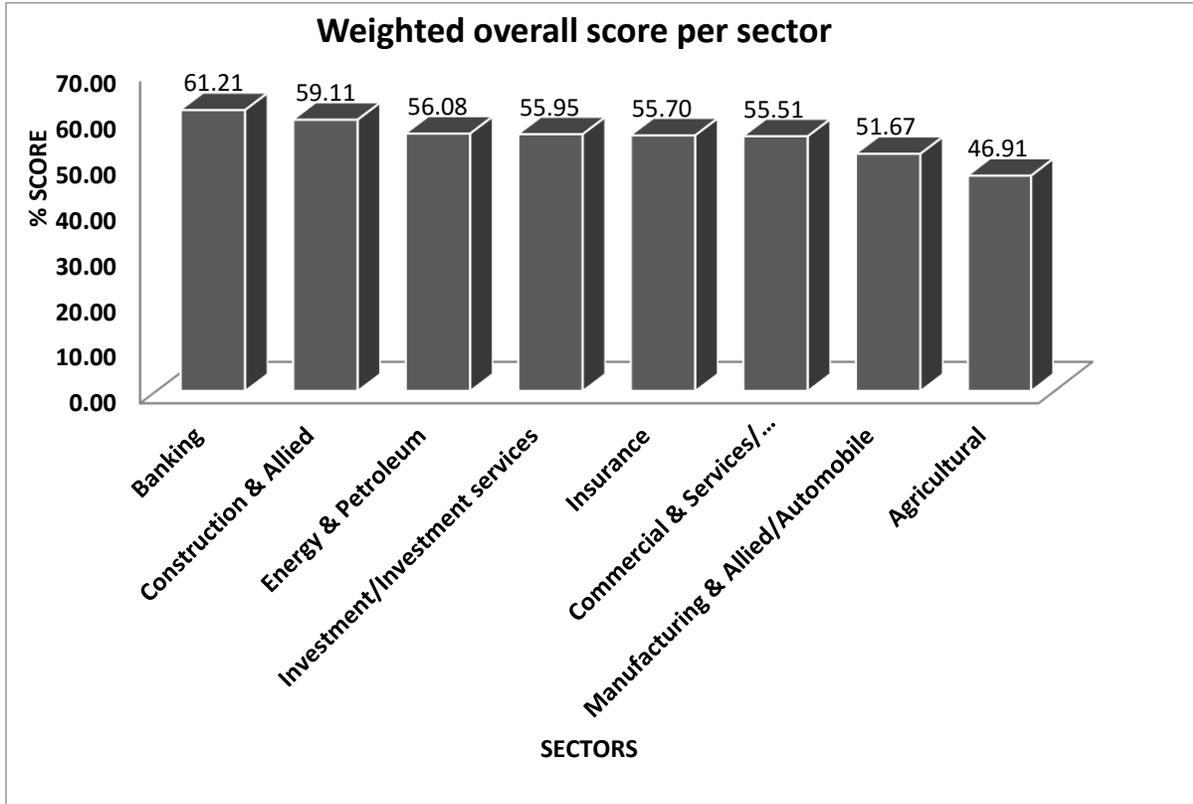


Table 26 Weighted overall score per sector

We note that no sector scored a “leadership” or “good” rating on the overall sectoral performance. All sectors were on fair rating except the agricultural sector which scored a ‘needs improvement’ rating.

5.5. OVERALL WEIGHTED SCORE ON MARKET SEGMENT SCORES

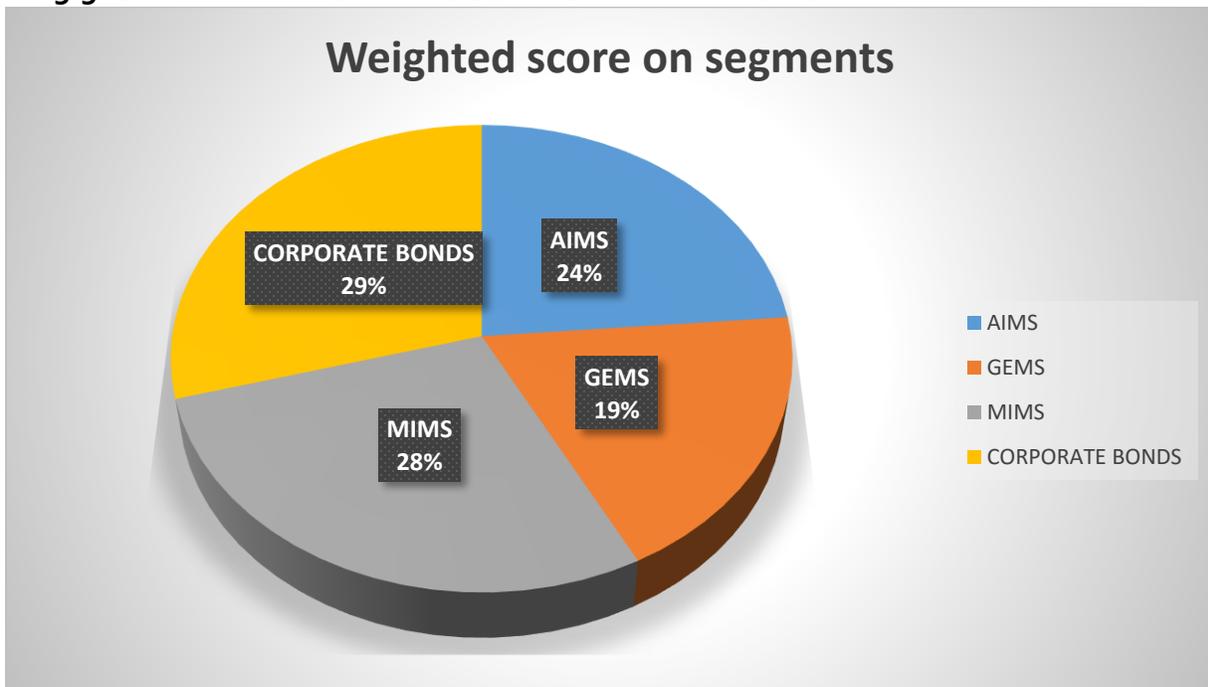


Figure 3 Weighted score on segments

* The above corporate bonds refer to listed bonds for unlisted issuers.

The corporate bonds (for unlisted issuers) performed best followed by the Main Investment Market Segment (MIMS). The performance is however rated fair as per the rating buckets. GEMS and AIMS were categorized as “needs improvement”.

5.6. HEAT MAP DISPLAYING RELATIVE PERFORMANCE IN THE SEVEN PRINCIPLES

	Commitment to good corporate governance	Board Operations and control	Rights of Shareholders	Stakeholder Relations	Ethical and Social Responsibility	Accountability, Risk management and Internal control	Transparency and Disclosure
SECTORS							
Banking							
Construction & Allied							
Energy & Petroleum							
Investment/Investment services							
Insurance							
Commercial & Services/ Telecommunication							
Manufacturing & Allied/Automobile							
Agricultural							

Figure 4 Heat map

Key for the heat map.

1.	Leadership
2.	Good
3.	Fair
4.	Needs improvement

A key conclusion from the heat map is that different sectors excel in different categories – the sectors with the highest overall scores do not necessarily perform well in all categories. Similarly, sectors with lower scores are not necessarily weak in all parameters. All sectors were rated 'fair' in board operations and control principles while the commercial and services/telecommunications sector got a fair rating on all the principles. The construction and allied sector scored leadership rating in the overall weighted score in the rights of shareholders.

6. CONCLUSION AND RECOMMENDATIONS

The 2017/2018 findings suggest a fair status of 55.00% weighted overall score in the application of the Code of Corporate Governance Practices for Issuers of Securities to the Public. Out of the fifty-six (56) issuers who were assessed, three (3) issuers were evaluated to be leadership practices, five (5) demonstrated good practices, thirty-one (31) demonstrated fair practices and seventeen (17) demonstrated needing improvement practices.

The Construction & Allied sector scored leadership rating in the weighted score in the rights of shareholders.

It was noted that no sector scored a “leadership” or “good” rating on the overall weighted performance. All sectors were on fair rating except the agricultural sector which scored needs improvement rating.

The assessment demonstrates that though improvements have been made, challenges remain. The following are the key challenges that issuers need to address-

- (i) **Board Charter:** issuers should make available their board charter on their websites;
- (ii) **Nominations Committee:** issuers should establish a nominations committee with majority independent and non-executive directors;
- (iii) **Legal and Compliance Audits:** issuers should conduct both internal and independent legal and compliance audits, every year and two years respectively, by a legal professional in good standing with the Law Society of Kenya (LSK);
- (iv) **Governance Audit:** issuers should carry out governance audits on an annual basis to confirm whether the company is operating on sound governance practices. This exercise should be executed by a competent and recognized professional accredited by the Institute of Certified Secretaries (ICS). In addition, issuers should formally disclose whether a governance audit was carried out;
- (v) **Key risks and sustainability:** issuers should establish and disclose company’s risk management framework;
- (vi) **Procurement:** issuers should disclose their policies on procurement;
- (vii) **Remuneration structure:** issuers should on an annual basis disclose in the annual report, the policies for remuneration including incentives for the Board and senior management. In addition, issuers should adopt the Companies (General) (Amendment) (No.2) Regulations on directors’ remuneration;
- (viii) **Whistleblowing policy:** issuers should disclose their whistleblowing policies in annual reports and websites;

- (ix) **Information technology and corporate reporting:** issuers should disclose their policies on information technology;
- (x) **Insider dealings:** issuers should focus on implementing clear policies to cater for handling of material price sensitive information as well as structures to restrict trading actively by insiders while in possession of material price sensitive information;
- (xi) **Level of awareness of the Code:** issuers should ensure that all directors, chief executive officers and management are made fully aware of the requirements of the Code;
- (xii) **Establishment of independent remuneration committee:** issuers should set up an independent remuneration committee or assign a mandate to a nomination committee or such other committee executing the functions of a nomination committee, consisting mainly of independent and non-executive directors, to recommend to the board the remuneration of the executive and non-executive directors and the structure of their compensation package;
- (xiii) **Policies/procedures for assessing the independence of independent directors:** issuers should develop and implement policies and procedures to annually assess the independence of independent board members;
- (xiv) **Equitable treatment of shareholders:** issuers should ensure that all shareholders, including minority and foreign shareholders are treated in an equitable manner;
- (xv) **Managing relationship with stakeholders:** issuers should develop policies, procedures and strategies to manage relations with different/key stakeholder groups;
- (xvi) **Formal dispute resolution processes:** issuers should establish formal dispute resolution processes to address internal and external disputes;
- (xvii) **Development and publication of the code of ethics & conduct:** issuers should develop and publicly disclose their code of ethics and conduct (which includes sustainability) and ensure its implementation by all directors, management and employees;
- (xviii) **Incorporation of ethical & sustainability risks and opportunities:** issuers should incorporate ethical and sustainability risks and opportunities in their risk management process; and
- (xix) **Introduction of integrated reporting:** issuers should work towards the introduction of integrated reporting (incorporating financial and non-financial information) using frameworks developed by any of the Integrated Reporting Council, The Global Reporting Initiative, the G4 Sustainability Guidelines and/or the Sustainability Accounting Standards Board.

7. NEXT STEPS

- (a) The Authority will continue to hold sensitization and capacity building sessions with issuers to discuss and enhance governance practices with particular focus on addressing the Scorecard findings and recommendations.
- (b) From the end of March 2019, the Authority will assess the quality and improvement of corporate governance practices of individual issuers against the Code and other globally accepted corporate governance standards. In this regard, both the Corporate Governance Reporting Template and the Scorecard will be adjusted to provide a basis for such a review and comparison within a Kenyan context.
- (c) Issuer specific assessment and rating is based on information which is publicly available to shareholders and potential investors. The assessment does not therefore rely on information that is within the issuer's knowledge but not yet publicly disclosed. As such, failure to submit a complete set of annual report and submission of incomplete/poorly filled reporting templates will attract an appropriate enforcement action for violating the continuous reporting requirements and circular No. CMA/MRT/004/2017 which provides guidance on the reporting timelines and how issuers should complete the reporting templates before submission to the Authority.
- (d) The Authority will continuously provide feedback to the respective issuers at the end of every assessment to enhance and improve corporate governance practices in Kenya.
- (e) The Authority is developing a progression matrix for measuring and monitoring the application of the Code.
- (f) A report on the State of Corporate Governance for Issuers of Securities will be prepared and published on the Authority's website by the end of the first quarter in every financial year.
- (g) To ensure the applicability, consistency and fitness for purpose of the ICS governance audit toolkits and templates, the Authority has partnered with Institute of Certified Secretaries (ICS) of Kenya to align the governance audit toolkits and templates with the regulatory environment in the capital markets sector.
- (h) The Authority has and will continue to engage institutional investors in line with the Stewardship Code for Institutional Investors, 2017, with the objective of ensuring that institutional investors take up their stewardship responsibilities as set out in the Stewardship Code.
- (i) The Authority, in consultation with Nairobi Securities Exchange and the issuers, will develop a corporate governance index to give issuers an opportunity to differentiate themselves in the market and tap into a growing pool of money committed to good governance and sustainability.
- (j) The Authority will conduct a survey among issuers and institutional investors on their capacity, appetite and opinions regarding increased disclosures on ESG reporting and the costs of compliance before the end of the financial year 2018/2019.
- (k) The Authority will take appropriate enforcement action on violations of the mandatory provisions and continuous reporting obligations which will be published as appropriate.

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