REPUBLIC OF KENYA
THE NATIONAL TREASURY AND ECONOMIC PLANNING

OWNERSHIP POLICY FOR GOVERNMENT OWNED ENTERPRISES IN KENYA

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Abbreviations

AGM – Annual general meeting

CS – Cabinet Secretary

GOE – Government-Owned Enterprise

GOK – Government of Kenya

KPI – key performance indicator

PFMA – Public Finance Management Act, 2012

PFMR – Public Finance Management Regulations, 2015

PPO – Public policy obligation

PSO – Public service obligation

I. Background

1. The formulation of the *Ownership Policy* for Government Owned Enterprises (GOEs) in Kenya is part of the wider governance reforms for the State Corporations (SCs) sector. Streamlining the system of governance of GOEs, of which the exercise of the ownership function is an important component, is expected to result in better financial and operational performance of the corporations, alongside other desirable outcomes such as less reliance on exchequer support and minimal fiscal risks.

2. The ownership policy will go a long way in supplementing and reinforcing the various governance instruments for SCs that have been instituted by the Government of Kenya (GoK) under the overall legal framework of the Constitution of Kenya 2010. The key instruments that have stepped up the governance systems for SCs since 2010 are the Constitution of Kenya 2010, Public Finance Management Act (PFMA) 2012 and the related regulations, the Mwongozo code of governance, and GoK circulars issued from time to time.

3. This policy seeks to address deficiencies that have been observed in the governance of GOEs in Kenya, with a particular focus on the exercise of the ownership function in the following areas:
    i. Less fragmented exercise of ownership function over GOEs;
    ii. More streamlined process of nomination and appointment of non-executive directors of GOEs;
    iii. Enhanced design of performance contracts and related oversight;
    iv. Differentiated ownership and governance framework for commercial (GOEs) and non-commercial SCs; and,
    v. Enhanced transparency and accountability at the GOE and GoK levels.

4. The legal ownership of SCs in Kenya is vested in the Cabinet Secretary to the Treasury as a body corporate established under the Cabinet Secretary to the Treasury (Incorporation) Act. For the cases of entities incorporated by GoK as companies under the Companies Act, with shares as units of ownership, the legal ownership of the shares by the Cabinet Secretary to the National Treasury is explicitly documented in the incorporation instruments. For a case, however, where a state corporation itself establishes a subsidiary in form of a company under the Companies Act, the legal owner of the subsidiary company explicitly stated in the incorporation instruments is the parent state corporation.

5. Under the current arrangement, the exercise of various components of ownership rights is diffused among various institutions of GoK, namely the National Treasury itself, the line Ministries and the Office of the President. This arrangement is inconsistent with established and tested good corporate governance practices, and tends to create a principal (owner)-agent (state corporation) relationship with a

multiplicity of principals who often send conflicting signals to the agent. The key ownership rights and responsibilities include the following:

i. Nomination of persons for appointment as non-executive directors of SCs in the manner spelt out in the relevant legal instruments;
ii. Performance expectations setting and monitoring, and determining performance rewards and sanctions;
iii. Approving directors' remuneration;
iv. Adopting the Audited Financial Statements of the Company for any particular year;
v. Approving significant strategic decisions such as mergers with any other entity, and creation of subsidiaries; and,
vi. Providing funding required of the owner, namely owner's capital.

6. The scope of this policy is confined to state corporations that have a *commercial* mandate. These commercial state corporations will hereinafter be referred to as *Government Owned Enterprises (GOEs)* as defined in Section 210 of the Public Finance Management (National Government) Regulations, 2015. GOE means an organisation which:
    i. is a legal person under the ownership and control of the national government;
    ii. has been assigned financial and operational powers to carry on a business activity;
    iii. as its main business, supplies goods or services in accordance with ordinary commercial principles; and,
    iv. is financed wholly or substantially from sources that do not require annual appropriation by National Assembly, or imposition of a tax, levy or other charge under legislation.

7. In order to refocus the GOEs on their commercial mandate and also provide a better legal setting for established corporate governance practices, the entire portfolio of GOEs in Kenya will be transitioned into limited liability companies created under the Companies Act, 2015. This will entail amendments of various existing statutes.

8. In view of the fact that GOEs perform public policy obligations (PPOs) – sometimes referred to as public service obligations (PSOs) – mainly of a non-commercial nature, either continuously or from time to time, a framework for GOEs to carry out PPOs will be developed by the National Treasury.

9. The norms developed under the GOE ownership policy will be customized and extrapolated to non-commercial SCs.

10. The National Treasury, through the Cabinet Secretary to the Treasury as a body corporate established under the Cabinet Secretary to the Treasury (Incorporation) Act, will exercise the ownership rights and responsibilities as envisaged in this Policy, in respect of GOEs.

II. Policy Objectives

11. The Ownership Policy will have the following objectives:
    i. To create an enabling ownership regime and business environment for better performance of GOEs and effective creation of value for society;
    ii. To put in place governance structures that are fit for the purpose of achievement of commercial objectives by GOEs;
    iii. To enhance accountability and appropriate incentives for GOEs to operate on commercial principles; and,
    iv. To position the Government as an informed and active owner – neither too passive nor unduly interfering with GOEs.
    v. To establish a transparent public service obligations accounting and funding structure that does not interfere with GOEs commercial objectives.

III. Principles

12. The following principles, which are interrelated and mutually-reinforcing, underpin the Ownership Policy for GOEs:
    i. There will be clear separation and allocation of ownership and oversight roles between the National Treasury and the rest of Government institutions.
    ii. The National Treasury will exercise the ownership function of GOEs, comprising key ownership rights and responsibilities outlined above.
    iii. All GOEs will be founded on a constitutive legal instrument – in this case the Companies Act 2015 with model Articles of Association – that provides a setting/framework that is more: (a) suitable for commercial businesses, (b) supportive of best practice corporate governance practices, and (c) effective in providing a level playing field i.e equally applicable to both private sector Entities and GOEs in a competitive marketplace.
    iv. GOEs will operate commercially to maximize shareholder wealth and returns, within a commercially-focused performance contract framework that will have a one-stop reference in GoK, namely the National Treasury.
    v. Where a GOE is required to undertake activities for other than commercial reasons and/or the mandate for which a GOE was established, such activities or PPOs will only be carried out on a separate operational and accounting basis and with contractual arrangements giving the GOE full compensation for the activity through budgetary provisions.
    vi. GOEs will run their businesses in a commercial and transparent manner and will, in principle, not enjoy direct or indirect favourable treatment from Government on the sole basis of their being GOEs.
    vii. GOEs will be required to enhance the standards of transparency and disclosure of their corporate information, including publicization of their annual reports on their websites and on such other platforms that are easily accessible to the public.

viii. For the case of GOEs whose shares are publicly listed in a securities exchange, the regulatory framework that applies to listed companies – as administered by the capital markets regulator – will apply to them, and GoK will not exercise roles, such as performance contracting with the GOE, that are not available to the rest of the shareholders.

IV. Institutional Arrangements and Roles

13. The distinct roles and responsibilities of the National Treasury and other Government institutions in relation to GOEs are defined below to avoid multiplicity – and potential overlaps – of accountability of GOEs, and also to enhance transparency and accountability.

a) Roles and Responsibilities of the National Treasury

14. The National Treasury in exercise of the ownership function in respect of GOEs will exercise rights and responsibilities that include the following:

i. Nomination through a structured, transparent and competitive search and selection process, of persons for appointment to be non-executive directors of GOEs.
ii. Entering into performance contracts with GOEs based on key performance indicators (KPIs) and agreed performance targets.
iii. Designing and implementing a performance incentive system for boards of directors of GOEs.
iv. Establishing a remuneration system for boards of directors of GOEs.
v. Carrying out performance evaluation of GOEs.
vi. Assigning public policy obligations (PPOs) when necessary.

b) Roles and Responsibilities of Sector Ministries

15. The sector ministries will be responsible for development and oversight related to sectoral policies. Sectoral policies – including administrative decrees that sector ministries may issue from time to time – will be equally applicable to private sector enterprises, where such enterprises exist, and GOEs in the particular industry that falls under the sector ministry. In issuing such policies or legal instruments, sector Ministries will not interfere with or assume ownership functions. It is reiterated for the avoidance of multiplicity and potential overlaps of accountability of GOEs to GoK authorities – and also to enhance transparency and accountability – that the National Treasury will be responsible for the ownership function [as listed in (a) above] while the line ministries will be responsible for sectoral policies. This will entail amendments of various existing statutes.

16. Sector ministries may propose PPOs to be assigned to GOEs by the National Treasury.

c) Roles and Responsibilities of Boards of Directors of GOEs

17. The boards of directors of GOEs will have roles and responsibilities that include the following:
    1. Appointment and removal of the Chief Executive Officer.
    2. Establishing the terms and conditions of employment of the GOE staff, taking into consideration all relevant factors such as industry dynamics, inputs from key stakeholders and long-term sustainability of remuneration.
    3. Setting of GOE strategic direction and approval of strategic plans.
    4. Approval of GOE annual budgets and the related funding at the GOE level.
    5. Setting key performance indicators (KPIs) for the Chief Executive Officer.
    6. Putting in place risk governance and risk management systems and processes, including setting the risk appetite for the GOE business, taking into consideration shareholder risk preference.
    7. Establishing and overseeing internal control systems and their continuous testing for efficiency and effectiveness.
    8. Performance evaluation of the Chief Executive Officer and top-level management.
    9. Entering into periodic/annual performance contracts with the National Treasury.
    10. Putting in place systems and processes to ensure compliance with all legal and regulatory requirements.
    11. Putting in place succession management framework comprising, (i) board nomination processes to identify candidates for consideration, by the CS/National Treasury, for appointment to the board of directors, and (ii) succession plans for the Chief Executive Officer and other critical positions within management ranks of the GOE.
    12. Establishing and implementing a Board self-evaluation system.

V. Accountability and Transparency

18. The accountability and reporting framework and requirements will be as follows:
    1. The GOEs under the overall stewardship of the boards of directors, who have fiduciary duties to the GOEs, will be making quarterly and annual reports to the Cabinet Secretary/National Treasury in the manner that will be prescribed by the National Treasury from time to time.
    2. The CS/National Treasury will analyze and utilize the information it receives from GOEs for decision-making pursuant to its roles and responsibilities under the GOE ownership function.
    3. The CS/National Treasury will make half-yearly reports to the Cabinet and annually, or as may be required, to the National Assembly.
    4. The CS/National Treasury will make public, on the National Treasury website and on such other platforms as may be easily accessible to the public, (a) audited annual reports of GOEs, and (b) GOE performance evaluation results in an analyzed

form, and (c) reports on the appointments of non-executive directors of GOEs and the procedures followed in arriving at the appointments.

v. GOEs will make public, on their individual websites and on such other platforms as may be easily accessible to the public, their (a) quarterly performance reports, (b) audited annual reports, (b) performance evaluation results in an analyzed form as communicated by the National Treasury, and (c) summary report of anti-corruption activities and outcomes for the relevant period.

vi. The reporting and disclosure requirements and processes applicable to publicly listed companies will be applicable to GOEs.

VI. Privatization

19. A GOE will be privatized when there is no justification for its continued existence as an entity under GoK ownership. The justification for continued existence of GOEs will include any one of the following[1]:
    i. Provide specific public goods or services to the society where it is proved that the market cannot (competitively and efficiently) provide the same goods;
    ii. Support national economic and strategic interests;
    iii. Perform business operations in a “natural” monopoly situation; and,
    iv. Increase access to public services especially to unserved and underserved regions/populations.

20. At least once every year, the CS/National Treasury in making the half-yearly reports to the Cabinet and/or the National Assembly, will include a review of any on-going privatization processes.

VII. Creation of GOEs

21. The converse of privatization of GOEs is essentially the creation, or even acquisition, of new ones. An implication of adding new GOEs to an existing portfolio is the expansion of the role of public sector entities in commercial activities that would be performed better by the private sector. Creating new GOEs may also crowd out weak, budding or prospective private sector operators that would, otherwise, be able to produce the same goods and services more efficiently and competitively, given the necessary policy support by government.

22. The National Treasury will, therefore, weigh carefully the case for creating any new GOE against alternative options of achieving the objectives for which the GOE is to be established. At a minimum, the justifications listed above for continued existence of a GOE will form the basis of the case for creating any new GOE by the National Treasury.

[1] Adapted from the OECD Guidelines.

In addition, the process stipulated in Section 86 of the Public Finance Management Act, 2012 and the requirements stipulated in Regulations 214 and 215 of the Public Finance Management Regulations will be strictly followed.

VIII. Procedures

(a) Appointment of Non-Executive Directors

23. In the case where GOEs are fully owned by GoK, the CS/National Treasury will nominate persons for appointment by the respective GOEs as non-executive directors. Where other co-shareholders in GOEs exist, the CS/National Treasury will participate in the election, by shareholders, of persons to be appointed as non-executive directors, taking into consideration the views of such co-shareholders. For these two purposes, the CS/National Treasury will appoint an ad hoc panel on *search and selection* of candidates for nomination as directors.

24. In order to strengthen the reputation of the search and selection panel and the credibility of the process, minimum requirements to be met by the members of the panel will be set by the CS/National Treasury. The requirements will include fulfilment of the requirements of Chapter Six of the Constitution of Kenya.

25. The search and selection panel will be in office for a term of three years. The composition of the panel will be as follows:
    i. Four persons, who are not public officers, appointed by the CS/National Treasury;
    ii. One person who is a public officer appointed, by the CS/National Treasury, from within the National Treasury;
    iii. One person who is a public officer appointed from the line Ministry by the Cabinet Secretary responsible for the sector under which the GOE's business falls; and,
    iv. One person who is a public officer appointed from the Office of the President.

26. The members of the search and selection panel will elect a chairperson of the panel from among the four persons who are not public officers. The panel may, from time to time, co-opt members with specific expertise and skills as may be necessary.

27. The panel will determine an objective set of general criteria for search and selection of non-executive directors for GOEs, which criteria will include diversity, *independence* of the majority of the persons and fulfillment of fit-and-proper tests that the CS/National Treasury will issue. An Independent[2] director means a person who:

[2] Adapted from World Bank (2014), *Corporate Governance of State-Owned Enterprises: A Toolkit* (pp.167 – 168).

i. Has not been employed by the company or its related parties, including its major shareholders, in the past five years.
ii. Is not an adviser or consultant to the company or its related parties and is not affiliated with a company that is an adviser or consultant to the company or its related parties.
iii. Is not affiliated with a significant customer or supplier of the company or its related parties, including banks or other financial institutions owned by any of the major shareholders.
iv. Has no personal service contracts with the company, its related parties, or its senior management.
v. Is not affiliated with a non-profit organization, or any organisation, that receives significant funding from the company or its related parties.
vi. Is not employed as an executive of another company where any of the company's executives serve on that company's board of directors.
vii. Is not a member of the immediate family of an individual who is, or has been during the past five years, employed by the company or its related parties as an executive officer.
viii. Is not, nor in the past five years has been, affiliated with or employed by a present or former auditor of the company or of a related party
ix. Is not a controlling person of the company (or member of a group of individuals or entities that collectively exercise effective control over the company) or such a person's close relative, widow, in-law, heir, legatee, and successor of any of the foregoing or the executor.
x. Has in the past five years not held a public office.
xi. Has in the past five years not been affiliated with a political party.

28. *Related party* means, with respect to the company and its major shareholders, any person or entity that controls, is controlled by, or is under common control of the company and its major shareholders.

29. The composition of the board of directors of a GOE will comprise eleven persons as follows:

i. A chairperson who is an independent director;
ii. Six persons who are independent directors;
iii. One person who is a public officer nominated from within the National Treasury by CS/National Treasury;
iv. One person who is a public officer nominated from the line Ministry by the Cabinet Secretary responsible for the relevant line Ministry;
v. One person who is a public officer nominated, by the Head of the Public Service, from the Office of the President; and,
vi. The Chief Executive Officer who will be a *ex officio* member of the board.

30. The search and selection panel will also take into consideration persons that the boards of directors of GOEs, through their board nomination processes, will have recommended to the CS/National Treasury for nomination and/or election in a general meeting of shareholders. Persons recommended through board nomination processes will comprise directors who are due to retire by rotation but are still eligible for re-election and/or recommended replacements for directors who are not eligible for re-election on account of their having served for the maximum term limit of six (6) years. The search and selection panel will document its procedures and proceedings which will be made public by the CS/National Treasury.

31. The CS/National Treasury will nominate the persons recommended by the search and selection panel, and forward the names of the persons to the respective GOEs for formal appointment as non-executive directors.

(b) Appointment of the Chairman of the Board of Directors of a GOE

32. The non-executive directors of a GOE will elect one person from among themselves to be the chairman of a board of directors of the GOE. Such a person will stand appointed as the chairman once elected.

(c) Appointment of Chief Executive Officers and Other Management Staff

33. For the position of Chief Executive Officers, the respective boards of directors of GOEs will run an open and competitive recruitment process leading to the selection of the most suitable person as determined by the board of directors using an objective set of criteria and without having to seek concurrence from the line Ministry. The proceedings of the recruitment of the Chief Executive Officer and other employees of the GOEs will be documented and a summary report made public.

34. The boards of directors will also be responsible for employment of all staff of the respective GOEs. The board of directors may, however, delegate to the Chief Executive Officer the recruitment of the staff in the lower ranks in keeping with internal policies that the respective Boards of GOEs may develop.

(d) Remuneration of Boards of Directors

35. The remuneration for non-executive directors of boards of GOEs will be governed by the remuneration structure and guidelines issued by the National Treasury from time to time, typically based on the categorization of the individual GOEs which will be made public. The remuneration for non-executive directors will consist of:

i. Directors' fees to be proposed by GOE directors with the concurrence of the National Treasury and determined at the AGM;
ii. Sitting allowance to be determined by the National Treasury; and,

iii. A bonus-type pay as a reward based on achievement of targets under the performance contract signed between the National Treasury and the GOE.

36. The directors' fees and sitting allowance will not be performance related. The performance related reward will be a one-off annual pay.

37. The CS/National Treasury will approve the structure of the performance pay that will form part of the performance contract signed with individual GOEs and made public before the start of the financial year. The evaluation of performance of GOEs will be based on audited financial statements.

(e) Remuneration of Chief Executive Officers and Other Management Staff

38. The remuneration of Chief Executive Officers will be determined by the board, taking into consideration the remuneration structure and guidelines issued by the National Treasury from time to time, typically based on the categorization of the individual GOEs. The GOE categorization and the corresponding remuneration structures will be made public.

39. Chief Executive Officers will also be eligible for performance-related bonus for a particular year. The board of directors of a GOE will approve the structure of the performance bonus that will form part of the performance contract, for a particular year, signed between the Board of Directors and the Chief Executive Officer. The board of directors of a GOE will be responsible for evaluation of the performance of the Chief Executive Officer. Performance bonus structures will be made public.

40. For the rest of the staff of a GOE, the board of directors will determine a system of performance-related bonuses.

(f) Performance Management

41. The CS/National Treasury will, by means of annual performance contracts, convey to every GOE the shareholder expectations regarding GOE performance. The performance contract will lay out objectively verifiable financial and operational key performance indicators (KPIs) and agreed performance targets that will be designed to enhance the commercial performance of GOEs in ways that, among others:
   i. Safeguard the long-term sustainability of the GOE;
   ii. Enable the shareholder to make a return commensurate with the investment made in GOE; and,
   iii. Minimize the fiscal costs and risks emanating from the GOE to the national exchequer.

42. Every GOE will submit quarterly and annual performance reports to the CS/National Treasury in formats that the CS/National Treasury may require from time to time. The

annual performance reports will be based on audited financial statements. This reporting framework will call for amendment of existing legal arrangements governing performance contracting.

43. The CS/National Treasury will make a decision on a performance-related pay for the board of directors of a GOE once performance evaluation of the GOE for the particular year is complete. The National Treasury will be responsible for performance evaluation and may co-opt relevant external experts, including those from line Ministries.

44. The board of directors will make a decision on the performance bonus for the Chief Executive Officer and the rest of the staff based on the performance of the GOE and also the performance of the individual members of staff. The performance bonus will be in accordance with the performance reward structure that will have been approved at the beginning of the financial year.

(g) Public Policy Obligations (PPOs)

45. For purposes of this policy, PPOs are broadly defined to cover obligations that the National Treasury may assign a GOE to produce goods and/or provide services that are not financially viable to the GOE and for which a subsidy, or full funding, by the National Treasury is necessary for sustained production. The goods and services under PPOs may fall within or outside the mandate for which the GOE was established.

46. The CS/National Treasury will assign PPOs to a GOE after approval of such PPOs by the Cabinet.

47. The operations required for PPOs will be costed and accounted for separately by the GOE. Similarly, PPOs will be audited separately.

48. The National Treasury will develop a framework for PPOs.

(h) Removal of a Director

49. Once appointed, a director of a GOE will serve for a three-year term, renewable once, or for a period of time that may be required before a director is due to retire by rotation. A person will cease to be a director only if the person:
   i. becomes incapacitated to discharge the duties of a director;
   ii. is adjudged bankrupt by a competent court of law;
   iii. becomes absent without the directors' permission for more than six (6) months from directors' meetings held during that period;
   iv. resigns by written notice given to the other directors or to the GOE;
   v. is prohibited from being a director by a written law; and,
   vi. is convicted of a criminal offence by a competent court of law.

50. The person will be given a fair opportunity to appeal against removal from a board of directors of a GOE even where he may be deemed removed from the board on account of any of the reasons given above.

51. The National Treasury will not seek, or support any attempts that seek, to have a person removed from the board of directors of a GOE for reasons other than those listed above.

(i) Non-Ownership Roles of National Treasury or GoK

52. The National Treasury, the GoK in general or autonomous institutions established by GoK, will continue to exercise non-ownership roles and functions over GOEs as may be provided for under various legal and regulatory frameworks. Examples of such roles and functions include approval of GOE budgets and borrowings and statutory audits by the Office of the Auditor-General.