# DETERMINANTS OF EFFECTIVE CORPORATE GOVERNANCE IN TANZANIA

**Lemayon L. Melyoki**

**University of Twente, The Netherlands**
**October 2005**

# DETERMINANTS OF EFFECTIVE CORPORATE GOVERNANCE IN TANZANIA

## DISSERTATION

to obtain
the doctor's degree at the University of Twente,
on the authority of the Rector Magnificus,
prof. dr. W.H.M. Zijm,
on account of the decision of the graduation committee,
to be publicly defended
on 27th October, 2005 at 13.15 hrs.

by

Lemayon L. Melyoki
born on 18th November 1969
in Arusha, Tanzania

This dissertation is approved by the promoter:

Prof.dr.ir. E.J. de Bruijn

**Promotion Committee:**

| | | |
|---|---|---|
| Chairman: | Prof.dr. P.J.J.M. van Loon | University of Twente |
| Secretary: | Prof.dr. P.J.J.M. van Loon | University of Twente |
| Promoter: | Prof.dr.ir. E.J. de Bruijn | University of Twente |
| **Members:** | Dr. M. J. Assad | University of Dar es Salaam |
| | Prof.mr.dr. A.J.P. Brack | University of Twente |
| | Prof.dr. A. Lovell | Nottingham Trent University |
| | Prof.dr. K. Rwegasira | Maastricht School of Management |
| | Prof.mr. J.T.P.M. Troch | University of Twente |

*Dedicated to my family, relatives and friends*

Lemayon L. Melyoki

Determinants of effective corporate governance in Tanzania

PhD Thesis University of Twente, Enschede. – With ref.

ISBN 90-365-2160-2

Printed and bound by: PrintPartners Ipskamp, Enschede

Copyright © 2005 L.L. Melyoki

*All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form by any means, electronic, mechanical, photocopying, recording or otherwise without written permission of the author.*

# PREFACE

Interest in the subject of corporate governance is internationally widespread, which is an indication of its importance for business development and for society as a whole. A large body of knowledge currently available addresses this phenomenon from the perspective of the United States and Europe. The knowledge base about this phenomenon in developing countries appears to be limited, but is currently growing.

My first encounter with the subject occurred on the MBA programme at TSM Business School, University of Twente, between 1997 and 1999. During the course, the discussion of the subject was limited to what are usually termed rich industrialised countries in the West: the Anglo-Saxon, Germanic, Japan and Latin countries. It was at that time that the question cropped up in my mind: what are corporate governance practices like in developing countries, in particular in Tanzania? When I got the opportunity to pursue PhD research in 2000, I set out to make a contribution by addressing this question. During one of my two visits to Nottingham Business School in 2002, I was invited to address final year undergraduate students about corporate governance in Tanzania, during which my view that it was important to address this issue was reinforced. Clearly the lack of discussion about corporate governance in such contexts was an indication of a knowledge gap in this area. There are a number of places similar to the TSM and NBS Business Schools. Now that my research has been completed, I express the hope that it contributes to TSM, NBS and other Business Schools as a source of knowledge.

Despite the currently acknowledged importance of corporate governance, the subject has not yet been actively debated in Tanzania, and in my opinion it should be. Tanzania has suffered from a lack of effective corporate governance practices. The collapse of the state-owned companies can partly be attributed to the paucity of corporate governance. Perhaps one of the reasons for the lack of active discussions about corporate governance stems from the fact that a number of reforms are taking place concurrently with a consequence that there has been insufficient time to reflect up on them. However, it is my aim that this research will increase interest and set in motion a process of searching for better practices within the boundaries of the Tanzanian context. Corporate governance cannot be ignored if economic development is to be achieved and poverty alleviated.

This research addresses corporate governance in firms listed on the Tanzanian stock market. It raises issues that also apply to a large number of companies in Tanzania. The research has taken a broad approach in addressing the issue, advancing arguments that touch on key governance mechanisms. It establishes the state of art of corporate governance and attempts to locate the control of companies. A framework for reflecting on issues such as: whether the current arrangements are likely to result in

sustainable social and economic developments in Tanzania; and the fit between the current arrangements and the current poverty eradication strategy of the government is provided. The link between socioeconomic development and the phenomenon of corporate governance makes it imperative that more active discussions on the issues involved commence.

Lemayon L. Melyoki,
Dar es Salaam, October 2005

ACKNOWLEDGEMENTS

Obtaining a PhD degree is a project that one pursues over a period of time. In the course of pursuing this project, one meets a number of people who in different ways contribute to the final success of the project. In this project I would like to thank the following people for their invaluable contributions.

My supervisor and promoter Prof.dr.ir. E.J. de Bruijn. His official role was that of supervisor and promoter which involves providing guidance and encouragement. In practice, he performed far beyond these typical roles. He got involved in practical ways in finding solutions to some of the problems that stood in the way of the PhD: financial and working tools. Also as part of his interest to go beyond the normal roles, we organised twelve internships for Dutch students in Tanzania. The firms in which the students executed the internships, and Prof. de Bruijn visited, were impressed by his practical approach to solving problems. This practical approach was also reflected in the supervision. There is no doubt that Prof. de Bruijn is an accessible supervisor and promoter. His unambiguous comments during this research and in particular during his last visit in Tanzania, were critical in giving this dissertation its final shape. I will remain indebted to Prof. de Bruijn for a long time.

I express my gratitude to the committee members who have had to perform the demanding task of going through the material in this dissertation and evaluating it: Dr. M. J. Assad, Prof.mr.dr. A.J.P. Brack, Prof.dr. A. Lovell, Prof.dr. K. Rwegasira and Prof.mr. J.T.P.M Troch.

Dr. Nico Schulte Nordholt made critical comments during the early phases of my research. His wide knowledge base and critical mind were useful and contributed in shaping my ideas. His comments made a valuable contribution to this work.

I am indebted to Dr. Sirp de Boer for his comments and the discussions we had, particularly during the early stages of the PhD. His accessible way of introducing and discussing complex subjects was very helpful in focusing the process and provided the motivation to keep going. Also his use of drawings to clarify issues helped me to grasp difficult issues more easily.

Dr. Irna van der Molen who was at an advanced stage of her own PhD research when I began this research also made a significant contribution. She discussed methodological issues in her research which had a significant inspirational effect on me.

Julia Ardesch and Annemiek van Breugel played an important part in this research. They contributed to creating a conducive working environment during my visits to the Netherlands. At one time I had health problems and still remember how Julia and Annemiek helped me to sort out the doctor issue. This was particularly helpful because in Tanzania the situation is very different.

Moments spent at Dr. Margaret Skutsch's home, which usually ended with extensive insightful discussions with Dr. Mike McCall, were valuable. For a foreigner on a PhD study these are very useful occasions.

A number of other people at the University of Twente, and in particular the Technology and Development Group (TDG), played important roles in my PhD process. Even through the names are not mentioned their contributions are well appreciated.

During the course of this PhD I had the privilege of visiting the Nottingham Business School at Nottingham Trent University in the UK. During these visits I met a number of people, some of whom became especially helpful during this research. Prof. Allan Lovell, head of the accounting department at Nottingham Business School, was very helpful. The countless hours spent in his office made a significant contribution. I found the discussions on the conceptual issues of the research particularly helpful. The opportunity to talk to his class about corporate governance in Tanzania helped me to reflect on the data and the phenomenon more deeply. I greatly thank Prof. Lovell.

I am also indebted to Peter Sanderson who during my visits to the Nottingham Business School was helpful in suggesting various pieces of literature. We also had a number of useful discussions. His clear interest in what I was doing kept me motivated.

Mr. Geoff Blackwell made sure I was comfortable during my stay at NBS. He organised a number of useful trips which were highly educational for me. He always made sure that I took advantage of the educational opportunities that presented themselves.

I would like to thank my employer, the University of Dar es Salaam, for providing me with the opportunity to conduct the research. The University of Dar es Salaam provided funds for the empirical part of the research as well as the working space and other important working facilities.

I am also indebted to Prof. Lettice Rutashobya of the University of Dar es Salaam for her useful role in this research. Prof. Rutashobya assisted and encouraged me to attend the corporate governance conference organised by the British Accounting Association Special Interest Group on Corporate Governance held in Belfast, Ireland in 2002. This conference was very helpful since it provided me with the opportunity to interact with other researchers in the area. Prof. Rutashobya has always been ready to assist in a number of ways.

Dr. Richard Mushi of the University of Dar es Salaam was also very helpful during this research. We spent a number of hours in his office discussing the research, particularly during the last months of the work. His comments helped in the reflection process.

I also would like to thank Dr. Erasmus Kaijage and all colleagues at the Faculty of Commerce and Management and the Department of Accounting, especially the head Dr. Mussa Assad for contributing in a number of ways to making this research a

success. During the last months of this research, I was not able to participate in a number of activities at the Faculty and I thank all my colleagues at the Faculty for bearing with me during these months of the PhD work.

I am particularly indebted to Dr. Abdiel G. Abayo of the Capital Markets and Securities Authority (CMSA) for facilitating access to the companies involved in this research. It was initially difficult to get the companies to agree to take part in the research because of the sensitivity of the issue. However, when Dr. Abayo contacted key individuals in the companies, access was achieved. I cannot be thankful enough.

I express my gratitude to the Dutch government for providing funding for this research through the FAME project. This funding covered the cost of my stay in the Netherlands, the supervision and the transport costs.

The empirical basis to this research was provided by a number of people: directors and senior management in companies, individual shareholders and senior officers of two regulatory organs – the Capital Markets and Securities Authority and the Dar es Salaam stock exchange. I am grateful to the directors of Tanzania Breweries Limited, Tanzania Oxygen Limited, Tanzania Tea Packers, and Tanzania Cigarette Company who made time for the interviews during the research. The interviews were detailed and required trust, yet the participants were generally co-operative. I also would like to thank the senior management of these companies, and in particular all the company secretaries, for their kind cooperation during the research. Thanks also go to individual shareholders as well as representatives of institutional shareholders who were interviewed within the framework of the research.

I would like to acknowledge the help of friends in my social network. I thank Mr. Ndumieshi Mushi for assisting me in a number of different ways. He provided assistance in obtaining relevant literature for this research, especially that pertaining to relevant laws as well as organising transport for my departures and arrivals in Tanzania.

Finally, I wish to thank members of my family: my wife Nembris and my two sons, Loleng and Loshipa, my brothers and other relatives for their continuous support and encouragement during the research. Without your kind support, it would have been impossible to accomplish this work. A number of other people in different parts of the world who are not mentioned here also made significant contributions to this research. I thank all of them.

# SUMMARY

Corporate governance became an issue attracting international concern and debate in the early 1980s, and through the 1990s, and this continued into the twenty-first century. The phenomenon of corporate governance is not new; it has existed since the incorporation of enterprises began (Vinten, 2003). The recent concern for, and debate on, corporate governance reflects the recognition of the centrality of major enterprises in allocating resources in the economy (Larzonic and O'Sullivan, 2000). The separation of ownership and control of corporations, that Berle and Means (1932) highlighted, lies at the heart of the debate on corporate governance (Stiles and Taylor, 2002).

Recent interest in corporate governance has been stimulated by a number of factors. The collapse of major corporations such as the Bank of Credit and Commerce International (BCCI), the Maxwell empire, Ferranti, Coloroll, and British and Commonwealth in the UK drew the world's attention to this phenomenon. The collapse of Enron and WorldCom and other major corporations in the US in 2002 reinforced interest in corporate governance. The Asian economic crisis also contributed to raising the profile of corporate governance as the crisis has been linked to poor corporate governance practices (Hoa, 2000). The notion of shareholder value, promoted by the conservative governments in the UK and US in the early 1980s, also had a significant impact on corporate governance developments.

In Tanzania, corporate governance practices have, until recently, been debated in the context of state ownership of corporations where corruption (embezzlement, nepotism) managerial incompetence, political interference and government subsidisation of failing enterprises have been the defining features (Bagachwa, 1992; Kihiyo, 2002). There have recently been attempts to address the challenge of corporate governance in Tanzania. The privatisation policy, the enactment of the Banking and Financial Institutions Act in 1991, and its Regulations in 1997, are important developments in this regard. In 2002, the Capital Markets and Securities Authority (CMSA) and the Steering Committee on Corporate Governance in Tanzania introduced separate but related sets of principles for effective corporate governance which companies are being encouraged to adopt and implement.

Despite the recent developments in Tanzania with respect to corporate governance, research on this phenomenon is still in its infancy. Studies aimed at understanding the determinants of effective corporate governance in the country have not been conducted. This research aims to contribute to the knowledge base on this issue. For this reason, the central research question for this research was formulated as:

**What are the determinants of effective corporate governance in Tanzania?**

The issue of context, in terms of the system for coordinating economic activities, has an important influence on corporate governance. The existing systems of corporate governance reflect the history of different societies, cultures and institutions (Weimer and Pape, 2000). The framework proposed by Clark (1998) has been adopted and applied in this research to analyse the Tanzanian context in order to embed corporate governance within its context. Two broad systems of economic coordination that are relevant to Tanzania are discussed: the centrally planned and the market-based systems, with the former giving way to the latter.

The literature on corporate governance reviewed shows that, currently, two perspectives exist: the liberalist and the communitarian. The two perspectives reflect the systems of economic coordination within which organisations operate. Assumptions made within each perspective have implications for corporate governance as discussed in the research. Within the two perspectives, four broad models of corporate governance are identified and debated: the Anglo-Saxon model, the Germanic model, the Japanese model and the Latin model. Corporate governance systems in developing countries broadly reflect these models of corporate governance in developed countries due to past colonial links.

Currently, there are worldwide efforts to improve the effectiveness of corporate governance. These include an initiative by the Organisation of Economic Cooperation and Development (OECD) and others by the Commonwealth Association of Corporate Governance (CACG) which have led to the development of principles for effective corporate governance. The possible convergence of the models is being debated. The phenomenon of increasing ownership concentration in the Anglo-Saxon model has been viewed as a movement toward the Germanic model. Reforms to encourage the markets for corporate control in Germany, Japan, the Netherlands and other countries are seen as movements toward the Anglo-Saxon model. However, opinions are still divided with regard to possible convergence (Clarke and Clegg, 1998; Denise and McConnell, 2003).

Seven theoretical perspectives for explaining the phenomenon of corporate governance currently exist: transaction cost theory, agency theory, resource dependence, managerial hegemony theory, class hegemony theory, stakeholder theory and stewardship theory. Two of these theoretical perspectives were used in this research: transaction cost economics and agency theory. Within these theories, a number of mechanisms of corporate governance that form the elements of the general model are discussed. These include legal and regulatory frameworks, competitive markets, ownership structure, debt and the board of directors. These mechanisms are confronted with the Tanzanian context to determine those that are likely to lead to an answer to the research question. The choice was made to empirically investigate ownership structures and boards of directors.

Four case studies of listed companies have been conducted: Tanzania Breweries Ltd (TBL), Tanzania Oxygen Ltd (TOL), Tanzania Tea Packers (TATEPA) and

Tanzania Cigarette Ltd (TCC). The findings show that they all have controlling shareholders holding more than 50% of the stock which provides them with control rights and incentives to exercise control. The extent to which these controlling shareholders exercise control varies within the companies researched. The phenomenon of ownership concentration is widespread in Tanzania, which suggests that shareholder control is also widespread. Findings with respect to the boards of directors are also discussed in the thesis.

A comparison of the existing situations and the recommended guidelines lead to the conclusion that some elements of these principles are already part of governance practices in companies, while others have not yet been incorporated into current practices. An important critique is also provided of the principles, which are being promoted, in terms of their suitability for addressing the current corporate governance challenges in Tanzania.

Extensive control by controlling shareholders is both useful and challenging. Controlling shareholders are effective in controlling agency problems (Clarke and Clegg, 1998). However, they also pose a challenge since they can abuse minority shareholders by extracting rent (Denise and McConnell, 2003; Berflof and Claessens, 2004). This implies that there exists a need to develop effective protection against such potential abuse. This also points to the need to reconsider the implications of a privatisation strategy on corporate governance in Tanzania. Privatisation of state-owned corporations is theoretically aimed at broadening the ownership of corporations and empowering a large number of people. The strategy of relying on strategic investors leads to the weakening of the small owners/shareholders rather than their empowerment.

The constitution of boards, which usually include senior civil servants (either current or retired) that are still influential in Tanzanian society points to fundamental problems of accountability of business to the larger Tanzanian society. These individuals are usually appointed by controlling shareholders. This can make any attempts to develop protections for minority shareholders difficult to implement.

The analysis of context indicates that, in general, institutions related to a market economy are still in their early stages of development, and deliberate efforts must be made to evolve effective practices appropriate to the Tanzanian context. This is also the case with corporate governance. Only a limited number of mechanisms are currently able to address the incentive problem. The need for initiatives that are directed at developing and strengthening the legal and regulatory frameworks that are able to support product markets, labour markets and capital markets, as well as boards of directors, is demonstrated. The ongoing initiative to operationalise the Tanzania Institute of Corporate Governance (TICG) to promote effective corporate governance is an important development, and needs to be continued. This development is in line with the emergence of institutions such as the Centres for Corporate Governance in other parts of the world.

# TABLE OF CONTENTS

PREFACE....................................................................................................I

ACKNOWLEDGEMENTS..................................................................................III

SUMMARY....................................................................................................VII

TABLE OF CONTENTS ..................................................................................XI

LIST OF TABLES ..........................................................................................XV

LIST OF FIGURES .......................................................................................XVII

LIST OF ABBREVIATIONS...........................................................................XIX

CHAPTER 1 INTRODUCTION, PROBLEM STATEMENT AND RESEARCH APPROACH.....................................................................................................1

1.1 Background to the research ......................................................................1
1.2 The rise of interest in corporate governance ............................................2
1.2.1 Recent interest in corporate governance..................................................2
1.2.2 Causes of corporate governance challenges ............................................8
1.2.3 Perspectives on corporate governance....................................................10
1.3 Corporate governance in the context of Tanzania ...................................12
1.3.1 The research objectives .........................................................................13
1.3.2 The problem statement ..........................................................................14
1.3.3 Research questions .................................................................................14
1.4 Relevance of the research.........................................................................15
1.5 The research approach..............................................................................17
1.5.1 Research design.......................................................................................17
1.5.2 Research methodology ...........................................................................17
1.5.3 Research methods....................................................................................18
1.5.4 Case study research .................................................................................19
1.5.5 Research quality ......................................................................................22
1.6 Structure of the research...........................................................................24

CHAPTER 2 CONTEXT ANALYSIS ................................................................27

2.1 The overview of the context .....................................................................27
2.2 Perspectives on systems of economic co-ordination ...............................30
2.3 Systems of economic co-ordination in Tanzania......................................34
2.3.1 The centrally-controlled system..............................................................34
2.3.2 Market-based system of reforms.............................................................43
2.4 Implications for corporate governance.....................................................50
2.4.1 Corporate governance under central-coordination.................................50

2.4.2 Corporate governance under the market-based system ....................57
2.5 The legal framework for corporate governance ....................58
2.6 Conclusion ....................61

CHAPTER 3 CORPORATE GOVERNANCE DEVELOPMENT AND THEORIES ....................63

3.1 The concept of a corporation ....................63
3.2 Perspectives on corporate governance ....................64
3.2.1 The liberalist perspective ....................66
3.2.2 The communitarian perspective ....................68
3.2.3 Operational research definitions ....................71
3.3 Models of corporate governance in practice ....................72
3.3.1 The Anglo-Saxon model ....................74
3.3.2 The insider model ....................77
3.3.3 Corporate governance in developing and transition economies ....................87
3.4 International initiatives on corporate governance ....................91
3.4.1 The OECD principles for effective corporate governance ....................92
3.4.2 CACG principles of effective corporate governance ....................96
3.4.3 Recent developments in corporate governance ....................99
3.5 The convergence of corporate governance models ....................101
3.5.1 The influence of globalisation on corporate governance models ....................101
3.5.2 The debate on the convergence of corporate governance models ....................102
3.6 Theoretical perspective on corporate governance ....................104
3.7 The theoretical research basis ....................106
3.7.1 Transaction cost economics theory ....................107
3.7.2 Agency theory ....................109
3.8 Effective corporate governance ....................113
3.9 Conclusions ....................113

CHAPTER 4 DEVELOPMENT OF THE RESEARCH MODEL ....................115

4.1 Mechanisms for addressing incentive problems ....................115
4.1.1 External mechanisms ....................117
4.1.2 Internal mechanisms ....................128
4.2 The pilot case study: the Friendship Textile Company (FTC) ....................135
4.3 The research model ....................139
4.4 Operationalisation of the variables in the research model ....................152

CHAPTER 5 CASE DESCRIPTIONS AND ANALYSES ....................155

5.1 Tanzania Breweries Ltd (TBL) ....................155
5.1.1 Background and profile of the company ....................155
5.1.2 Corporate governance arrangements ....................157
5.1.3 Ownership structure and control ....................158

5.1.4 Effectiveness of the board of directors ... 165
5.1.5 Board control ... 168
5.2 Tanzania Oxygen Company Ltd (TOL) ... 170
5.2.1 Background and profile of the company ... 170
5.2.2 Corporate governance arrangement ... 172
5.2.3 Ownership structure and control ... 172
5.2.4 Effectiveness of the board of directors ... 176
5.2.5 Board control ... 179
5.3 Tanzania Tea Packers group Ltd (TATEPA) ... 182
5.3.1 Background and profile of the company ... 182
5.3.2 Corporate governance arrangement ... 183
5.3.3 Ownership Structure and Control ... 183
5.3.4 Effectiveness of the board of directors ... 186
5.3.5 Board control ... 190
5.4 Tanzania Cigarette Company (TCC) ... 191
5.4.1 Background and profile of the company ... 191
5.4.2 Governance arrangement ... 193
5.4.3 Ownership structure and control ... 193
5.4.4 Effectiveness of the board of directors ... 196
5.4.5 Board control ... 199

CHAPTER 6 CROSS CASE ANALYSES AND GUIDELINES FOR CORPORATE GOVERNANCE IN TANZANIA ... 203

6.1 Ownership structure and shareholder control ... 203
6.2 Effectiveness of the board of directors ... 206
6.3 Board control ... 209
6.4 Comparison of recommended guidelines with empirical findings ... 211
6.4.1 The Steering Committee's recommended guidelines ... 212
6.4.2 CMSA's recommended guidelines ... 215
6.5 Discussion of the comparison of guidelines with the empirical findings ... 225

CHAPTER 7 CONCLUSIONS AND RECOMMENDATIONS FOR DEVELOPMENT OF CORPORATE GOVERNANCE IN TANZANIA ... 227

7.1 Current body of knowledge and concepts appropriate for assessing the effectiveness of corporate governance in Tanzania ... 227
7.2 Current situation with respect to effectiveness of corporate governance in Tanzania and the factors determining it ... 229
7.3 Issues concerning the development of effective corporate governance in Tanzania ... 233
7.3.1 The foundation for effective corporate governance ... 233
7.3.2 The potential expropriation problem ... 233

7.3.3 Factors affecting the effectiveness of the board of directors ................235
7.4 Summary: determinants of effective corporate governance in Tanzania ............237
7.4.1 Ownership structure............................................................................237
7.4.2 Effectiveness of the board of directors ...............................................238
7.5 Reflection on the research ...................................................................239
7.6 Conclusions and recommendations......................................................241
7.6.1 Conclusions......................................................................................241
7.6.2 Recommendations ..............................................................................243
7.7 Contribution of the research .................................................................248
7.8 Issues for further research....................................................................249

REFERENCES ...........................................................................................251

ADDENDUM .............................................................................................269

APPENDIX 1 DATA COLLECTION AT THE COMPANIES ...............................287

APPENDIX 2 CASE STUDY PROTOCOL..........................................................289

APPENDIX 3 INTERVIEW SCHEDULE: OPEN-ENDED AND CLOSED QUESTIONS ...........................................................................................291

# LIST OF TABLES

Table 1.1 Principles of corporate governance around the world .................................. 5
Table 1.2 Corporations' contribution and policy outcomes in the US .......................... 7
Table 1.3 Foreign Direct Investments (FDI) Flows to Tanzania, 1997-2003 ............. 16
Table 1.4 Research approaches and the associated methodologies ............................ 18
Table 1.5 Size of enterprises ........................................................................................ 21
Table 2.1 Comparative output growth rates: 1998-2003 ............................................ 28
Table 2.2 The economic crises in Tanzania in the early 1980s and its causes ............ 41
Table 2.3 Major administrative barriers to investments ............................................. 47
Table 2.4 Structure of ownership in successful privatised firms in Tanzania ............. 58
Table 3.1 Perspectives on corporate governance ........................................................ 65
Table 3.2 Taxonomy of governance corporate systems ............................................. 73
Table 3.3 Ownership structure of UK companies ....................................................... 75
Table 3.4 Ownership structure of German companies ............................................... 80
Table 3.5 Ownership of the top 50 companies in France ........................................... 86
Table 3.6 Theoretical perspective on Corporate Governance .................................. 106
Table 4 Operationalisation of variables ................................................................ 152
Table 5.1 Performance of TBL from 1998-2004 ...................................................... 157
Table 5.2 The Ownership structure of the TBL ........................................................ 159
Table 5.3 Shareholder control at TBL ...................................................................... 164
Table 5.4 Effectiveness of the board of directors at TBL ........................................ 168
Table 5.5 Board control at TBL ............................................................................... 169
Table 5.6 Performance of TOL from 1997-2003 ..................................................... 171
Table 5.7 The ownership structure of TOL ............................................................. 173
Table 5.8 Shareholder control at TOL ..................................................................... 176
Table 5.9 Effectiveness of the board of directors at TOL ........................................ 179
Table 5.10 Board control at TOL ............................................................................. 180
Table 5.11 Performance indicators for TATEPA from 1997-2004 ............................ 183
Table 5.12 The ownership structure of TATEPA ..................................................... 184
Table 5.13 Shareholder control at TATEPA ............................................................ 186
Table 5.14 Effectiveness of the board of directors at TATEPA ................................. 189
Table 5.15 Board control at TATEPA ...................................................................... 190
Table 5.16 Performance of TCC from 1997-2004 .................................................... 192
Table 5.17 Ownership structure of TCC .................................................................. 194
Table 5.18 Shareholder control at TCC .................................................................... 195
Table 5.19 Effectiveness of the board of directors at TCC ....................................... 199
Table 5.20 Board control at TCC ............................................................................. 200
Table 6.1 The ownership structure of the companies ............................................... 203
Table 6.2 Shareholder control in Tanzanian companies .......................................... 205

Table 6.3 Effectiveness of the boards of directors in Tanzanian companies ............. 209
Table 6.4 Board control in Tanzanian companies .................................................... 210
Table 6.5 Shareholder control .................................................................................. 214
Table 6.6 Board control and its determinants .......................................................... 215
Table 6.7 The shareholders control - CMSA ........................................................... 216
Table 6.8 Directors' control activities ...................................................................... 219
Table 6.9 Aspects of board constitution .................................................................. 221
Table 6.10 Aspects of board leadership structure ...................................................... 222
Table 6.11 Appointment and independence of directors ............................................ 223
Table 6.12 Board audit committee ............................................................................. 225

# LIST OF FIGURES

Figure 2.1 Perspectives on systems of economic coordination.................................... 31
Figure 2.2 Corporate governance of state-owned corporations ................................... 55
Figure 2.3 Relationship between shareholders, directors and top management ............ 60
Figure 3.1 The Anglo-Saxon (outsider) model ........................................................... 76
Figure 3.2 The insider model of corporate governance ................................................ 77
Figure 4.1 General model of corporate governance ................................................... 116
Figure 4.2 The research model .................................................................................... 140
Figure 5.1 The control of TBL by SABMiller ........................................................... 161
Figure 5.2 The control of TCC by JTI ....................................................................... 196

# LIST OF ABBREVIATIONS

AFROX African Oxygen and Acetylene Company
AGM Annual General Meeting
ALI American Law Institute
AMA American Management Association
AMSCO Africa Management and Services Company
AMEX American Stock Exchange
ASB Accounting Standard Board
ASP Africa Shirazi Party
ASU Air Separating Unit
AU African Union
BCCI Bank of Credit and Commerce International
BOC British Oxygen Company
BOT Bank of Tanzania
BRELA Business Registration and Licensing Authority
CACG Commonwealth Association of Corporate Governance
CCM Chama Cha Mapinduzi
CDA Capital Development Corporation
CDC Commonwealth Development Cooperation
CED Chief Executive Director
CEO Chief Executive Officer
CFO Chief Financial Officer
CGO Chief Governance Officer
CIS Commonwealth of Independent States
CIPE Centre for International Private Enterprise
CMSA Capital Markets and Security Authority
CTI Confederation of Tanzania Industries
DAHACO Dar es Salaam Airports Handling Company Limited
DRC Democratic Republic of Congo
DSE Dar es Salaam Stock Exchange
EABL East African Breweries Limited
EADB East African Development Bank
ECSAFA Eastern, Central and Southern African Association
EMH Efficiency Market hypothesis
EMD Executive Managing Director
EPS Earning Per Share
GDP Gross National Product
GAAPs Generally Accepted Accounting Principles
FASB Financial Accounting Standards Board

| | |
|---|---|
| FDI | Foreign Direct Investments |
| FIPA | Foreign Investment Protection Act |
| FRC | Financial Reporting Council |
| FTC | Friendship Textile Company |
| FTM | Friendship Textile Mill |
| IBRI | International Business Research Institute |
| IFC | Internal Finance Corporation |
| IHT | International Herald Tribune |
| IASB | International Accounting Standards Board |
| JTI | Japan Tobacco International |
| IMF | International Monetary Fund |
| LDA | Livestock Development Corporation |
| MBA | Master of Business Administration |
| MEMARTS | Memorandum and Articles of Association |
| MIC | Ministry of Industry and Commerce |
| MP | Member of Parliament |
| NAFCO | National Agricultural and Food Corporation |
| NATCO | National Textile Corporation |
| NBAA | National Board of Accountants and Auditors |
| NCG | Nordic Consulting Group |
| NBS | Nottingham Business School |
| NDC | National Development Corporation |
| NED | Non-Executive Director |
| NEC | National Executive Committee |
| NEPAD | New Partnership and Development |
| NESP | National Economic Survival Programme |
| NIPPA | National Investments Promotion and Protection Act |
| NPC | National Price Commission |
| NSSF | National Social Security Fund |
| NYSE | New York Stock Exchange |
| OECD | Organisation of Economic Cooperation and Development |
| PAT | Profit After Tax |
| PPF | Parastatal Pension Fund |
| PSPF | Public sector Pension Fund |
| PSRC | Parastatal Sector Reform Commission |
| PSCGT | Private Sector Corporate Governance Trust |
| PTA | Preferential Trade Area |
| PTF | Privatisation Trust Fund |
| RC | Regional Commissioner |
| RUBADA | Rufiji Basin Authority |

| | |
|---|---|
| RHI | Robert Half International Inc. |
| REDMA | Resource Development and Management Associates |
| RSA | Republic of South Africa |
| SAB | South African Breweries |
| SABI | South African Breweries International |
| SACCOS | Savings and Credit Cooperative Societies |
| SAP | Structural Adjustment Programme |
| SCOPO | Standing Committee on Parastatal Organisations |
| SEC | Securities exchange Commission |
| SME | Small and Medium Size Enterprises |
| STAMICO | State Mining Corporation |
| SSAP | Statement of Standards Accounting Practice |
| SSE | Southerneast European countries |
| TAC | Tanzania Audit Corporation |
| TAS | Tanzanian Shilling |
| TANU | Tanganyika Africa National Union |
| TATEPA | Tanzania Tea Packers |
| TBL | Tanzania Breweries Limited |
| TCC | Tanzania Cigarette Company |
| TDL | Tanzania Distilleries Limited |
| TIC | Tanzania Investment Centre |
| TICG | Tanzania Institute of Corporate Governance |
| TNBC | Tanzania National Business Council |
| TOL | Tanzania Oxygen Limited |
| TRA | Tanzania Revenue Authority |
| TRC | Tanzania Railway Cooperation |
| TVCF | Tanzania Venture Capital Fund |
| UK | United Kingdom |
| URT | United Republic of Tanzania |
| US | United States of America |
| UTT | Unit Trust of Tanzania |

# CHAPTER 1 INTRODUCTION, PROBLEM STATEMENT AND RESEARCH APPROACH

## 1.1 Background to the research

Corporate governance emerged as an issue of international concern and debate in the early 1980s, through 1990s and this has continued into the twenty-first century. Corporate governance is not new; it has existed since the incorporation of business began (Vinten, 2003). The recognition of the centrality of major enterprises in allocating resources in the economy underlies contemporary debates about corporate governance. However, ideas about the concept of corporate governance date back to 1776 (Tricker, 2000; Denise, 2001) when Smith, in *The Wealth of Nations*, raised the issue of a lack of incentives on the part of directors to look after other people's money with as much care as the owners themselves would:

> The directors of companies, being managers of other people's money rather than their own, it cannot be expected that they should watch over it with the same anxious vigilance with which the partners in the private copartnery watch over their own (Smith, 1776 cited by Tricker, 2000).

Smith did not use the term corporate governance; the term only emerged in the 1980s (Tricker, 2000). However, this comment indicates that he had a sound understanding of the issue of corporate governance: when the owners of a corporation are different from those who manage it, incentive problems tend to occur.

The nature of the debate on corporate governance is influenced by the way in which corporations are viewed. Clarke and Clegg (1998) contend that 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. When a corporation has acquired its own separate existence, the issue of control arises.

Mintzberg (1984) points out that, historically, 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 (Scott, 1997), received greater emphasis following the Berle and Means article: *The Modern Corporation and Private Property* (Berle and Means, 1932).

They observe that:

> …in 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?

Berle and Means suggest that the notion of ownership of property when applied to corporations especially large ones, is not straightforward. It is in this context that Minztberg (1984) poses the question: who should control the corporation, and for the pursuit of what goals? Minztberg contends that as ownership of corporations became dispersed, owner-control weakened and corporations came under the implicit control of their managers. Stiles and Taylor (2002) point out that although corporate governance as a subject has attracted widespread interest internationally, the nature of the debate about it is still largely shaped by the Berle and Means analysis.

## 1.2 The rise of interest in corporate governance

### *1.2.1 Recent interest in corporate governance*

A number of factors have contributed to raising the issue of corporate governance to prominence internationally: the collapse of a number of large corporations and hostile takeovers particularly in the UK and the US, the increasing power of corporations and the antisocial behaviour of some corporations. The collapse of major corporations in the UK has contributed significantly to raising the profile of corporate governance in the UK itself and gradually around the world. 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 the UK have had a significant impact on subsequent developments in corporate governance worldwide (World Bank, 2000).

BCCI, one of the largest UK Banks, was forced to close business by the Bank of England in July 1991 amid fraud allegations. The Maxwell Group collapsed in late 1991 and, soon after, it was discovered that over £400 million was missing from the pension funds. The money was used to finance a lavish lifestyle and corporate expansion. Robert Maxwell, the owner of the group, presided over 400 companies and was known to have been channelling money between companies before he died in November 1991 (http://news.bbc.uk, August, 2003). Apart from such fraud cases, which raised the

profile of corporate governance, there were also 'honest' failures. They include Ferranti, Coloroll, British and Commonwealth (Stile and Taylor, 2002). The resulting focus on corporate governance in the UK culminated in the Cadbury report on the financial aspects of corporate governance in 1992. Other reports followed the Cadbury report: the Greenbury report on director remuneration in 1995, and the Hampel report in 1998 that stressed the role of the board in enhancing the prosperity of the corporation. The London Stock Exchange Combined code was introduced in July 1998, and was followed by the Turnball report in 1999 which focused on internal control and risk management. The Cadbury report has had a significant influence on corporate governance debates internationally, witnessing the publication of codes in at least fourteen countries (Cadbury, 1997 cited by Stiles and Taylor, 2002; Monks and Minow, 2002).

The economic crisis that swept across the Southeast Asian Countries also contributed to raising the profile of corporate governance internationally, and in particular in the region. This crisis, which started in early July 1997 in Thailand, and spread to other countries in South East Asia, North East Asia and, to a lesser extent, Russia and Latin America (Hoa, 2000) has been linked to poor corporate governance practices in these countries.

The conservative governments in the UK and US in the early 1980s played a role in promoting values which were to have a significant impact on corporate governance practices. The market driven, growth-oriented, attitudes of Thatcherism and Reaganite economics popularised the notion of shareholder value (Larzonic and O'Sullivan, 2003). Shareholder value is a norm that requires managers to focus exclusively on maximising shareholder wealth (Roe, 2003). The introduction of shareholder value had the impact of reinforcing the responsibility of directors to increase shareholder value (Tricker, 1994). Friedman further argued that the social responsibility of the corporation is to increase its profits (Roe, 2003). Shareholder value/wealth became the basis for privatising state-run corporations, initially in the UK and gradually around the world. Tricker (1994) points out that, in the UK, state-run corporations such as rail, coal, electricity, and water were privatised as part of the focus on shareholder value.

The takeovers that took place in the US were motivated by the shareholder value norm. The threat of predators and the hostile takeovers that took place in the Anglo-Saxon countries were viewed as incentives to encourage greater focus on shareholder value (Prowse, 1998). However, the downside of focusing on shareholder value became apparent and called into question corporate governance practices in Australia, Japan and in the US, as well as in the UK (Tricker, 2000). In Australia, the names of Alan Bond, Laurie Connell of Rothwells, and the Girvan corporations were being associated with questionable governance practices. In Japan, Nomura and the Recruit Corporation were being accused of dubious governance practices.

In the US, the names of Ivan Boesky, Michael Levine and Michael Milken, involving insider dealings with Drexel, Burnham and Lambert are but some of the cases which drew attention to the challenges of corporate governance associated with an exclusive focus on shareholder value. The following case in the US illustrates how the takeovers gave rise to interest in corporate governance.

> In December 1988, the securities house pleaded guilty to six felony charges alleging widespread securities fraud and insider dealings. Drexel agreed to pay a fine of $650 million. The following March, the US Attorney's office in New York issued a 98-page indictment charging Michael Milken with similar crimes. Milken had single-handedly made Drexel successful via his aggressive hawking of junk-bonds, a security that financed most of the takeovers of the 1990s. So central was Milken to Drexel's success that the firm paid Milken compensation of as much as $550 million in one year alone. Faced by the charges of fraud, and damaged by the increasing collapse of junk bond financed firms, Drexel filed for bankruptcy protection in February 1990. Just two months later, Milken agreed to plead guilty. In November 1990, he was sentenced to a prison term of ten years. The sentence was later reduced and Milken was eventually released in the summer of 1993. He subsequently taught a Finance course at the University of California at Los Angeles (Monks and Minow, 2002).

This case shows how a focus on shareholder value motivated individuals to pursue criminal activities under the pretext of shareholder value with the resultant collapse of corporations. The financial scandals involving Enron, WorldCom, Adelphia and Global Crossing during 2002 in the US led to the introduction of the Sarbane-Oxley Act in 2002. Under this law, company audit committees must be independent, chief executive officers (CEOs) and chief financial officers (CFOs) must certify their company reports, and directors who misbehave may be punished by significant fines and jail sentences of up to twenty years. Auditors must have their fees for non-audit services approved by board audit committees, and audit firms may be required to change their partners after five years.

In Japan, a chief executive officer of Nomura Securities was charged with having acquiesced to threats from Sokaiya gangsters (corporate extortionists) even though this was illegal. Sokaiya, who are linked to yakuza (gangsters), purchased shares in Japanese companies in order to gain admittance to annual shareholder meetings and then demand payments in return for not raising embarrassing questions or issues at the forum (http://www.jei.org, August, 2003). These questionable corporate governance practices were a reason for interest in corporate governance outside the Western world. The collective effect of all these events was an upsurge in interest in corporate governance worldwide.

The collapse of major corporations and the Asian economic crises discussed previously, with their attendant social consequences such as loss of jobs and loss of

investments, have emphasised the link between corporate governance and socioeconomic development. While this recognition occurred initially in the UK and US, the concern for corporate governance in these countries was gradually reflected in other countries. These concerns formed the background for a number of initiatives, at both the national and international levels, aimed at improving corporate governance practices. International organisations have devoted increasing attention to corporate governance as a subject of global concern. For example, the Organisation of Economic Cooperation and Development (OECD) and the Commonwealth Association of Corporate Governance (CACG) have issued separate, but related principles for effective corporate governance in 1999. The OECD set of principles was updated in 2004.

In June 1999, the OECD and the World Bank signed a memorandum of understanding that created the Global Corporate Governance Forum for the discussion and coordination of global standards of corporate governance. Other multilateral agencies: the International Monetary Fund (IMF), the Asian Development Bank, the Asia-Pacific Economic Cooperation Organisation, and American and British institutional investors are actively pursuing agendas to bring about reform of corporate governance around the globe (Larzonic and O'Sullivan, 2000). A number of countries have formulated country-specific principles within the broad framework set by the OECD and/or CACG principles. The principles shown in Table 1.1 constitute practices that are regarded as resulting in effective corporate governance when adhered to. The principles seek to introduce checks and balances in the exercise of the power of corporations.

**Table 1.1**
**Principles of corporate governance around the world**
*Source: Monks and Minnow (2002) with additions*

| Name of the Principles | Country/Organization | Year of Publication |
|---|---|---|
| OECD Principles of Good Corporate Governance | Organization of Economic Cooperation and Development (OECD) | 1999, updated in 2004 |
| CACG Principles of Good Corporate Governance | Commonwealth Association of Corporate Governance | 1999 |
| King's Report | South Africa | 1994, updated in 2002 |
| Dey report | Canada | 1994 |
| Swedish Academy Report | Sweden | 1994 |
| Viénot Reports, I & II | France | 1994, 1999 |
| Bosch Report | Australia | 1995 (3rd edn) |
| Peters Recommendations | The Netherlands | 1997 |
| Tabaksblad code Netherlands | The Netherlands | 2003 |
| Corporate Governance Forum of Japan | Japan | 1998 |

| Name of the Principles | Country/Organization | Year of Publication |
|---|---|---|
| The Governance of Spanish Companies | Spain | 1998 |
| Gardon Report | Belgium | 1998 |
| German Panel of Corporate Governance | Germany | 2000 |

Mintzberg (1984) raises the issue of goals that a large corporation could pursue. The actions of large corporations increasingly have consequences on the way society develops. The rise of the notion of the "social responsibility" of corporations in the 1960s is a reflection of concern for such consequences, and drew attention to the issue of corporate governance. For example, the rise of environmental groups such as the Greenpeace and Friends of the Earth (Stiles and Taylor, 2002) have brought pressure on corporations to consider the consequences of their actions on the environment (Maassen, 1999). At the very minimum, corporations are required to comply with laws as part of their social responsibility (Monks and Minow, 2002). However, the power of corporations to involve themselves in key political processes poses serious challenges to the development and enforcement of such laws. In theory, corporations are regulated by the government, or by society through their governments (Demb and Neubauer, 1992). In practice, corporations have influenced governments as much as governments have influenced them (Monks and Minow, 2002).

Corporate governance standards, established by law, are argued as having the value of creating the illusion of accountability by corporations. Determined investors and managers can always find ways of going around the law. For example, in the US, corporate laws forbid perpetual directorships, but managers repeatedly nominate the same people for directorships (Monks and Minow, 2002). Monks and Minow provide an example of General Motors, where one member of the board had been a director for twenty years and another fifteen years.

In the US, corporations are also allowed to take part in important political processes usually reserved for citizens. In *The Bank of Boston v. Belloti* case, the court upheld the right of corporations to enter the political arena of political advertising. With this ruling, the bank could spend shareholder funds as it thought appropriate to influence the voting processes on a referendum on a matter that was not related to its business. Corporations are also involved in political campaigns and make contributions. According to Common Cause, cited by Monks and Minow (2002), the national political parties committees raised a record, US$ 107, 210,420 during 1999, 81 percent more than that raised during the 1995 election. A large part of these contributions were from corporations. This suggests an increasing influence by corporations over the political processes. Table 1.2 shows the contributions made by corporations in the US to political campaigns to back those candidates who stood for policies that promoted the interests of

the contributing corporations. The table shows various policy changes that were introduced after the candidates these corporations supported were elected.

**Table 1.2**
**Corporations' contribution and policy outcomes in the US**
*Source: The Guardian 27, April 2001, p.2 cited by Fisher and Lovell, 2003*

| Industry | $M donated | Actions taken following election |
|---|---|---|
| Tobacco | 7.0 | Removal of federal lawsuits against cigarettes. |
| Timber | 3.2 | Restrictions on logging roads scrapped. |
| Oil and Gas | 25.4 | Restrictions on $CO_2$ emissions abandoned; Kyoto agreement scrapped; moves to open Artic refuge to drilling. |
| Mining | 2.6 | Scrapping of environmental clean-up rule, e.g. arsenic limits in water supply. |
| Banks and Credit card companies | 25.6 | Bankruptcy bill making it easier for credit card companies to collect debts from bankrupt customers. |
| Pharmaceuticals | 17.8 | Medicare (government-supported health insurance) reform removing price controls. |
| Airlines | 4.2 | Federal barriers to strikes introduced; back-pedalling on anti-trust (mergers and monopolies) legislation. |

Corporations also use their power to influence governments so that governments reduce the intensity of competition in the marketplace. Generally, corporations claim to prefer free markets with little interference from government. In practice, whenever corporations can persuade governments to protect them from the free market by legislating barriers to competition or limiting their liability, they do so (Monks and Minow, 2002). In Tanzania, the acquisition of KIBO by Tanzania Breweries Limited (TBL), in order to shield itself from the competition, and for which TBL managed to persuade the government not to enforce the Fair Trade Practices Act of 1994 is illustrative of the power to work towards reducing market competition. With respect to the TBL - KIBO case, a circular to shareholders states:

> " …that Tanzania Breweries has *inter alia*, agreed subject to the requisite approval of Tanzania breweries shareholders and such other regulatory approvals as may be required to acquire KIBO Breweries from EABL in exchange for an issue of shares in Tanzania Breweries….. the Tanzanian beer market has shown low growth over the past two years, despite substantial investments in the market place by both Tanzania Breweries and KIBO Breweries. Although Tanzania Breweries has been able to post a pre-tax earnings growth during this period of low market growth, the outlook for the near future is modest with little change expected in the market place. The proposed transaction is therefore seen as value enhancing extensions of

> Tanzania Breweries core business and in line with its strategic intent to increase capacity utilization and market share growth" (Circular to TBL shareholders, November, 2002).

Developments such as in the TBL-KIBO case have negative consequences on competition and, through it, on the consumers. As competition weakens, the disciplinary effect of the market as advocated in corporate governance literature is reduced. In this regard, the observation by Smith with respect to the corporations-society relationship has particular resonance:

> "People of the same trade seldom meet together but the conversation ends in a conspiracy against the public or in some diversion to raise prices" (Smith cited by Monks and Minow, 2002)

The activities of some corporations and their effect on the environment have contributed to raising the debate about corporate governance in relation to business ethics. Such concern reflects the growing recognition of the negative effects of the antisocial behaviour of some corporations, e.g. the dumping of toxic waste as in the *Love Canal* case, and the exploitation of national governments through the manipulation of transfer prices by multinationals (Tinker, 1985, cited by Fisher and Lovell, 2003). Corporations are considered to provide the best mechanism for externalising costs, which usually then have to be born by society either directly or through the government (Clark, 1998). However, questions are increasingly being raised with regard to the manner in which corporations are governed and held to account for damaging the environment (Maassen, 1999). The notion of "corporate citizenship", which it is argued should replace corporate social responsibility (as this is too restrictive), is an attempt to call upon corporations to behave like citizens of a country (Fisher and Lovell, 2003). Wood and Logsdon (2001 cited by Fisher and Lovell, 2003) suggest the term "business citizenship" to overcome the more localised and parochial connotations that they argue corporate citizenship implies. There are conceptual challenges in asking corporations to behave like citizens. However, attempts to encourage the managers of corporations to consider social goals alongside economic goals are being made.

### *1.2.2 Causes of corporate governance challenges*

The issues that have stimulated interests in the phenomenon of corporate governance, point to particular causes of corporate governance crises. These include weak legal and regulatory systems, inconsistent accounting and auditing standards, and poor banking practices. Thin and poorly regulated capital markets, ineffective oversight by corporate boards of directors, and little regard for the rights of minority shareholders are also problems with respect to corporate governance (World Bank, 2000).

The problem of weak legal and regulatory systems is generally viewed as a problem of developing countries. Developed economies tend to have developed and sophisticated regulatory systems, while less industrialized ones tend to display less efficient systems of law and regulations (Lin, 2000). The thinness and lack of effective stock exchange regulation may also be viewed as mainly part of the problem in developing countries. This is associated with the low level of market development in such economies (Lin, 2000; World Bank, 2000). When legal and regulatory systems are weak, the enforcement of contracts becomes difficult. For example due to weak legal and regulatory systems, particularly the enforcement of laws in Russia and the Czech Republic, controlling shareholders were able to siphon off profits leading to a loss of investments by minority shareholders (World Bank, 2000).

The application of varying accounting and auditing standards is another challenge to corporate governance (Clarke and Clegg, 1998). This problem emanates from the use of various financial accounting standards by corporations whose operations span different countries in the preparation and presentation of financial statements (Bradley et al., 1999). For example, US Corporations employ an American system of GAAPs developed by FASB, whereas UK-based corporations apply a different set of accounting standards (SSAPs) developed by the Accounting Standards Board (ASB) and the Financial Reporting Council (FRC). This use of different accounting standards makes the evaluation of performance across companies operating globally difficult (Bradley et al., 1999). This challenge has led to the need to harmonize standards through the use of accounting standards promoted by the International Accounting Standards Board (IASB). This initiative is reflected in the current attempts to harmonise accounting standards in Eastern, Central and Southern African regions through the Eastern, Central and Southern Africa Federation of Accountants -ECSAFA (Gathinji, 2002).

The poor banking practices reported by the World Bank are particularly related to the Asian crisis where banks provided credit to companies under the influence of the political elite. Either one family, or a corporation under a family's control, generally own Asian firms. Such families have close connections with the government, and politicians, and dominate the national economy to a large extent (Hanazaki and Liu, 2003). Using these connections, corporations have been able to borrow funds from banks without the proper disclosure of the information required to enable full evaluation of company performance and establish creditworthiness (World Bank, 2000).

The cases of Maxwell, BCCI, Nomura and a number of other large corporations show how the lack of effective oversight by directors can lead to corporate governance crises. This lack of effective oversight by boards of directors has resulted in boards' failures to prevent a large number of fraud cases and the subsequent collapse of corporations (Tricker, 2000; Stiles and Taylor, 2002). Mace (1971) argues that boards of directors are 'Christmas ornaments' and do not effectively control senior managers.

Demb and Neubauer (1992), posit that this is paradoxical since chief executive officers exercise the power of corporations which should be the preserve of directors.

### *1.2.3 Perspectives on corporate governance*

Corporate governance can be addressed from two broad perspectives: the liberalist and the communitarian perspectives (Bradley et al., 1999; Clarke and Clegg, 1998). The liberalist perspective views corporations as only accountable to shareholders. In this perspective, a corporation's legitimate goal is to serve the interests of those who own it i.e. the shareholders. The legitimate claims of other stakeholders are satisfied by meeting the contractual terms between them and the corporation.

Within the communitarian perspective, corporations are required to be accountable to other stakeholders than the shareholders alone. In this respect, shareholders become one stakeholder group among a number of stakeholder groups. The results of these differing views are different goals for corporations, for which managers are held accountable (Bradley et al., 1999). The case of SGL, a German manufacturer of graphite and carbon which wanted to attract capital from American investors, is provided to illustrate the implications of these perspectives.

> In 1992, SLG AG lost more that $71 million as part of a restructuring programme to turn the company around, top management altered the firm's governance structure by: adopting US transparent accounting practices, establishing corporate goal of enhancing shareholder value which is a norm in the US corporate governance, listing its stock on the New York Stock exchange, and even changing the company official language to English. Top management wanted to make the company look "Less German". By 1995, SGL had seen its revenues increase to more that $159 million dollars. Top management attributes much of the improvement to the changes in corporate governance. Thus, corporate governance provides firm-specific competitive advantages in the global capital market (Rubach and Sebora, 1998).

The case of SGL highlights the debate that has been going on for over a hundred years regarding the primacy of individuals versus the primacy of community (Bradley et al., 1999). This debate tends to be settled in each society in favour of one or the other: in Anglo-Saxon societies, the individual is assumed to have primacy and therefore his/her freedom to pursue their own goals, aimed at the maximization of their own utility, is argued for. This freedom is recognised in economic spheres and is actualised through the notion of private property. Respect for private ownership is central in the pursuit of economic activities, and in enjoying the benefits of such activities. A corporation is viewed in the same way as private property, and considered to belong to those who have put in their money as capital for the purpose of pursuing their economic interests (Scott,

1997). The goal is thus the maximisation of the wealth of its shareholders. In the above case, shareholders in the US required SGL to commit itself to this goal.

The SGL case implicitly points to an alternative perspective regarding the notion of freedom one in which the primacy of individuals is recognised but within the bounds of the larger society. In this context, the argument is advanced for individuals to pursue freedoms subject to constraints imposed by society, and the economic activities pursued should serve some social goal (Fisher and Lovell, 2003). In the context of Germany, where SGL is based, corporations are expected to have goals that reflect the interests of a number of stakeholders in addition to shareholders (Weimer, 1995). This perspective is usually viewed as being broad (Clarke and Clegg, 1998).

The SGL case shows that the globalisation of capital in a world that is dominated by American corporations is forcing other countries (or corporations in other counties) to re-evaluate their governance systems in an attempt to meet the demands of multinational corporations. Monks and Minnow (2002) point out that when Mercedes Benz wanted to raise capital on the New York Stock exchange, it had to adapt to the US accounting practices to facilitate investors' evaluation of the company. The American system of corporate governance requires corporations to apply accounting practices that align financial reporting with the interests of parties outside the corporation with respect to the provision of information these parties require. The accounts are required to present a "true and fair" view of the business in the American system, as opposed to the "true and correct" requirement of the company law in Germany (Kendal and Sheridan, 1991). These authors point out that such a system helps parties outside the firm, particularly shareholders, to evaluate the corporation's performance to assess the return on investment. In the German communitarian perspective, corporations are required to comply with detailed civil laws governing accounting.

The two perspectives are of great importance in the discussions on corporate governance. Corporate governance practices are expressions of these perspectives, and are embedded in the problem of social conflict (Roe, 2003). Corporate governance evolves to address incentive problems brought about by the separation of ownership from management (Tricker, 1994). The two perspectives shape the manner in which corporate governance develops. The Anglo-Saxon perspective suggests a conflict perspective, and thus corporate governance evolves to protect the interests of shareholders (Albert, 1993 cited by Macquand, 1993). In other countries, for example Japan and Germany, corporate governance is viewed as enhancing performance for the long-term survival of the corporations and for the benefit of multiple stakeholders (Sebora and Rubach, 1998; Weimer, 1995; Maassen, 1999; Letza et al., 2002). The distinct perspectives indicate that understanding the prevailing perspective in a particular context is of paramount importance in understanding corporate governance in that context.

## 1.3 Corporate governance in the context of Tanzania

This research addresses the Tanzanian context. The issues discussed in the previous sections have to be applied to the context of this country. The central planning system for economic coordination in Tanzania, and the ownership of corporations by the state, implies that the significant experiences of corporate governance will be related to state-owned corporations. Between 1967 and 1992, state-owned corporations were the most common type of large corporations found in Tanzania. In these corporations, corruption, (embezzlement and nepotism) managerial incompetence, political interference and government subsidisation of failing corporations were the predominant characteristics of corporate governance. Corporations were shielded from the discipline of the market (Bagachwa, 1992; Kihiyo, 2002). Control and accountability became the prime casualty within these corporations. Bagachwa et al. (1992) point out that the lack of accountability and effective control of these corporations left the managers with unfettered powers. They attribute these problems to the ambiguous property rights in the state-owned corporations.

The problems reported by Bagachwa et al. apply to a large extent to other countries in sub-Saharan Africa. Etukudo (1999) reports the paucity of corporate governance in sub-Saharan Africa arising from the ambiguous relationship between the state, as the owner of the corporations, the boards of directors and senior management. The paucity of corporate governance in state-owned corporations in Tanzania has resulted in dismal performance and the failure of these corporations (Wangwe, 1992). One result of the poor performance of these corporations has been their inability to provide the necessary "push" for the attainment of social and economic development as envisaged by the post-independence government (URT, 1999).

The system of central planning, including the state ownership of corporations, is being reformed through a series of market-promoting schemes. This process formally started in 1986 following an agreement between the Government of Tanzania and multinational financial institutions – the IMF and the World Bank - in 1986 (Mukangara, 1993; World Bank, 2002). The reforms included adoption of competition-friendly policies and the transfer of ownership of state assets/corporations to private shareholders. There had been earlier minor reforms towards a market orientation, e.g. the National Economic Survival Programme (NESP) of 1981-1982. However, these were largely unsuccessful, and this justified the need for the more comprehensive reforms that began in 1986 (Bagachwa et al., 1992). Following reforms, a number of corporations have been privatised. Some of the privatised corporations have shown significant improvements in their performance (URT, 2003). Indeed, privatisation has been viewed as a solution to the problem of governance (Wangwe, 1992).

Developments in the African region and worldwide have also created the need to develop an understanding of corporate governance practices in Tanzania. As a member

of the African Union (AU), Tanzania is required to join the comity of other African countries in improving corporate governance practices. The Africa Union has developed a development vision in which member countries are individually required to implement initiatives to improve corporate governance practices within them. This vision, called New Partnership and Development (NEPAD), recognises corporate governance as one of the key issues that need to be addressed to achieve social and economic development on the African continent. The vision underscores that issues of poverty alleviation are best addressed through wealth creation, in which corporate governance plays a key role since it improves efficiency in the allocation of resources. Thus, NEPAD draws a direct link between corporate governance and wealth creation (Gathinji, 2002).

Beyond the African region, Tanzania is also a member of the British Commonwealth. The member countries of the Commonwealth have agreed to undertake measures to improve corporate governance practices (CACG, 1999). CACG points out that corporate governance is important in improving the competitiveness of member states in attracting capital and in enhancing the performance of corporations. This adds to the need to understand current practices and make such understanding the basis for further improvement initiatives in the Tanzanian context.

### *1.3.1 The research objectives*

The general objective of this research is to explore qualitatively the determinants of effective corporate governance in Tanzania, with a view to raising issues that must be addressed to further improve practice. Verschuren and Doreeward (1999) assert that there are two principle types of research objectives: theory-oriented and practice-oriented ones. Theory-oriented research is concerned with contribution to the development of theory about a given phenomenon, while practice-oriented research is concerned with finding a solution to a practical problem confronting an organization or society. This research combines both elements by contributing to the body of knowledge as well as raising issues of practical relevance. The specific objectives for this research are:

1. Evaluation of the concepts available in the current body of knowledge and the selection of those concepts which are appropriate for assessing the effectiveness of corporate governance in Tanzania.

2. Description of the current situation with respect to effective corporate governance in Tanzania, and the factors that determine this effectiveness.

3. Identification of relevant issues in the further development of corporate governance in Tanzania.

### *1.3.2 The problem statement*

The importance of corporate governance for economic development in Tanzania is increasingly being recognised by policymakers and regulators. The transfer of the ownership of corporations from state to private shareholders reflects this recognition. Private shareholding, operating in a market economy, is considered more effective in controlling management than government shareholding in a centrally controlled system (Bagachwa et al., 1992). This, in turn, should result in the efficient allocation of society's resources (URT, 2001). The introduction, by the Steering Committee on Corporate Governance in Tanzania, of guidelines for corporate governance for Tanzania; and the development and recommendation of principles for effective corporate governance by the Capital Markets and Securities Authority (CMSA), are further indications that corporate governance is beginning to receive increased attention. Policymakers and regulators view the adoption of the recommended practices as an important step in influencing the behaviour of managers and directors with regard to effective discharge of their roles in promoting shareholder interests.

The promulgation of principles for effective corporate governance and the transfer of ownership from the state to private shareholders are significant developments. However, for an effective system of corporate governance to evolve, information is required which can provide the basis for decisions and steps to be implemented. Unfortunately, research on understanding the determinants of effective corporate governance in Tanzania is still limited. Kiure (2002) found that corporate governance practices do influence investment decisions. However, her research did not cover the effectiveness of these practices in a Tanzanian context. Given the relevance of this issue for business development in Tanzania, the central research question in this research project is formulated as:

**What are the determinants of effective corporate governance in Tanzania?**

This central research question reflects two aspects: the need to understand the context of Tanzania and the prevailing corporate governance practices; and the functional objective of corporate governance. Practices need to be embedded within the relevant perspective of corporate governance. In this regard the liberalist and communitarian perspectives discussed earlier are important reference points. The effectiveness of corporate governance is assessed in relation to its functional objective in the Tanzanian context.

### *1.3.3 Research questions*

To address the central research question, a division into three research sub-questions has been made.

1. What are the concepts available in the current body of knowledge that are appropriate for assessing the effectiveness of corporate governance in Tanzania?

2. What is the current situation with respect to the effectiveness of corporate governance in Tanzania, and what are the factors determining this effectiveness?

3. What are the relevant issues for the further development of corporate governance in Tanzania?

The answers to each of these research sub-questions will address the research objective and contribute to an integrated answer to the central research question. In the first sub-question, an exploration of the existing body of knowledge forms a starting point for obtaining insights into the state of art of the subject at hand. The literature will also supply the concepts that are to be used to explore practices of corporate governance in Tanzania. The second research question addresses the issue of the effectiveness of corporate governance in Tanzania. It seeks to contribute to the central research question by exploring current practices of corporate governance in Tanzania. The concepts found in answering the first research question will be applied in exploring practice.

The third research sub-question contributes by raising those issues that need to be addressed to further improve corporate governance practices in Tanzania. This question also seeks to advance the debate by highlighting issues of theoretical significance with respect to the development of corporate governance in Tanzania, and the developing world in general.

## 1.4 Relevance of the research

The relevance of research can be assessed on two aspects: its scientific and social relevance. Scientific relevance concerns the relevance of the research to the body of knowledge being accumulated. In general, at the University of Twente, research should reflect both the social and the scientific relevance (Weimer, 1995). Social relevance concerns the use to which the outcome of the research will be put. Regarding the research in hand, the social relevance is unequivocally linked to the significance of the phenomenon of corporate governance in general, and to Tanzania in particular. The importance of corporate governance arises from its influence on a corporation's ability to allocate resources efficiently, attract capital at low cost, and attain long-term sustainability.

In addition to the general importance of corporate governance, Tanzania requires to develop corporate governance as an important measure for addressing issues of poverty alleviation. Corporate governance can contribute to the development of the private sector, which is currently viewed as the “engine of economic growth”.

Development of the private sector depends, among other things, on the steady supply of long-term capital for which the effectiveness of corporate governance is a critical factor (OECD, 1999; World Bank, 2000). Developing countries, such as Tanzania, face the challenge of attracting the foreign capital needed to stimulate the economy. Improving corporate governance contributes by improving a country's competitiveness in attracting foreign capital (Sebora and Rubach, 1998). Table 1.3 shows that foreign direct investment (FDI) flows to Tanzania have been increasing over the last seven years, but that there have also been large fluctuations. The high levels of FDI in 1999 and 2001 reflect large investments inflows in the mining sector (URT, 2005). To sustain and encourage further investment inflows into the economy, corporate governance issues have to be addressed. By accumulating knowledge of, and recommending improvements in, corporate governance, this research will help to improve the country's competitiveness in attracting foreign investments, as well as encouraging local entrepreneurs to invest. This can be considered as the social relevance aspect of this research.

**Table 1.3**
**Foreign Direct Investments (FDI)**
**Flows to Tanzania, 1997-2003**
*Source: Economic Survey, 2004 and 2005*

| Year | Amount in US$ Million |
|---|---|
| 1997 | 157.8 |
| 1998 | 172.2 |
| 1999 | 516.7 |
| 2000 | 463.4 |
| 2001 | 327.4 |
| 2002 | 240.4 |
| 2003 | 247.8 |
| 2004 | 260.2 |

Corporate governance affects the efficiency with which resources are allocated within the economy (Clarke and Clegg, 1998; OECD, 1999, World Bank, 2000; OECD, 2004). Decisions about investments made by corporations are determined within the framework of their governance structures. This implies that, to the extent that corporations allocate resources in the economy, their efficient allocation depends on the effectiveness of their corporate governance systems. Researching corporate governance in Tanzania, and recommending improvement measures, will help to improve the allocation of resources in the Tanzanian economy and hence contribute towards the country's socioeconomic development. This is also an element of the social relevance of this research.

Despite having been recognised for over two hundred years as an important issue, research on corporate governance is relatively recent (Tricker, 2000; Sloan, 2001,

Denise, 2001), and most of this research has taken place in developed countries. Research on corporate governance in developing countries is limited (World Bank, 2000; Rwegasira, 2000). The research in hand will add additional insights to the existing body on knowledge of corporate governance from the perspective of developing economies, and Tanzania in particular, and this constitutes the scientific relevance of this research.

## 1.5 The research approach

### *1.5.1 Research design*

The research design should constitute a logical sequence that connects the empirical data to a study's initial research questions and ultimately to its conclusions (Yin, 1994). It consists of two different, but related, sets of activities: the first set of activities (also termed the conceptual part) is concerned with the question to be answered in the research in order to reach the research goal. The second set of activities is related to how one is going to collect relevant data to answer the research question specified in the first part (Verschuren and Doreeward, 1999). In executing the second part of the research design, the researcher should comply with a scientific methodology that is defined as an informal and strict set of rules that has evolved to ensure the integrity, reliability and reproducibility of the research work (Remenyi et al., 1998). The explication of research design is important because it aids the assessment of the whole process of research (Eisenhardt, 1989).

With respect to the research in hand, the conceptual part has been addressed by specifying the central research question. The formulation of the central research question for this research leaves room for interpretation as to how to approach and address it: descriptively or prescriptively. The descriptive approach leads to a description of the determinants as found from practice in the existing situation. A prescriptive interpretation implies providing a prescription, and contains a more normative, or opinion-oriented, answer to the research question. Such an answer would likely reflect a wish which need not be grounded on practical reality. In this research, the choice has been made to use a description of the determinants as found in practice in the current situation in Tanzania. A description of practices allows an analysis to be performed based on the practical reality so as to arrive at conclusions that address that reality. A description of practices is also critical for gaining insight into practices and provides a sound basis for judging their effectiveness – a central issue in this research - and forms a reliable basis for providing recommendations for further improvements.

### *1.5.2 Research methodology*

Burrell and Morgan (1979) refer to methodology as a way in which one attempts to investigate and obtain knowledge about the social world. Research methodology is a

way to systematically solve a research problem. The importance of the research methodology emanates from the fact that it provides the logic behind the method selected. Kothari (1985) points out that "when we talk about research methodology, we not only talk about research methods, but also consider the logic behind the methods we use in the context of our research and explain why we are using a particular method or technique so that research results are capable of being evaluated either by the researcher himself or by others".

A hermeneutics methodology, which has been selected and applied in this research, is a research methodology that uses a personal interpretive process to obtain insights about reality. It adopts an objective view of the social world, but uses an understanding and interpretive approach to investigate this world. For the purpose of this research, this methodology has been selected because it provides the researcher with the possibility to access and generate the detailed data required for a detailed description of corporate governance practices in Tanzania. This will provide a sound basis for addressing the central research question, and with this the possibility to probe issues in detail.

### *1.5.3 Research methods*

Research methods refer to the techniques employed in collecting relevant research materials and processing such materials into answers to the research question(s) (Kothari 1985; Verschuren and Doreeward, 1999). Various methods can be employed in collecting the requisite research material (evidence) required to answer the research question. Galliers (1992, cited by Remenyi et al., 1998) provides a survey of research methods for the two major research approaches, and these are summarised in Table 1.4. The table shows that some of the research methods are specific to one particular research approach while others have applications in both approaches.

Positivist research is research that seeks to explain and predict causal relationship between constituent parts of a phenomenon (Burrell and Morgan, 1979). It seeks to provide an explanation in terms of what causes what. Non-positivism reflects an inquiry process of understanding a social or human problem based on building a complex, holistic picture, formed with words, reporting detailed views of informants and conducted in a natural setting in order to gain insights about a phenomenon (Hollis, 2000). In this type of research, qualitative methods predominate.

**Table 1.4**
**Research approaches and the associated methodologies**
*Source: Remenyi et al. (1998) with slight modification*

| Research methods | Positivist methods | Non-positivist methods |
|---|---|---|
| Action research | | Strictly non-positivistic |
| Case studies | Have scope for both | Have scope for both |

| Research methods | Positivist methods | Non-positivist methods |
|---|---|---|
| Ethnographic | | Strictly non-positivistic |
| Field experiments | Have scope for both | Have scope for both |
| Focus groups | | Mostly non-positivistic |
| Forecasting | Strictly positivist with some room for interpretation | |
| Futures research | Have scope for both | Have scope for both |
| Game or role playing | | Strictly non-positivistic |
| In-depth surveys | | Mostly non-positivistic |
| Laboratory experiments | Strictly positivist with some room for interpretation | |
| Large scale surveys | Strictly positivist with some room for interpretation | |
| Participant-observer | | Strictly non-positivistic |
| Scenario research | | Mostly non-positivistic |
| Simulation and stochastic | Strictly positivist with some room for interpretation | |

With positivist research, the research process is linear; whereas the process is circular for the non-positivist research methods (Remenyi et al., 1998). In this research, a case study approach has been applied within which three different techniques have been used.

The case study approach is justified in the literature in relation to certain types of research. Three types of research exist, and are classified according to the level of theory development. Weimer (1995) cites Kelringer (1983) and Drew (1980), who point out three forms of research: exploratory research, descriptive research, and explanatory or theory-testing research. Exploratory and descriptive researches are deemed appropriate when the current level of theory development is low. This is the case with respect to corporate governance where theory is still in the process of development (Tricker, 1994; 2000). It is even less developed with respect to developing countries such as Tanzania (World Bank, 2000; Rwegasira, 2000; Okeahalam and Akinboade, 2003). Okeahalam and Akinboade (2003) posit that, due to the current state of knowledge on corporate governance in Africa, case studies are suitable for understanding current practices. For these reasons, a case study approach has been selected for this research.

### *1.5.4 Case study research*

Yin (1994) defines a case study as an “empirical inquiry that investigates a contemporary phenomenon within its real-life context especially when the boundaries between phenomenon and context are not clearly evident”. A case is what a researcher focuses on in order to understand a phenomenon. It can be an individual, a group such

as a family, or a class, or an office; an institution such as a school, a company, a large-scale community such as a town, an industry or a profession (Gillham, 2000).

Yin (1994) distinguishes three types of uses of case research: exploratory, descriptive and explanatory. Exploratory cases are used as a basis for developing precise questions or testable hypotheses. In this sense, the research is oriented towards generalisations, and the case study is used to clarify the problem before more extensive research is conducted.

A descriptive case study is an attempt to paint a picture of how a particular phenomenon looks like or occurs. Gummesson (2000) challenges this description of a descriptive case study arguing that, in making descriptions, choices are made which are guided by paradigms, access and prior knowledge. He observes that exploratory and descriptive case studies are usually accorded low status and viewed as ancillary to other methods, while explanatory case studies are viewed with scepticism. A source of this criticism is the frame of reference. Researchers who subscribe to an objective reality, a determinist perspective aiming for generalisation, are likely to view case studies with scepticism. Researchers who subscribe to an interpretive view of the world, and wish to gain a deep insight into a phenomenon, favour the case study approach as a research tool.

**Case selection**

Stake (1995) contends that there are two types of cases: intrinsic and instrumental ones. An intrinsic case is preselected and represents a situation of having no choice. This means that to understand the phenomenon of interest only one particular case can be studied. An instrumental case is selected when there is a research question, puzzlement and a need for general understanding, and a feeling that one may gain insights into the question by studying a particular case. The instrumental argument encourages studying a particular case if that case provides the possibility of understanding a particular phenomenon. This is also described as strategic case selection (Patton and Appelbaum, 2003).

In terms of this research, the instrumentality argument is the motivation behind selecting large listed companies in Tanzania. Corporate governance is an issue in listed companies where the issue of ownership and control, which lies at the heart of the debate on corporate governance, will surface (Stiles and Taylor, 2002). Listed companies tend to have widely dispersed ownership because they raise capital from a large number of investors. These companies also tend to be large. In this research, large corporations, by Tanzanian standards have been selected. The size criteria used in Tanzania are provided in Table 1.5.

**Table 1.5**
**Size of enterprises**
*Source: URT, 2003*

| Category/size criteria | Micro | Small | Medium | Large |
|---|---|---|---|---|
| Number of employees | 1-4 | 5-50 | 51-100 | Above 100 |
| Capital invested (TAS in million)[1] | Up to 5.0 | 5.1-200 | 201-800 | Above 800 |
| Turnover (TAS in million) | 12 | 150 | 300 | Above 300 |

Large companies are thus those that employ more that 100 employees, have a capital above TAS 800 million and a turnover above TAS 300 million. All the companies included in this research fall within this category. Including companies that fall within the same size category has a theoretical justification: it clarifies the domain of the findings and reduces extraneous variation (Eisenhardt, 1989).

At the start of the research, the plan was to cover all large companies listed on the Dar es Salaam Stock Exchange (DSE) which, at the start of the research, amounted to only four firms. As the research progressed, three additional companies were listed which increased the potential number of research companies to seven. Since the three additional companies were relatively new to the exchange, and also because insufficient time was available to provide meaningful measurement, it was decided not to include them in the research. In general, for case study research, between four and ten cases are recommended. Eisenhardt (1989) argues that less than four cases are too few to provide sufficient evidence, while more than ten cases is not required. In this research, thus, it means the requirement for sufficiency of evidence has been met.

**Data collection for the research**

For the research in hand, three methods were used to collect data: interviews, document analysis, and observations. The interviews involved face-to-face contacts with company directors, senior management and shareholders. Interview schedules were used as prompts to questions. Interviewees were encouraged to describe how they carried out various activities related to corporate governance by providing examples. These examples were used to capture everyday practices related to corporate governance. Interviews with government regulatory organs: the Capital Markets and Securities Authority (CMSA) and the Dar es Salaam Stock Exchange (DSE) were also conducted.

Documents and company reports such as annual reports, prospectuses and

[1] The average exchange rate of the TAS in 2003 was around 1047/US$

minutes of annual general meetings (where they were accessible) were used. Internal memos and documents were accessed, and were used to support assertions made by interviewees and to extend the discussion of the issues. Publicly available information was used to provide initial information about the companies and for elaborating on the questions during the interviews. Observations were made by attending annual general meetings of shareholders, and by viewing videocassettes of earlier annual general meetings. During the data collection process, field notes were kept for each of the companies involved in the research.

**Data analysis and presentation**

In case study research, data analysis is closely linked to data collection (Eisenhardt, 1989). Data analysis involves detailed case write-ups and reflection on the descriptions, a practice recommended in the literature. Eisenhardt (1989) posits that case analysis typically involves detailed case write-ups for each case. The case write-ups are pure descriptions, however, they are central to the generation of insights (Gersick, 1998; Pettigrew, 1988 both cited in Eisenhardt, 1989). The literature suggests that there is no standard way in which the descriptions can be provided (Einsenhardt, 1989).

In this research, descriptions include narratives of the histories of the companies, the tabular presentations of performance, and the ownership patterns. Also, where feasible, the identity of the shareholders is provided. The identity of those shareholders with significant holdings has been provided in all cases. The data are summarised qualitatively.

### *1.5.5 Research quality*

Kidder and Judd (1986 cited by Yin, 1994) provide a summary of criteria for judging the quality of a research design in social science: construct validity, internal validity, external validity and reliability. Construct validity refers to the establishment of correct operational measures for the concepts being studied. Yin (1994) points out that the construct validity is a relatively difficult test to pass in case study research. However, he offers proposals for increasing the validity to be applied during the data collection process. The use of multiple sources of evidence is one of the ways to increase construct validity in a way that encourages convergent lines of inquiry. The various sources of evidence provide multiple measures of the same phenomenon. In this research, multiple sources of evidence have been used: interviewing various directors, both executive and non-executive ones, company secretaries, senior members of management and shareholders. Evidence from documents and observations was also obtained.

Establishing a chain of evidence is another tactic recommended for enhancing construct validity (Yin, 1994). This tactic is based on a notion similar to criminology and it should help the reader to follow the case from end back to beginning or vice versa. This approach was used during this research, particularly to understand the

relative power of shareholders with a special emphasis on how large shareholders exercise control over corporations.

The find technique for ensuring construct validity is to have key informers review the case report. During this research, key informers were given the draft reports to read and give comments or make necessary corrections.

Internal validity refers to the establishment of a causal relationship in which certain conditions are shown to lead to other conditions, as distinguished from spurious relationships. Internal validity is a concern only for causal (explanatory) case studies where the researcher is trying to determine whether one event led to another (Yin, 1994). The usual way of dealing with internal validity in case studies is by making inferences: showing that certain conditions lead to other conditions (Rowley, 2002). In this research, internal validity was achieved by placing emphasis on understanding the relationships between variables.

External validity refers to the establishment of the domain to which a study's findings can be generalized. The notion of external validity in a case study refers to the type of case to which results of one case can be generalised. This issue is still debated in the literature: whether any generalisation is possible from a case. One perspective argues that generalisation from a case is not necessary since each case tends to be unique (Stake, 1995). The other perspective posits that generalisation from a case is possible, provided the case has been conducted properly, is informed by theory, and can therefore be seen as adding to the established theory (Rowley, 2002). However, the type of generalisation that can be made from a case is not statistical, it is analytical. Analytical generalisation involves the use of previously developed theory as template with which to compare the empirical results of a case study (Rowley, 2002). Rowley further observes that if two or more cases support the same theory, replication can be claimed. To achieve this aspect of generalisability, a replication logic must be applied. Replication logic refers to the logic which underlies each case, and this must be the same for all cases (Yin, 1994). In this research, a common approach was followed in collecting data in all the cases. This was made possible by the use of a case study protocol.

Reliability is about demonstrating that operations within the study, such as data collecting procedures, can be repeated with the same results being obtained by another researcher. The goal of reliability is to minimize errors and biases in the case study. Yin (1994) notes that one way to deal with the issue of reliability is to document the procedures followed in the case. In this respect, a case study protocol is recommended as a major tactic for increasing the reliability of case research. In this research, a case study protocol was prepared in advance of going to the field to collect data. During the execution of the study, reliability was also ensured by maintaining a case study database.

## 1.6 Structure of the research

Chapter 1 provides the background to this research. It addresses the rise of corporate governance as an important issue internationally. It highlights the recent experiences of corporate governance in Tanzania, and specifies the central research question to be answered in the research. Sub-questions that contribute to answering the central research question are elaborated upon. The research approach is also discussed in the first chapter. This includes the research, the methodology and the methods applied in this research.

Chapter 2 provides an analysis of the context in which companies operate in Tanzania. The system of economic coordination and the implications for corporate governance are addressed. The four traditional perspectives, which underlay systems of economic coordination, are discussed and reflected upon against the context of Tanzania. It provides a basis for assessing the appropriateness of the proposed model, relative to the objective of the research.

Chapter 3 contains a literature review in which the concepts of corporations and corporate governance are explored. Based on the literature, the operational definition of corporate governance for this research is provided. The opposing paradigms of corporate governance, which reflect the perspectives that set the framework for discussions and practice are presented: the liberalist and the communitarian perspectives. These perspectives, which are embedded in the theory of social conflict, are reflected in practice through the stylised models of corporate governance. The models are discussed and elaborated on to provide the operational base for this research. The relevant theoretical perspectives in the study of corporate governance are also discussed in the context of these viewpoints. Within the analysis of the context, the theories, which fit the objective of the research, are selected and discussed. These theories form the basis for selecting the specific elements used in the development of a model employed in the empirical investigation.

In Chapter 4, the research model for empirical investigation is developed in two stages. The first stage culminates in a general model of corporate governance. The general model provides a broad view of the mechanisms of corporate governance that can be researched to answer the research question. The second stage constitutes the explanatory or research model. This is the operationalised model and reflects the choices that are made within the framework of the general model focusing on mechanisms that address the central research question. The propositions for the research are also provided.

In Chapter 5, the individual case studies are described and analysed. The propositions are verified for each case. Chapter 6 contains a cross-case analysis of the four cases with the propositions being verified across the four case studies. In this chapter, the guidelines for corporate governance as recommended by the Steering

Committee on Corporate Governance in Tanzania and the Capital Markets and Securities Authority (CMSA) are discussed and compared with the findings from the case studies.

Chapter 7 contains the conclusions, reflections and recommendations for further development of corporate governance in Tanzania. Directions for further research are suggested.

# CHAPTER 2 CONTEXT ANALYSIS

## 2.1 The overview of the context

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[2]; and twelve political parties had obtained their registration by 1993 (Muya, 1998). Chama Cha Mapinduzi (CCM) has since been the dominant political party. Elections for both the presidency and parliament are held every five years. 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 (URT, 1999)

Dar es Salaam constitutes the operating *de facto* capital of Tanzania. The designated *de júre* capital is Dodoma. The decision to move the capital to Dodoma was made in 1973. Thirty years on, the government continues to insist on moving to Dodoma. However, only four out of the current thirteen ministries have moved to, and currently operate from, Dodoma. The rhetoric of moving the capital to Dodoma continues, although with much less vigour than in earlier times. For example, in July 2003, the President reminded ministers to prepare themselves for the move to Dodoma, insisting that the decision to move to Dodoma was irreversible[3]. This illustrates one of the gaps between ideology and practice in the country.

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

---

[2] 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 (Muya, 1998).

[3] The Guardian 30th July, 2003

wildlife and a number of tourist attractions (World Bank, 2002). Despite this potential and rich resource endowment, Tanzania remains one of the least developed countries in the world; poverty remains pervasive and deep. As illustrations, about half of the Tanzanian citizens are poor, 32 percent illiterate and the infant mortality rate stands at 99 per 1000 live births (World Bank, 2002). This suggests that the resources are not being sufficiently utilised to bring about social and economic development. The appalling level of poverty forms the basis for the current strategy for poverty eradication (Chachage, 2003). 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 mid-1990s. Table 2.1 provides the output growth rates for Tanzania, Africa, developing and developed countries over recent years.

**Table 2.1**
**Comparative output growth rates: 1998-2003**
*Source: World Bank 2002, Economic Survey, 2000-2003*

| Country/Region | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 |
|---|---|---|---|---|---|---|
| Tanzania | 4.0% | 4.7% | 4.9% | 5.9% | 6.2% | 5.6% |
| Africa | 3.3% | 2.3% | 3.0% | 3.6% | 3.4% | 4.1% |
| Developing Countries | 3.0% | 3.8% | 5.8% | 3.9% | 4.6% | 6.1% |
| Developed Countries | 2.0% | 3.4% | 5.8% | 0.8% | 1.8% | 2.1% |
| The World | 2.0% | 3.5% | 4.8% | 2.3% | 3.0% | 3.9% |

Table 2.1 shows that the economy has been growing over the last six years; with annual growth rates of more than 4%. This growth is greater than that for the whole of Africa, and also that of both developing and developed countries as well as the world's overall performance. The strong economic growth rates point to increasing efficiency in the utilisation of available in the economy.

Tanzania remains largely an agrarian economy. The rural population, about 76% of the total population, relies on agriculture for its livelihood, and forms an important source of foodstuffs for the urban population (World Bank, 2002). Agriculture has been contributing about 48% to the GDP over the last ten years. This sector is linked to a large number of other sectors of the economy particularly industry and commerce. It is for this reason that the belief is held that the development of agriculture will result in rapid economic development in Tanzania (TANU, 1967; Nyerere, 1968, World Bank, 2002).

Other important sectors of the economy include trade, hotels and restaurants; financial business services; and manufacturing. Trade, hotels and restaurants (combined) form the second most important sector of the economy, and has been contributing about 16% of GDP over the last ten years. This sector is gradually growing reflecting recent developments linked to the adoption of market reforms that began in 1986. The reforms have led to increased trade and growth in the tourism industry. For

example, in 1998, tourism contributed 7.6% to the GDP up from a paltry 1.5% in the early 1990s. This sector has recently been growing at an annual rate of 22% (World Bank, 2002).

The financial services sector is the third largest contributor to the economy of Tanzania. This sector has had a stable contribution to the GDP of about 10% over the last ten years. The manufacturing sector ranks fourth in terms of contribution to GDP, with a consistent contribution of about 8% between 1992 and 2002. The public sector, transport and communication, construction, mining and quarrying, electricity and water are other important sectors of the economy. With respect to the phenomenon of corporate governance, the analysis of relevant context is considered in this research to begin with the colonisation of the country since this marked the beginning of corporate development leading to current practices.

From a historical perspective, the abolition of the slave trade in the later part of the nineteenth century (around the 1870s) saw an increased interest by the Western powers seeking to establish spheres of influence on the African continent and in other parts of the world. In the context of Tanzania, the first colonial experience began with the German colonisation of Tanganyika following the outcome of the Berlin Conference of 1884-1885. German rule lasted from 1884 to 1919. With respect to corporate governance, laws constitute the main way in which colonial experience influences prevailing corporate governance practices in colonised countries (Djankov et al., 2003). However, the influence of German law on corporate governance is nowadays nonexistent in Tanzania. This is because World War Two led to Tanzania becoming a protectorate of the British following the endorsement of the League of Nations (now called the United Nations). This was the point at which British colonial influence penetrated Tanzania, the legacies of which are still present. The most significant legacy of this linked colonial past, with respect to corporate governance, is the British legal system which has provided the framework for corporate governance in Tanzania to the present time.

In addition to the legal system, systems of economic coordination are important determinants of corporate governance practices (Gilpin, 2001). They reflect assumptions about social life in different societies, and how economic activities are coordinated. Corporate governance practices are embedded in systems of economic coordination. The cultural, legal and institutional aspects of different societies influence corporate governance (Tricker, 1994; Sebora and Rubach, 1998). An understanding of the systems of economic coordination is helpful for placing corporate governance practices in their appropriate context.

## 2.2 Perspectives on systems of economic co-ordination

The coordination of economic activities involves two types of decisions: what goods and services are to be produced in an economy, and how much of such goods and services are to be produced. The implementation of these decisions involves the allocation of resources in the economy (Clark, 1998). Two broad systems within which such decisions are made exist: a centrally controlled system and a market-based system. These systems can be viewed as forming a continuum with government coordination at one hand and the market at the other. A large number of economies around the world are located somewhere between the two extreme positions. The system of economic coordination defines the relationship between the market and the government.

In a centrally-controlled system, the government makes the decisions about what goods and services to produce and in what quantities. This is achieved through centralised planning. In this respect, the government allocates resources in the economy. A market-based system is one in which the two decisions are made by individuals, households and private, as well as public, institutions based on market signals. Goods and services are produced based on the demand for such goods and services. Consequently, the market (or market forces) are said to allocate resources in an economy. The efficiency with which these production decisions are made and implemented varies within the two broad systems (Clark, 1998).

Within different systems of economic coordination, corporations are governed in different ways. The fact that corporate governance systems are located in specific contexts, in which the state and the market relate in different ways, explains their differences (Tricker, 1994; Gilpin, 2001).

Market-based systems of economic coordination are associated with capitalism due to their reliance on private capital and enterprise. Different forms of coordination in market economies result into various forms of capitalism which, in turn, give rise to different forms of corporate governance systems (Gilpin, 2001). In a centrally-coordinated system, corporate governance takes a different form with the government assuming a greater role in the economy.

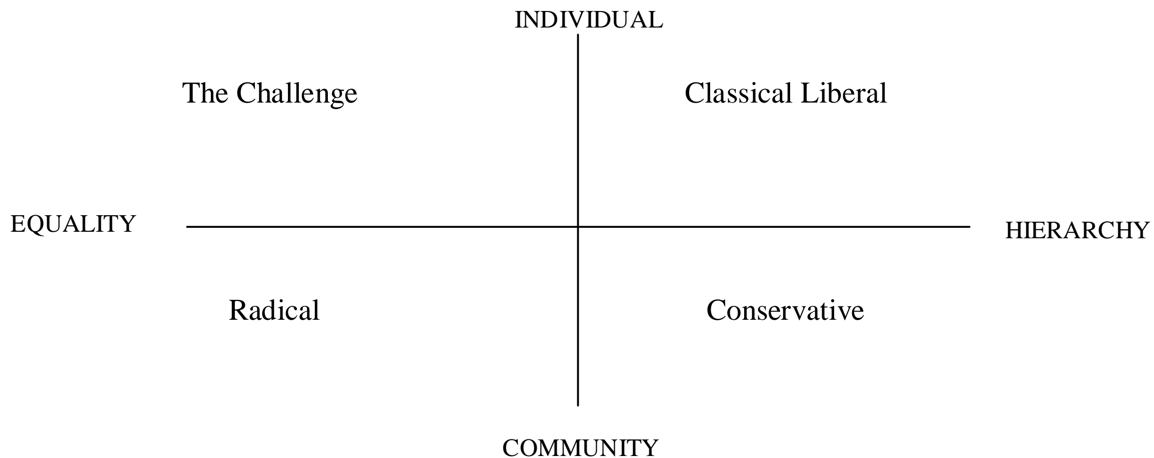
Clark (1998) outlines a general scheme, as shown in Figure 2.1 which consists of four perspectives on the political economy used to distinguish systems of political and economic coordination: the classical liberal, the conservative, the radical and the modern perspectives. These perspectives are referred to in this research as perspectives on systems of economic coordination.

The four perspectives are differentiated by the values to which each is committed: individualism and community on one hand, and hierarchy and equality on the other. These values originate from the general concept of liberalism[4], which has

[4] Liberalism stands for individual freedom and rights against the arbitrary exercise of power by the Church, state or other persons (Clark, 1998)

traditionally been associated with enlightenment. Enlightenment, or the age of reason, refers to the period during which Western Europe was transformed with respect to ideas about the role of an individual in society and the role of society in shaping that individual.

**Figure 2.1**
**Perspectives on systems of economic coordination[5]**
*(Adapted from Clark, 1998)*




Enlightenment was caused by a number of factors. The impact of commerce in Western Europe gradually eroded the feudal economy of the middle ages. This created opportunities for the expression of individual aspirations and encouraged entrepreneurial behaviour that had been suppressed by the church, the state and the community (Clark, 1998). The protestant revolution initiated by Martin Luther in Germany provided further impetus for change. The combined result of these developments was the birth of Enlightenment. Enlightenment constituted a rejection of the medieval view of society as a divinely ordered hierarchy in which each person's role and purpose is well defined and, instead, the acceptance of a worldview which centred on the autonomous individual and the human capacity for reason (Clark, 1998). The renaissance of the fourteenth century paved the way for the scientific enquiries of Corpenicus, Galileo, Bacon and Newton (Remenyi et al., 1998) which is an application of human capacity to reason.

The traditional debate about the role of an individual in society has tended to focus on the issue of equality and hierarchy. Those who advocate hierarchy are often referred to as "rightists" to reflect the 1789 event in the French National Assembly in which the defenders of aristocratic privileges and hierarchy in society stood to the right side of the chamber while the proponents of equality and individual freedom stood on the left. The notion of hierarchy, as advocated by "rightists", refers to the defence of a

---

[5] Moving clockwise, the classical liberal perspective is located in the first quadrant.

society in which hierarchical social relationships (of the feudal society) are maintained: being considered essential for a good society (Weiskopf, 1972).

The “leftists” on the other hand claim that human development flourishes when individuals engage in cooperative, mutually respectful, relations and that these thrive only when excessive differences in status, power, and wealth (characteristics of the feudal society) are eliminated. They argued that a society without substantial equality would distort the development of the deprived persons as well as those whose privileges undermine the motivation and sense of social responsibility. Over time, divisions developed within these two values over the question of whether individual private interests should take precedence over those of society or not. The divisions gave rise to new conflicting values: individualism and communitarianism.

Individualism reflects the claim that an individual’s interests should take precedence over the interests of society (Clark, 1998). Individualists claim that a community has no interests other than the aggregation of the individual interests within it. The notion of public interest, in their view, is a myth: the good community is one that allows individuals to freely pursue their private interests. Individualists are not concerned about the well-being of the community because they remain confident that any community that secures individual freedom will become prosperous by the energies and talents of its citizens.

Though individualism leads to hierarchy and negates the realisation of the liberties that enlightenment promises, hierarchy can be viewed as essential for the profitable use of individuals’ talents, leading to the good of society. Individuals need distinctions of status to differentiate themselves from others; a society lacking sufficient hierarchy will fail to provide incentives for its citizens to excel, resulting in stifling mediocrity leading the whole society to economic stagnation, boredom, and apathy. In this respect, individualists support hierarchy, but one that one is achieved through competition.

As indicated in Figure 2.1, classical liberalism, located in the first quadrant, is committed to values of individualism and hierarchy. This perspective is traced to a number of social and political philosophers: Thomas Hobbes, John Locke, Adam Smith, Friedrich Hayek and Robert Nozick among others. Adam Smith is credited for providing an elaborate explanation of how individuals, pursuing their self-interests lead to the common good of society. This perspective is also referred to as the utilitarian perspective; it is assumed that economic interactions consist of voluntary exchanges among individuals and that every person has the right to pursue their own interests unconstrained by the arbitrary use of power by the government or church (Clark, 1998). This perspective advocates the free market as opposed to state coordination of economic activities. Smith advocated the working of the market through the “the invisible hand” directing a myriad of economic transactions (Fisher and Lovell, 2003).

In a free market, no individual person or company is able to affect price and the

resulting transaction, and the prices that bring suppliers and consumers to the market place reflect people's preferences. The role of the government is to protect individual rights including those of property. Equality in the context of classical liberalism is viewed in terms of allowing individuals to engage in economic activities, and the civil rights are those that individuals establish. The classical liberal perspective evolved during the twentieth century into a number of perspectives: neo-classical liberalism (Austrian and Cambridge perspectives), the public choice perspective and new classical economics.

The communitarian perspective contends that society is the shaper of an individual. The interests of society should thus take precedence over those of the individual. It argues that human development is determined by the quality of the social environment: the nurturing and support. Communitarians acknowledge and support room for the community to influence the behaviour of its members and what they do (Bradley et al., 1999). They assert that, by themselves, individuals are helpless in the face of social forces over which they have no control. However, the community as a whole can consciously engage in actions that make possible the development of individual interests and shape individual character. This perspective is considered to take a holistic view of society. This broad category covers both conservative and radical perspectives.

The conservative perspective is committed to the values of hierarchy and community. This perspective is associated with Edmund Burke, Thomas Carlyle, Vilfredo Pareto and Joseph Schumpeter among others. In this perspective, a role for the market is justified, but a role for the government is also acknowledged and allowed to influence and shape individuals. This perspective evolved over time into neo-fascism, corporatism and neo-conservatism.

The radical perspective is a constituent part of communitarianism and is committed to values of community and equality. This perspective is associated with: Jean Jacques Rousseau, Karl Max, Edward Besntein, Thorstein Veblen, V.I.Lenin and Jűrgen Habermas among others. Though these authors take different positions with respect to how to achieve equality, they can broadly be grouped within this perspective. This perspective considers collective ownership of property to be an appropriate system, and one which would allow full enjoyment of the benefits of enlightenment. It calls for government involvement in the coordination of economic activities. The current theories of institutional economics, social economics and post-Marxism have their background in this radical perspective of economic coordination.

The modern liberal perspective is a broad one that is committed to the conflicting values of individualism and equality. These values are conflicting as one excludes the other. For the purpose of this research, the modern liberal perspective is referred to as the c*hallenging* perspective. Individualism calls for individuals to be allowed to exercise their freedom in pursuit of their interests, without suffering interference by

either the government or any other authority. In economic spheres, the free market is argued for, as the best form of economic coordination. In practice, individualists argue for a reduced role of the government in the economy. Equality on the other hand, demands equal access to resources and opportunity, and this in practice can imply government intervention, hence the challenge within this perspective.

The challenging perspective requires balancing the state and market involvement in the economy so as to promote equality while allowing individuals to pursue their self-interests. The proponents of this perspective include Jeremy Benthan, John Stuart Mill, Thomas Hill Green, Alfred Marshal, John Maynard Keynes, John Rawls and others (Clark, 1998). This perspective has also undergone evolution. New Keynesian economics, neo-corporatism, and post-Keynesian economics are some of the current perspectives which have originated from the "challenging" perspective. The framework, consisting of the four perspectives, provides a framework within which the system of coordination in Tanzania can be discussed. This will help place the phenomenon of corporate governance in context.

## 2.3 Systems of economic co-ordination in Tanzania

### *2.3.1 The centrally-controlled system*

Reflected by the first quadrant of Figure 2.1, prior to 1967, the system of economic coordination, under the British colonial administration, was based on the market in line with the views of the classical liberals (Kiondo, 1993). The immediate postcolonial government instituted changes that had profound impacts on the country's social economic philosophy and practice. For example, the 1965 constitutional changes that made Tanzania a one-party state, made it possible for the government to intervene in a monopolistic way in all affairs of the country: political, social and economic (Kiondo, 1993; Hartmann, 1990). This development reflects a movement towards the radical perspective of economic coordination (see Figure 2.1).

The gradual movement towards a state-controlled system of economic coordination reflects the early experiences and concerns of the newly independent state. Bagachwa et al. (1992), Hartman (1990) and Pratt (1976), contend that the genesis of the ideas for a centrally-planned system of economic coordination in Tanzania is to be found in the early experiences following independence: a lack of capital to finance social and economic development and the lack of a sufficient number of local entrepreneurs able to finance economic activities (Wangwe, 1992; Ngemera, 1993; Bagachwa, 1992; Pratt, 1976). The post-independence government, under the leadership of Nyerere (1961-1985), identified three related problems that confronted the country: ignorance, poverty and disease (Nyerere, 1968). Various solutions were proposed to address these problems. The solutions revolved around a system for coordinating economic activities that would address the three interrelated problems. The shortage of

capital was recognised and debated within the government policymaking machinery. The Minister of Agriculture in the post-independence government made the following observation which illuminates this:

> "We have the land, we have a lot of energy. We have the knowledge but we need the capital to allow us to take the best advantage of the very promising combination. …If we go ahead without it and this we certainly can do in a good year, we shall be able to put a little aside for development, but in a bad year we can loose that little and perhaps slip back again. In that case, it will take a considerably long time to develop and the standards of living, the education of our children and the health for our families will all suffer as a result" (Hansard, 1962; cited by Hartmann, 1990).

The above statement shows that a market-based system was being suggested that would bring some benefits. However, the challenge associated with it was also recognised and debated, giving rise to two opposed perspectives: a state-controlled economy versus a market-based one. A market-based system works according to the principle of "to each according to what he and the instruments he owns produce" (Friedman, 1962 cited by Weisskopf, 1972). It was accepted that economic development based on private capital would benefit only a small number of people, probably foreigners, at the expense of the already disadvantaged indigenous people. However, this challenge would be addressed through the welfare programme to be implemented through a system of taxation and government social expenditure programmes (Hartmann, 1990). In terms of Figure 2.1, this reflects the balancing of the market role with that of the state as advocated in the 'challenge' perspective.

The other perspective considered advocated state coordination of economic activities on the ground that such an economy would be just and could potentially achieve equality which was emerging as an underlying principle. The relationship between economic power and political power was also recognised in post-independence Tanzania. Demand for consolidation of political power played an important part in arguing for an increased role of the state in the economy (Pratt, 1976). It was held that a market-based system would interfere with true political independence of the state as it would permit a powerful social class to emerge.

The demand for a redistribution of wealth and increased control of the economy by the state to check the increasing inequalities and consolidate political independence went hand in hand (Chachage 1986, cited by Chachage, 2003). In this respect, redistribution, which was conceived of in the form of state control of the economy, would act as a vehicle towards both social justice and a greater political control. State-control of the economy through state capital, Africanization of the civil service, and the introduction of co-operatives as vehicles for economic development were viewed as important elements of political consolidation (Pratt, 1976).

In view of the two contending perspectives, the government selected a middle

ground in an attempt to appease both sides. The government agreed to the demands for rapid Africanisation and indigenisation of the civil service, and the rapid expansion of the co-operatives. By 1964, Africanisation of the civil service was achieved and the law governing cooperatives, the co-operative societies ordinance of 1963, was changed to make the registration of co-operatives a political decision rather than evolving from the people (URT, 1966, cited by Hartmann, 1990). On the other hand, the government strengthened the position of the market perspective by introducing the Foreign Investments Protection Act (FIPA) in 1963.

The FIPA provided compensation for foreign investors in the event of the nationalization of their investments. It also permitted the repatriation of profits by foreign investors. Subsequent government plans also relied on private capital, a move that was interpreted as being supportive of the market perspective. The first five-year development plan (1964-1969) was prepared on the basis of continued private investment (Bagachwa, 1992). Agricultural, manufacturing and trade policies were also prepared in anticipation of private investment. However, market coordination continued to be argued against during the first six years of political independence. This led to the formal acceptance and implementation of a state-controlled system through the Arusha Declaration.

**The Arusha Declaration**

The pressure to adopt a system of economic coordination which would provide equal opportunities in terms of access to resources and benefits is in line with the claims of the radical perspective discussed previously. The Arusha Declaration, introduced in February 1967, gave effect to the ideology of socialism and self-reliance (Ujamaa na kujitegemea) as the cornerstone of the country's sociopolitical and economic policy (Kiondo, 1993). The objectives of the Arusha Declaration included building an egalitarian socialist state in which people are either workers or peasants, and one in which exploitation would not be tolerated. It also included a policy of self-reliance, rural and economic development.

The Arusha Declaration represented a formal rejection of the classical liberal system of market coordination in favour of a model that can be identified as more in line with the radical perspective of Figure 2.1. The Arusha Declaration contained a vision of a country in which every citizen would have a decent living. It also contained a strategy to achieve this vision: governmental planning and control of the economy (URT, 2002). The Arusha Declaration was premised on what was described as "the TANU[6] Creed" (TANU, 1967). The creed consisted of a number of broad underpinning principles:

---

[6] TANU stands for Tanganyika Africa National Union, a political party formed in 1954 to coordinate and spearhead the struggle for independence in Tanganyika then. TANU merged with the ASP (Africa Shirazi Party) of Zanzibar in 1977 to form CCM, the currently ruling party.

(i) That all human beings are equal;
(ii) That every individual has a right to dignity and respect;
(iii) That every citizen is an integral part of the nation and has the right to take equal part in government at local, regional, and national level;
(iv) That every citizen has the right to freedom of expression, of movement, of religious belief and of association within the context of the law;
(v) That every citizen has the right to receive from society protection of his life and of property held according to law;
(vi) That every individual has the right to receive a just return for his labour;
(vii) That all citizens together possess all natural resources of the country in trust for their descendants;
(viii) That in order to ensure economic justice the state must have effective control over the principal means of production; and
(ix) That it is the responsibility of the state to intervene actively in the economic life of the nation so as to ensure the well-being of all citizens and so as to prevent the exploitation of one person by another or one group by another and so prevent the accumulation of wealth to an extent which is inconsistent with the existence of a classless society.

A critical element of this creed was the state ownership of major means of production. Common ownership of the major means of production through a democratically-elected government formed the hallmark of the envisaged egalitarian state. Despite the need for private capital expressed previously, private ownership of property including corporations (an important element of a market-based economy) was viewed as an impediment to the construction of society in which equality of opportunity and benefits would be valued. Nyerere observed that:

> "It is true we need these enterprises. We have passed an Act of parliament protecting foreign investments in this country… but could we agree to leave the economy of our country in the hands of foreigners who would take the profits back to their country? … And … how can we depend on gifts, loans and investments from foreign companies without endangering our independence? The truth is we cannot…. And the policy of inviting a chain of capitalists to come and establish industries in our country might succeed in giving us all the industries we need, but it would also succeed in preventing the establishment of socialism" (Nyerere, 1968).

TANU (1967) defined the major means of production to include: land, forests, mineral resources, water, oil and electricity, communications, transport, banks, insurance, import and export trade, wholesale businesses, steel, machine tools, arms, motor cars, cement and fertiliser factories, the textile industry and any other large industry upon which a large section of people depended for their living and which provided essential

components for other industries, and large plantations especially those that produce essential raw materials.

The implementation of the Arusha Declaration involved the nationalisation of major means of production including corporations. The nationalised corporations included all banks operating in the then Tanganyika, (except the Co-operative Bank), insurance businesses and firms that were involved in foodstuffs including Tanzania Millers, Chande Industries, Pure Food Products and Rajwani Mills. Firms that were involved in the external and the wholesale trades were also nationalised. There were also firms in which the government intended to acquire majority shareholdings: Tanzania Brewery, British America Tobacco, Kilimanjaro Brewery, Bata Shoe Company, Tanganyika Metal Box, and Tanganyika Cement (TANU, 1967). Although not all corporations were nationalised, the nationalised corporations were a dominant phenomenon following the Arusha Declaration.

State-ownership of corporations was not a new phenomenon, but they became more widespread after the Arusha Declaration was introduced. The Mwanachi Development Corporation, established during the colonial era, was reconstituted as the National Development Corporation (NDC) in 1965 with an expanded mandate to become a holding corporation. By 1971, NDC had 22 subsidiaries. In 1967, there were 64 state-owned corporations in the country; by 1974, the number had reached 139; there were 320 by 1982 and over 400 in 1986 (Chachage, 2003). The wholesale trade was nationalised in 1970 while houses were nationalized in 1971.

The Arusha Declaration was also underpinned by the belief that economic development in Tanzania required people (labour), land, good policies and good leadership. With respect to leadership, a leadership code was introduced which was binding on TANU members and government officers (leaders). The code aimed at preventing the use of public office for private gain. The leadership code had five key elements provided in the TANU (1967) resolutions:

(i) Every TANU member and government leader[7] must be either a peasant or a worker and should not be associated with the practices of capitalism or feudalism;
(ii) No TANU or government leader should hold shares in any company;
(iii) No TANU or government leader should hold directorships in any privately-owned enterprise;
(iv) No TANU or government leader should receive two or more salaries;
(v) No TANU or government leader should own houses which he rents to others.

[7] The leader was defined as comprising members of TANU National Executive Committee; ministers, members of parliament, senior officials of organizations affiliated to TANU, senior officials of parastatals organizations, all those appointed or elected under any clause of the TANU constitution, councillors, and civil servants in high and middle cadres. The leader also means a man or a man with his wife; a woman, or a woman and her husband.

A number of other policies that followed the Arusha Declaration made further clarifications and reinforced it. For example, the introduction of "Ujamaa villages" in the rural areas in 1974 lead to the establishment of Ujamaa Villages and required people in the rural areas to live in recognised and specified locations for ease of providing social services.

**Economic crisis and pressure for change**

As early as the 1970s, there were indications that economic and social development, based on the policy of Ujamaa na Kujitegemea, was problematic. For example, the nationalization policy that was limited to foreign-owned firms in the initial stages[8] sparked fear among the local entrepreneurs that they too would be affected by the nationalization policy. This discouraged them from carrying out any further investment (TANU, 1967; Hartmann, 1990). The Public Ownership Policy in Tanzania had outlined areas reserved for the government, and attempted to encourage private investments in other areas not reserved for government (Nyerere, 1968). Through this policy, the radical form of socialism was moderated. This provided the space for the development of a mixed economy comprising both state and private capital. President Nyerere observed that:

> "….when we benefit (through private capital) by increased 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 matters 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" (URT, 1964-1969 cited by Hartmann, 1990)

The willingness to accommodate some form of market coordination and private capital in the economy was revealed through the application, by financial institutions, of different criteria in evaluating investments for credit purposes. Hartmann (1990) asserts that a number of financial institutions supported private capital in order to improve the chances that their own financial stakes would be safe, as well as improving profitability. These institutions legitimatised their position by referring to the Public Ownership Policy in the Arusha Declaration. However, the support given to private investors through credit was criticised as it was interpreted as giving open support for an exploitative system. Such criticisms, which led to a cessation of credit to the private sector, had negative effects on production. This situation, along with the poor performance of the parastatals and the oil crises of 1973-74 led to an initial economic crisis in Tanzania manifested in the failure, by 1974, of the major development plan.

In the wake of stagnating production, a meeting of private businessmen was

[8] At independence, the majority of corporations were foreign-owned, especially by the British.

called, in Dar es Salaam in October 1977, for the first time since the Arusha Declaration to discuss problems of production. Issues discussed during this meeting included: difficulties in obtaining bank credit and foreign exchange allocation, the interference in the management of corporations by political decisions and the total lack of appreciation of private capital and its contribution to development. Emanating from this meeting was a policy of de-confinement ushering in the first liberalization. The subsequent treatment of the private sector by the government is summarised in the 1979 Daily Newspaper:

> "Mwalimu Nyerere said that the Arusha Declaration defined the place of the private sector in the country's economy. He said he was therefore not worried about the existence of private industries as such, as long as there was committed party membership and leadership.
>
> …..Mwalimu wondered whether the Party leadership was very clear on this issue. He said he was not sure whether all party leaders knew that private investments were deliberately allowed in some areas where presently public participation was either not possible or called for" (Daily News, 6th November, 1979 cited by Hartmann 1990).

The comment above shows that Nyerere had became accommodating towards private capital because of the important role it could play in the development of the economy. This reflected an increased realisation of the deteriorating production in the country and the potential role of private capital in reviving it. With regard to the contending perspectives, the change in Nyerere's position, in favour of private enterprise, strengthened the position of those who advocated a market-based system of economic coordination. A number of other steps taken by the government confirmed this shift. For example, throughout 1978-79, the Minister of Industry and Trade mobilized and encouraged private investors to invest in the manufacturing sector to alleviate the extreme shortage of goods in the country.

As part of the general trend to attract investors, the Ministry published two booklets: a manual for investors in Tanzania (1980) and a handbook for the promotion of industrial projects (1980). These documents defined an investor as including local or foreign governments, institutions, companies and individuals wishing to invest capital and management or technical skills in the country. However, the somewhat capital-friendly stance required investors to operate within the framework of socialist planning: the government continued to dictate the conditions under which the private capital was to operate and consequently shape the development of the economy.

The centrally-controlled system faced a severe test at the start of 1979 and this continued through the early 1980s. The economic crisis was manifest in the balance of payments crisis that curtailed the purchasing power to import essential goods. In 1980, the volume of imports, other than food grains and petroleum, was 16% lower than in 1978 (Hartmann, 1990). The shortage of foreign currency affected the manufacturing

sector to a large extent due to its heavy reliance on imports. Transport problems and lack of fuel led to an extreme shortage of consumer goods and resulted in the emergence of black markets in which goods were sold at rocketing prices (Bagachwa, 1992). The magnitude of the crisis led to serious and active questioning of the system of socialism, and forced a re-evaluation of the system of economic coordination based on central planning and state entrepreneurship. Table 2.2 lists the indicators of the crisis and identifies their causes.

**Table 2.2**
**The economic crises in Tanzania in the early 1980s and its causes**
*Source: Based on World Bank, 1991; cited by Bagachwa, 1992*

| Indicators of the crisis | External causes of the crisis | Internal causes of the crisis |
|---|---|---|
| Real GDP growth declined from an annual average of 5.1% between 1970 and 1976 to 1.2% between 1980 and1985. | The country's worsening terms of trade; e.g. in 1985 the purchasing power of Tanzania's exports were one-third that of 1977. | Neglect of the agricultural sector which received a low level of investment; low prices for produce, little investment in supportive infrastructure, and extension services; poor marketing arrangements for agricultural produce and poor distribution network for agricultural inputs. |
| Real per capita income growth declined from 2.5% in 1965 to –1.5% between 1980 and 1985 | Sharp increases in petroleum prices experienced in 1973 – 1974 and further oil price doubling in 1979-1980. | Emphasis on large scale industry which was both capital and import intensive thus aggravating the problem of foreign exchange shortages, under-capacity utilization and technological and managerial dependencies. |
| Inflation rose from an average rate of less than 10% per annum in 1970-1976 to 31% between 1980 and 1985 | Military spending occasioned by the Uganda war in 1978-1979, which cost the country about US$500 million-equivalent to one year's total export earnings at the time. | Excessive rise in public administration which doubled its share of GDP between 1971 and 1983. |
| The overall budget deficit rose by more that sixfold during 1979-1985 | The break up of the East African Community in 1977 which ended Tanzania's legitimate trade with its neighbouring partners. | Villageisation programme which forced most peasants to move to unplanned communal production centres causing immense disruption, at least in the medium term, which resulted in loss of output. |

| Indicators of the crisis | External causes of the crisis | Internal causes of the crisis |
|---|---|---|
| Pressure on the balance of payments intensified as the balance on the external account deteriorated abruptly from a surplus of US $137 million in 1977 to a deficit of US 395 million in 1985 | Severe droughts experienced in 1973-1974, 1981-1982 and 1983-1984. | Expansion of public sector beyond technical managerial capacities, which was invariably associated with proliferation of unproductive bureaucracies, financial losses, shortages, and growth of the secondary (parallel) markets.<br><br>Excessive government intervention in the form of quantitative restrictions on all categories of imports, government monopolisation of internal trade and distribution (Confinement) and widespread domestic price controls. |

The government was faced with contradictory views in terms of how to address the crisis, i.e. whether to intensify state control or to abandon it in favour of the market. In a move that reflects the strength of the market perspective, CCM's[9] National Executive Committee (NEC) held a seminar at Arusha in 1980 to discuss, among other things, a policy on private capital. During this seminar consensus was reached on allowing private enterprise and capital to participate in both the agricultural and the manufacturing sectors. This marked the beginning of the formal acceptance of the private sector in the country and of gradual attempts to roll back the government. The advocates of this policy applied the notion of "strategic retreat". It was considered that, in certain instances, it is necessary for socialism to take a step back in order to leap forward. The Minister of Planning and Economic Affairs at the time observed that:

> "In general to allow the existence of private capital is a temporary measure. This step should not be seen as an attempt to destroy the policy of Ujamaa. As far as the Agricultural Sector is concerned, private capital should not be allowed to function there at all. Likewise, trade/commerce should be in the hands of the state. The time has come to fight capitalism and exploitation and their temptations otherwise the roots of capitalism will continue to expand and spread" (Malima, in Hartman, 1990)

Malima's contradictory position reflects the tension that existed in the decision-making organs of the state and failed to persuade either of the contending perspectives. The critics were not convinced by Malima's argument for a temporary compromise with capitalism and viewed it as politically unacceptable. This lead to the issuance by these critics of a document titled 'Mwongozo was CCM', in 1981. This document was, in essence, a direct criticism of market-based private capital and sought to make a link with the radical version of Arusha Declaration.

> "Today capitalist tendencies have grown more in the country than in the period before

[9] See footnote 6

> the Arusha Declaration because even though the public sector has expanded, private capital has expanded and infiltrated it. That is why capitalism has dared to come out in the open to slander socialism, to confuse some of the leaders and to try to convince us to change our policy" (Mwongozo wa CCM 1981, cited by Hartman, 1990)

The crisis deepened as the debate continued. The government attempted to introduce partial market-oriented reforms in a bid to address the crisis. Bagachwa et al. (1992) and Kiondo (1993) posit that the first effort to manage the crisis, the National Economic Survival Programme (NESP) of 1981-1982, was an attempt to mobilize the resources to defend the system through austerity measures and an export drive. This programme failed and was replaced by another, more liberal, programme, the Structural Adjustment Programme (SAP), in 1983-1985. This programme also failed to rescue the economy. Bagachwa et al. point out that the SAP depended heavily on external capital inflow which did not materialise as anticipated due to failed negotiations between the government and the IMF. This necessitated comprehensive reforms towards a market-based system of economic coordination.

### *2.3.2 Market-based system of reforms*

Following the government's agreement with the IMF and the World Bank in 1986, a market-oriented system of economic coordination modelled on the classical/neo-classical perspective (Figure 2.1) was re-introduced (Kiondo 1993; Bagachwa et al., 1992; Mukangara, 1993). This development reflected the worldwide victory of the classical liberalism which advocates market's coordination of economic activities (Keat, 1993). The adoption of a pluralistic political system as mentioned earlier is viewed as a move to match the political domain with the economic domain. For Tanzania, the reforms were also aimed at preventing further economic deterioration stemming from years of central planning, and to stimulate the economy and reduce the mounting national debt (Bagachwa et al., 1992).

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 (Starr, 1988). In the context of Tanzania, liberalisation reforms included ones that rolled back the government from active involvement in economic activities: trade sector reforms, agricultural policy reforms, monetary reforms, credit and financial sector reforms, civil service reforms, social sector reforms and institutional reforms.

Trade sector reforms addressed the liberalisation of trade through the removal of price controls[10] and the adoption of a de-confinement policy to encourage competition.

[10] Until the early 1980s, about 400 categories of goods were subjected to price control. Under the confinement policy, wholesale, trade and in some cases retail trade, for essential domestic and imported commodities were restricted to particular state-owned corporations.

Elements of the trade sector reforms included an own funds import scheme, an open general licence and specific export promotion policies. Among the most effective schemes the own funds import scheme has permitted the importation of goods using ones own foreign exchange, a practice not allowed before. This facility represented a de facto trade liberalization arrangement, and has exposed the industrial sector to external competition (Bagachwa et al., 1992).

Agricultural policy reforms addressed producer prices, crop marketing, input distribution and the restructuring of cooperatives (Amani, 1992; Zuberi, 1993). Reforms in the financial sector involved the privatisation of state-owned banks and the introduction of the new Banking Act of 1991[11]. Other reforms involved the exchange rate regime by way of regular adjustment in the exchange rate. Currently, the value of the currency is allowed to fluctuate freely according to demand and supply.

Civil Service reforms were also implemented. These were linked to a reduction in the size of the government and included retrenchment of employees and the creation of incentive packages (attractive compensation based on performance). These reforms also led to the elimination of ghost workers from the government payroll. The reduced size of the government was considered to be in line with a new role for the government which, as classical liberal ideas have indicated, is limited to the protection of private property through the maintenance of law and order and the provision of public goods (Lipumba, 1992). Lipumba (1992) posits that:

> " the main objective of the structural and institutional reforms (in Tanzania) is to create a conducive environment for households, private and public enterprises to efficiently produce goods and services to promote economic growth and social progress".

This comment points to a neoclassical liberal system of economic coordination in which the private sector is viewed as the promoter of efficiency in resource allocation. In a business environment in which organizations will compete for resources and where efficiency in the allocation of resources is key, the less/efficient firms will be driven out of the market (Bagachwa, 1992; Wangwe, 1992). By promoting competition, the welfare of individuals will be maximized by enhancing individual choice, in line with Smith's notion of an "invisible hand"

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 (Wangwe, 1992). A Presidential Commission on parastatal sector

[11] This Act had implications for corporate governance in banks. For example, directors and the top management of a bank must be approved by the Bank of Tanzania (BOT). The act also gives BOT greater power in supervising banks.

reform (PSRC) was established in 1993[12]. 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 (Scott, 1993). 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.

Other methods of divestiture that have been applied include: trade sale, liquidation and total business closure, floatation, restructuring, management by contract, leasing and sale of non-core assets. By December 2003, 289 corporations had already been privatised constituting over two thirds of state-owned corporations earmarked for privatisation (URT, 2004).

The privatisation initiatives of the 1990s and beyond reverse 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 called the Zanzibar Declaration (Tripp, 1997). 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 Zanzibar Declaration is sometimes argued to have allowed the ruling elite to transfer the base of their influence from political processes to shareholding and directorships. However, these can be viewed as mutually supporting and reinforcing[13]. The Leadership Act, introduced in 1995, is a dilution of the TANU leadership code discussed previously. While it does not bar civil servants from engaging in the activities barred by the Leadership Code of 1967, it requires them to publicly declare their property through a government-controlled register. Despite the intention to prevent the use of office for personal gain, recent claims of corruption by senior civil servants have shown that the effectiveness of this mechanism is questionable[14].

The Presidential Commission on the state of corruption in Tanzania pointed to deficiencies in the Leadership Code Act including: the fact that it does not specify the ethical standards that should be adhered to, involves the President in the evolution of ethical standards, provides for a lengthy process of inquiry into indictments, provides

---

[12] However, according to PSRC records, a number of privatizations took place before the PSRC was established – see PSRC Annual review 2001/2002.

[13] The debate surrounding the appointment of the Speaker of Parliament to a directorship position of a private company points to this assertion (Guardian, May 21st 2003).

[14] The claims against a senior civil servant by one politician which prompted contradictory steps by the authorities dealing with corruption, as reported in the press, are indicative of the difficulty in applying this law. Rai, 17th-23rd July; 7th -13th August, 2003, Mtanzania, July, 16th, 2003,

room for the concealment of illegal income by differentiating between declarable and non-declarable assets, provides no explicit power to the Ethics Commissioner and fails to provide for penalties to be imposed on those who breach the ethical code (URT, 1996).

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 security market and establish the stock exchange. The stock exchange (Dar es Salaam stock exchange-DSE) was established in 1996 and began operations in 1997. However, the stock market is still in early stages of development with only seven firms currently listed. The East African Development Bank also issues debt security through the exchange.

Although the reforms have had a significant impact in orienting the Tanzanian economy toward a market-based system of economic coordination, a number of factors still stand in the way of realising a well-functioning market economy. The absence of an efficient transport system in several of areas of the country, which would facilitate the movement of goods and services and which was discussed even before the re-introduction of the market as a coordinator of economic activities, remains a large problem. The communication system especially in rural areas is also not yet sufficiently developed to enhance information flows among the market participants. Such elements are central to the operation of the "invisible hand" in coordinating economic activities. There are also problems with laws and regulations.

Table 2.3 shows the aspects of the legal system where reforms are currently being implemented to evolve laws that are compatible with a market-based economy. Although a legal framework generally exists in Tanzania, challenges remain with respect to enforcing the existing laws. The legal system in Tanzania is ineffective (Rugumamu and Mutagwaba, 1999). The Work Bank (2002) points out that a key deficiency in the legal framework is in the area of enforceable property rights. The process of legal reform has lagged behind such that it cannot support the operations of a market-oriented system of economic coordination.

Banks in Tanzania face problems of non-repayment of credit extended to individual borrowers, and fail to realise collateral on overdue debts. The time required to process the recovery of debts through the courts remains exceedingly long, and the outcome of the legal process is unpredictable. This has led to a general lack of confidence in the judicial system. Other problems with the legal system include a low capacity in terms of resources, manpower and facilities. There is also the issue of vested interests[15], which makes the application of laws difficult. Table 2.3 lists the reforms

[15] The World Bank (2002) has not defined "vested interests". However, it is interpreted to mean personal interests by individuals whose influence in society can shield them from being made accountable at law.

already implemented.

**Table 2.3**
**Major administrative barriers to investments**
*Source: Adopted from PriceWaterhouse Coopers and Lybrand(1997,1999b cited by World Bank, 2002*

| Issues | Status | |
|---|---|---|
| Employment issues | Residency permits | Right to five expatriate employees without extensive scrutiny; improved Department of Immigration with a "green channel" for TIC certified investors |
| | Labour relations flexibility in hiring and firing | Labour laws under review by the government |
| Location issues | Land purchase, transferring deeds, developing land | Land laws revised; Effective implementation necessary to address issues of purchase and transfer. Procedural/regulatory simplification introduced by the registrar of companies, internal trade section, industrial licensing board, and others |
| | Utility hook ups | Privatisation and regulatory framework being introduced for key utilities |
| Reporting to the Government | Business registration, incentives, environmental compliance and tax registration and reporting | Increased procedural/regulatory simplification and improvement in communications under way in the TIC, Registrar of Companies, Ministry of Lands, TRA, National Environmental Management Council, and others leading to improvement |
| Constraints on business operation | Importing and exporting | Imports/exports have improved; single bill of entry, reduced number of goods requiring reshipment inspection, random inspection systems (an automated system for customs duties administration) adopted, computerisation of some customs functions, capital goods tariff rates lowered and qualified system simplified |

| Issues | Status | |
|---|---|---|
| | Profit repatriation | Capital account liberalised; 1997 investment act guarantees unconditional transferability of net profits; serving payments for foreign loans; royalties, fees; technology transfer fees, liquidation proceeds remittance; emoluments, other benefits paid to foreign personnel employed in Tanzania for business to which the Act apply. |

As shown in table 2.3, a number of important changes have been made in Tanzania to make it a market economy. Despite these developments, the World Bank (2002) points to a number of ordinances which are currently weak and outdated covering contract law, bankruptcy laws and labour laws. The World Bank reports that these laws still have vestiges of the previous state-controlled system of coordination. At present the courts are still using the British laws and regulations dating back to 1891. The Tanzanian labour laws, which were developed in the 1960s, are not consistent with the operations of the market system. For example, the procedures for firing and retrenching employees are considered cumbersome and provide only a limited number of ways for disciplining them, hence restricting employers' options for changing the mix of the workforce. The labour laws are currently being reviewed to make the process of laying-off easier and faster.

**The Tanzanian development vision 2025**

The issues concerning economic development that face Tanzania relating to the required economic growth to address the growing levels of poverty across wide sections of the population have not changed since independence (Nyerere, 1967; URT, 1999; 2001). However, the strategy to address these problems has changed. Whereas, during the early days of independence, the radical visions of development were thought to provide the best approach, the adoption of market polices in the 1990s represent a U-turn. The adoption of a market approach in which the private sector is viewed as the engine of economic growth is central to the new vision[16].

Currently, there exists a development view termed vision 2025, which is considered to provide a framework for evolving strategies for social and economic development. In terms of vision 2025, 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

[16] Opening statement by President B. Mkapa of Tanzania at the Consultative Group Meeting in Dar es Salaam, 24th May, 2000.

well-educated and learning society; a competitive economy capable of generating sustainable growth" (URT, 1999). A major weakness of vision 2025 is the lack of a clearly articulated strategy indicating critical requirements for the attainment of the said aspirations. It is unclear what should be executed in order to achieve those goals. Indeed, the vision presents good governance as a requirement for achieving the vision while also presenting good governance as an attribute that must be achieved by 2025.

Despite the lack of a clear-cut means-ends dichotomy, the vision clearly acknowledges the role of the private sector in the economy: in direct contrast to the early vision of the Arusha Declaration. "…harnessing the power of the market, and the dynamism of private initiative… the role of the state must be clearly redefined to permit and facilitate various actors, (e.g. the family, business enterprises and civic organisations) to participate in the market in the context of national and global realities" are important elements of vision 2025 (URT, 1999). In terms of the various perspectives on economic coordination, this vision sits within the challenge perspective discussed previously. This is because the vision recognises private initiatives executed in the market as key players in the economy while at the same time recognising the role of the state in shaping this development and in regulating it.

Within the framework of vision 2025, institutions that are focused on advancing the interest of the private sector and helping to redraw the boundaries of the state in the management of the economy are evolving. The establishment of the Tanzania National Business Council (TNBC), the most senior forum for public-private sector dialogue, constitutes an important development in this regard. The objectives of the TNBC, as stated in Presidential Circular No. 1, 2001, are: to provide a forum for public/private sector dialogue with a view to reaching consensus and mutual understanding on strategies relating to the efficient management of development resources; to promote the goal of economic growth with social equity and even development; to review from time to time developments in the external and domestic environment, the challenges they pose to Tanzania and propose a course of action.

Other objectives of the TNBC include the exchange of views on the prevailing operating and regulatory environment and to propose ways to facilitate the public service to improve service delivery and make the civil service business friendly; to review and promote the attractiveness of Tanzania products on the world market; to encourage and promote the formulation of coordinated policies on social and economic matters, including consideration of existing and proposed economic legislation, and make recommendations through the government to parliament or other appropriate bodies.

The changes that have taken place in Tanzania with respect to the coordination of economic activities have had implications for a number of other issues in Tanzania. The shift of emphasis from communal ownership of the major means of production and state control of the economy to private ownership of the same major resources, and the

market-based coordination of economic activities have implications for corporate governance.

## 2.4 Implications for corporate governance

### *2.4.1 Corporate governance under central-coordination*

The two systems of economic coordination within which business has been operating imply that corporate governance can be discussed under the two forms of economic coordination. The centrally-controlled system of coordination had implications for corporate governance practices with respect to state-owned corporations. This was the most important form of corporation during the Ujamaa and Kujitegemea era. Figure 2.2 indicates the system of governance that evolved with respect to state-owned corporations under the centrally-controlled system. The figure shows three different levels of governance: the people, the ruling party, and the government and parliament (Mwapachu, 1983). The way in which state-owned corporations were to be governed was stated in the Public Corporations Act and by individual Acts that established specific corporations. In this regard, the Public Corporations Act of 1969, amended in 1976, applied until 1992, when the current Public Corporations Act was enacted.

**(i) People and party control**

TANU aimed at placing the ownership of enterprises in the hands of the Tanzanian people through their government and that they would exercise ultimate control of corporations both directly and indirectly. Direct governance involved the use of social pressure brought to bear on the managers of the corporations. Social pressure is recognised as one of the mechanisms by which corporations can be controlled (Demb and Neubaeuer, 1992). For example, complaints about the conduct of managers reported in the media constituted one of the deterrents to the abuse of the power entrusted to managers (Mwapachu, 1983). People could also send reports to the Permanent Commission of Inquiry which was established to address the problem of abuse of power and corruption practiced by civil servants including the managers of state-owned corporations.

Indirect control by the people was exercised through the ruling party, TANU and later CCM. Control through the party was more prevalent during the early days following the Arusha Declaration and was mainly exercised through party directives to the government (Mwapachu, 1983). The notion of party supremacy is applied to express the extent of control that the ruling party exercised (Kiondo, 1993).

Party control was also exercised through the appointment of party representatives[17] who were placed in corporate offices. These officers reported directly

[17] Party representatives were individuals appointed by the party (i.e. CCM) to promote the pary's policies at places of work.

to the national party organs on the performance of the managers of the corporations. They could send confidential reports to the national party organs such as the National Executive Committee (NEC). This way of reporting gave representatives significant influence on the management of state-owned corporations; managers feared the disciplinary action that could be taken against them if they were reported to the NEC.

***Parliamentary control***

Parliamentary control was (and still is) exercised at two stages. At the stage of debating and approving the bill, and during the life of a corporation. At the establishment stage, the government, through a sector ministry under which the corporation would be placed, is required to satisfy the parliament of the relevance of the corporation to be established. This was to ensure that the corporation being proposed fitted the national interests in terms of development plans, and that public funds were directed into important areas. There were problems, however, in relation to those state-owned corporations which were established by presidential order[18]. In this event, the parliament has no way of vetting the usefulness of a corporation.

Parliamentary deliberations about the performance of corporations were (and still are) useful ways of exercising control over state-owned corporations. In 1978, the Parliament established a Parastatal Organisations' Accounts Committee which served as an important control mechanism. This committee verified whether funds utilised were legally appropriated and whether funds have been expended on approved services and projects. The Committee also looked into budget overruns, and the reasons for them, and checked for wasteful utilisation of public funds. In discharging its responsibilities, the committee employed the services of the controller and auditor general (CAG) and those of the Tanzania Audit Corporation (Mwapachu, 1983).

**(ii) Governmental control**

***Presidential control***

Presidential control has been both formal and informal. Formal control applied to specific corporations that, by the Act establishing them, had to report directly to the President. These include the Capital Development Authority (CDA) and the Rufiji Basin Authority (RUBADA). Presidential control was exerted over all other corporations through the appointment of the chief executives/chairmen of the holding corporations. According to the 1992 Act, the President appoints the chairmen of those corporations in which the government is the only shareholder.

According to the 1969 and 1992 public corporation acts, the appointments have to be based on recommendations by the sector ministries. Further presidential control, over state corporations, was exercised informally through consultation and planned

[18] In Tanzania, corporations could be established either by Act of Parliament or by presidential order

visits by the President to these corporations. The President also exercised control through his powers to require corporations solely owned by the government to keep records as the President directed. The borrowing powers of such corporations are also vested in the president.

Mwapachu (1983) reports that during the customary annual consultation sessions between the president and the heads of public corporations, particularly holding corporations, the managers of the corporations were required to present their latest briefs on their performance and problems. These occasions also served as forums for managers to present their problems and receive support in areas such as foreign exchange. The occasional visits provided a means for interaction between the president and directors and senior management of public corporations. During these visits the President is reported to have made orders on steps that needed to be taken. The President also had a fully-fledged advisory economic unit which is regarded as having been useful in gathering information about the performance of corporations and advised the President accordingly. This provided the President with further opportunities and means for exercising control over corporations.

***Ministerial control***

Ministerial[19] control concerns sectoral control over state-owned corporations. The 1969 Presidential Circular No 2 stipulates that each state corporation should be responsible to one sectoral ministry (Mwapachu, 1983). Sector ministers exercise control over corporations through: ministerial directives, ministerial appointment of directors of parastatals, access to information on demand, control of borrowings, budget approval, control over investments and audit scrutiny. Ministers are empowered by law to provide directives of both general and specific character to state corporations. The ministers are responsible for ensuring that the corporations operate in the national interests. Mwapachu (1983) contends that the lack of a clear definition of the national interests left the issue open to interpretation by the responsible minister. This control could be applied in ways that could frustrate management and lead to the poor performance of the corporations. The 1992 Act still requires the minister of the parent ministry to give corporations directives. Section 6 of the Act states:

> "Where the government is the sole shareholder, the minister responsible for the parent ministry 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"

The 1992 Act also gives the minister of the parent ministry the power to appoint directors for corporations in which the government is the sole shareholder. With this

[19] In Tanzania, the President appoints all the ministers with the prime minister only requiring parliamentary approval. Ministerial control can therefore be considered as indirect presidential control.

Act, every proposed appointment has to be forwarded to the treasury registrar. The Act specifies that where the government is not the sole shareholder, instruments under which such corporations are established govern the appointment of directors. When the directors are appointees of the minister, the boards provide the link between the minister and the management of the corporation.

The responsibilities of boards of directors of holding corporations include the development of mechanisms for sending information to the ministers of the parent ministries and reporting about the property of the corporation as well as its operations. Directors were also required to submit, to the minister, accounts (including annual reports) and any other reports the minister demanded. A copy of the audited annual accounts had also to be made available to the sector ministry.

As part of ministerial control over investments, most of the parastatals could not (and still cannot) take out loans or overdrafts without prior approval of the sector minister. In some cases, both the sector minister and the Minister for Finance must approve any borrowings. For example, Tanzania Railways Corporation (TRC) cannot undertake borrowing without the prior approval of the sector ministry as well as of the Minister for Finance. The 1981 laws covering miscellaneous amendments introduced this double control for all state-owned enterprises.

In relation to budget approval, budgets prepared and approved by boards of directors must be in the form and detail specified by the parent ministry; final approval of the budget rests with the minister. Investments of funds by public enterprises are also subject to approval by the parent ministries. However, there were variations with respect to investments. For example, in the case of Tanzania Posts and Telecommunications Corporation[20] there was no such requirement, whereas such a requirement exists for the Board of Internal Trade, National Lotteries, and the National Milling Corporation (Mwapachu, 1983).

With respect to holding-subsidiary relationships, holding corporations act on behalf of the parent ministry. The performance of the holding corporations reflect the performance of their subsidiaries. Prior to 1992, holding corporations, operating under parent ministries, were treated as custodians of government equity in the operating companies (subsidiaries and associates[21]). They were charged with the responsibility of overseeing the individual companies. These holding corporations included the National Development Corporation (NDC), the National Textile Corporation (NATCO), the National Agricultural and Food Corporation (NAFCO), the State Mining Corporation (STAMICO) and the Livestock Development Authority (LDA) (Mwapachu, 1983).

In relation to their overseeing function, the holding companies were required to

---

[8] This company has been split into three separate companies for Postal Services, Telecommunications and the Postal Bank.

[21] A subsidiary company is one a holding corporation has a controlling stake (above 50% equity) while an associate is one in which it has shares but a controlling stake.

carry out a number of activities: planning, promoting, organizing and integrating subsidiaries into a specific sector of the economy, and acting as entrepreneurs on behalf of government. Thus, holding corporations were required to identify new areas of economic investment and to participate in carrying out such investments. They were also required to coordinate the activities of subsidiary companies in terms of defining the economic and financial objectives, guide and direct their performance for optimal capacity utilization, and review and control performance using budgetary controls.

Holding corporations were also required to appoint directors and the top management of subsidiaries, and provide research, marketing and development services, recruitment and training services at the management levels. Auditing, financial management services and the determination of salary structures, in collaboration with relevant Government authorities particularly SCOPO, were other duties of holding corporations with respect to subsidiaries.

***Central control***

Central control refers to the exercise of control by the treasury registrar. This is part of the formal control exercised by the government. Formal mechanisms are ones that have been stipulated in the law that established state-owned corporations, i.e. the 1969 Act and relevant regulations. The post of treasury registrar was first established by the colonial government for the purpose of controlling and allocating the resources of that government. The post independence government adopted the same model[22]. This office, in the Ministry of Finance, is there to acquire, hold and manage investments of the government.

Under the control of the treasury registrar various mechanisms were instituted. These include the establishment of committees designed to enable the treasury registrar to exercise control. For example, the treasury registrar established a special committee on parastatal management agreements for the purpose of evaluating proposals for management agreements with state-owned corporations. It also established a finance and credit plan council, under the direction of the Ministry of Finance. This was to ensure that financial resources, accruing to the government and its institutions, were put to priority use. It also ensured the involvement of financial institutions in financial management and credit allocation. Central controls also included a control function for banks and financial institutions by the Bank of Tanzania (BOT) through the Government Loans, Guarantee and Grants Acts of 1975.

The Tanzania Audit Corporation (TAC), the National Price Commission (NPC) and the Standing Committee on Parastatal Organisations (SCOPO) were also involved in the control of state-owned corporations. The control role of the TAC related to powers and obligations to provide audit and auxiliary services including advisory and accounting services. NPC exerted control on enterprises through its powers to fix and

---

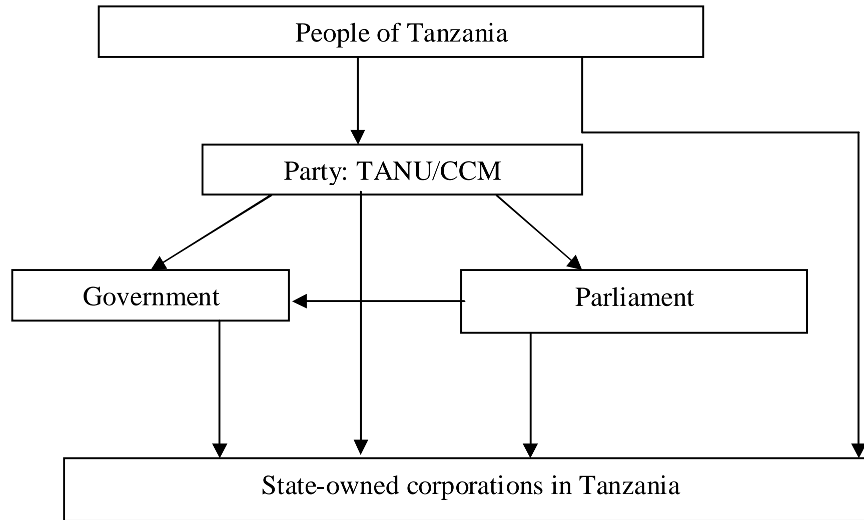
[22]Treasury Registrar Act of 1959, 1980

control prices of products and goods both produced within the country and imported.

The argument behind the establishment of the NPC was to ensure that corporations realised profits by increasing efficiency rather than through exploitative pricing. In that way, NPC would protect consumers from unreasonable pricing as well as limit the competition that existed between private and public enterprises. While this objective was plausible it was not achieved. Wangwe (1992) points out that price controls did not offer incentives for efficiency because inefficient managers could price their goods/services at the stipulated prices where they could have been lower if efficiency was effected.

In the early days of the Arusha Declaration, the remunerations of employees of state corporations were set by SCOPO. SCOPO was established immediately after the nationalisation policy of the Arusha Declaration to: formulate training programmes for employees of state-owned corporations, review salary and benefits of parastatals to bring them into line with those of other public servants with comparable skills, review and approve the conditions of employees seconded from public service to state-owned corporations, approve transfers between parastatals and the Ministry of Manpower Development and to review localisation arrangements with state corporations to bring them in line with the government policy requiring all posts be filled by competent citizens. According to the 1992 Act, all the activities that SCOPO once performed have become the domain of boards of directors of these corporations. Figure 2.2 depicts the governance system of state-owned corporations.

**Figure 2.2**
**Corporate governance of state-owned corporations**
*Source: Based on Mwapachu, 1983; Public Corporations Act 1969 and 1992*




Key: Arrows imply control relations

**Reflection on the corporate governance system**

The corporate governance of state-owned corporations reflects the role of the state in

coordinating economic activities. The former corporate governance system of state-owned corporations 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[23] occur which lead to an absence of monitoring (Hart, 1995). It cannot, be expected that the people would have the motivation and adequate information about the performance of corporations to exert sufficient pressure on management.

At the presidential/ministerial level, there are also problems of information and incentives. For example, with regard to holding corporations, the President appointed the CEO/chairmen while the sector minister appointed other directors. The directors could not exercise control over the decisions of the CEO/chairman. The minister under whom the corporation was placed could not discipline the CEO if they wanted to, except by making recommendations to the appointing authority. Kihiyo (2002) raises the problem of information not reaching the President in time for action. However, it can be argued that information might not reach him at all and, even if it did, it could easily be distorted in line with the interests of the people in the chain of command in the matter being reported. The system was therefore informationally deficient, permitting problems to go unchecked.

In addition to the problems relating to the structure of the corporate governance system, state-owned corporations operated without clear objectives. Social and economic objectives were imposed, instructions to management from government ministries conflicted those from other government agents, political interference was rampant and the role of the state as shareholder and regulator of business was ambiguous (Wangwe, 1992). The result was a lack of specific criteria for assessing performance. The system was also bureaucratic in that decisions had to follow a number of steps before action could be taken. This slow pace of decision-making translated into a lack of the flexibility needed to take advantage of opportunities.

The ineffectiveness of the corporate governance of state-owned corporations contributed to their poor performance. Gregory and Simms (in Monks and Minow, 2002) suggest that the effectiveness of corporate governance will be reflected in a firm's performance[24]. 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. By the late 1980s, the public corporations were regarded as such a burden on the state that they had to be divested. These governance problems

[23] 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.

[24] There are no clear measures to establish the link between performance and corporate governance. However, it is believed that corporate governance has a significant influence on the performance of corporations.

resulted from a system that made managers accountable to those who appointed them rather than to the people; these “management problems” point to the lack of control and accountability (Chachage, 2003).

### *2.4.2 Corporate governance under the market-based system*

At the level of the corporation, the ongoing reforms have implications for the form of corporate governance that will evolve. High levels of poverty characterise the social context in which economic reforms are taking place in Tanzania (Mtatifikolo, 1992; World Bank, 2002). This limits the extent to which the majority of local people can effectively participate in the process of reforms, with particular reference to the privatisation of the state-owned corporations. Because of the shortage of local capital, privatisation through strategic investors[25] has become an important method for privatising state-owned corporations.

Privatisation through strategic investors has implications for corporate governance: it provides an opportunity for a small number of individuals and corporations to acquire significant holdings in the privatised corporations and hence result in a concentration of ownership in the corporations. This issue was of concern during the early years of privatisation. Ngemera (1993) cautioned that if privatisation was not carefully handled, it could end up by creating an economy which was either foreign dominated, or locally dominated by a small group of people. Notwithstanding these warnings, the majority of the privatised corporations have single controlling shareholders[26]. Although poverty is generally considered to have reduced the ability of indigenous people to acquire the privatised corporations, leading to a greater reliance on strategic investors, other reasons for the reliance on strategic investors have been suggested. Chachage (2003) observes that:

> “…what we are seeing is a situation whereby stupendous wealth is accumulated by a tiny fraction of the population through exploitation and pillage of human, mineral, and natural resources during mounting poverty, destitution and structural adjustment”

The above comment implies that a number of individuals have exploited the reform process for private gain. The process of privatisation has been criticised by members of the public, including members of parliament, for being indifferent to the interests of

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

[26] The PSRC annual reports for 2002/2003 indicate that the majority of privatized corporations have controlling shareholders.

local people (Simba, 2003)[27]. Table 2.4, provides a list of some of the companies that have been privatised, and the extent of ownership concentration in such companies. The majority of the corporations in Table 2.4 have been referred to as major corporate taxpayers by the Tanzania Revenue Authority (TRA)[28] which points to their importance in the economy particularly with respect to their contribution to the government revenues (URT, 2003).

**Table 2.4**
**Structure of ownership in successful privatised firms in Tanzania**
*Source: The Economic Survey, 2001 and annual reports*

| Company name | Ownership in % | | | | Company name | Ownership in % | | |
|---|---|---|---|---|---|---|---|---|
| | Private shareholders | Govt | Other shareholders * | | | Private shareholders | Govt | Other shareholders |
| TCC[+] | 75 | 2.5 | 19.5 | | Tanzania Cables | 51 | 49 | - |
| TBL[+] | 52.8 | 4 | 43.2 | | Kilombero Sugar Estate | 75 | 25 | - |
| ABB Tanalec Ltd | 70 | 30 | - | | Tanzania Portland | 55 | 45 | - |
| Blankets and Textile | 100 | 0 | - | | Mbeya Cement | 100 | 0 | - |
| MKONO (formerly called HANDICO) | 100 | 0 | - | | TANESCO Wood Plant | 100 | 0 | - |
| Morogoro Canvas | 100 | 0 | - | | NABICO | 100 | 0 | - |
| DAHACO | 51 | 0 | 49 | | Tanzania Pharmaceutical | 60 | 40 | - |
| Mtibwa Sugar Estate | 95 | 5 | - | | Sungura Textiles | 100 | 0 | - |
| Maponde Tea Factoty | 100 | 0 | - | | NBC | 55 | 30 | 15 |

+ Listed on the DSE and with the largest shareholder being foreign-based.
* These include individuals, other corporations and institutional investors.

## 2.5 The legal framework for corporate governance

The legal framework for privately-owned corporations in Tanzania is linked to the colonial past. Djankov et al. (2003) point out that when European powers conquered and colonised other nations, they brought with them a large number of their political, legal and regulatory institutions, and most importantly their laws. England transplanted

[27] The rise of the indigenisation debate in Tanzania is reflective of the indifference by the government to local interests. The whole privatization process in Tanzania has been criticized for a number of reasons. See Daily News, August 5th, 2003; Majira, August 5th, 2003

[28] TRA has established a special unit that deals exclusively with these major corporate taxpayers.

its laws to the United States, Canada, Australia, and other members of the Commonwealth including Tanzania. In this respect, the company ordinance of 1932, whose origin is in mid-1800s Great Britain, is relevant in Tanzania. For this reason, the corporate governance framework in Tanzania has some semblance to that of the UK as is discussed in Chapter 3.

Essential elements of the legal framework include the incorporation and governance of corporations. The model that applies in Tanzania was developed in England in the 17th century and was transplanted to Tanzania through colonial channels. In England, an 1844 Act laid down the mode of a company in which people who subscribed their names to a memorandum of association became its shareholders (Tricker, 2000). The concept of limited liability for members was introduced in 1854.

In general, the underlying principle of incorporation has not changed. This principle is reflected in the Company Ordinance (Cap. 212) as well as in the Company Act of 2002 which repeals the Company Ordinance when it comes into operation. This law reflects the English individualism (at the onset of enlightenment) of the 13th century characterised by the market, urbanizing society and eventually industrialization (Tricker, 2000). Ownership in a company provided shareholders with property rights which permitted them to participate or be represented in the company decision-making organs such the board of directors and annual general meetings. Company law, Cap. 212 section 26, states:

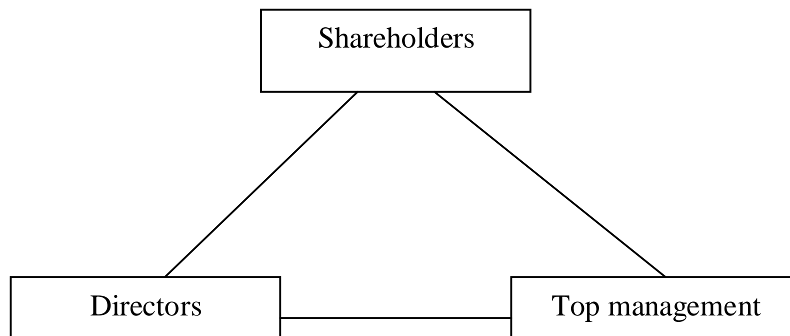
(1) The subscribers to the memorandum of a company shall be deemed to become members of the company and on its registration shall be entered in its register of members
(2) Every other person who agrees to become a member of a company and whose name is entered in its register of members, shall be a member of the company

The Company Act, 2002[29] has not departed from Cap. 212 significantly. Section 24 (1) and (2) of the Act defines members of the company as those who have subscribed to the memorandum of the company; sec. 133 (1) (a-f) describes the meetings of members where disclosure is executed by directors through financial reporting and the directors' report as means of accountability. Founders of a company prepare MEMARTS which detail the way in which the company is governed internally, and the way in which it relates to the outside world. The MEMARTS have to be drawn up within the framework of company law and to suit the shareholders of a company. Other relationships between the company and various other constituencies e.g. employees and managers are regulated by employment contracts and other relevant contracts. This approach to corporate governance has been referred to as the contractarian approach (Bradley et al., 1999).

[29] The new law has been passed by Parliament and accented to by the President of Tanzania. However, its operationalisation awaits regulations from the Minister for Trade and Industry.

Figure 2.3 depicts the model of corporate governance that applies in Tanzania. It involves the relationship between shareholders as providers of capital and directors and management as agents of shareholders. Table A of Cap. 212 requires companies to be managed by directors appointed by members. The ordinance specifies a number of issues with regard to the power of directors and members (shareholders) in the governance of the companies. In terms of Figure 2.1, the model that applies in Tanzania, as provided in Figure 2.3, falls both within the classical and challenge perspectives of economic coordination. Both these perspectives respect the freedom of the individual, including their property.

**Figure 2.3**
**Relationship between shareholders, directors and top management**
*Source: Clarke and Clegg, 1998*




The Company Act 2002 requires directors to act in good faith and in the best interests of the company. Cap. 212 does not specify this role. Section 182 of the Act states:

> "Subject to this section, a director of a company, when exercising powers or performing duties, must act honestly and in good faith and in what the director believes to be in the best interests of the company" [Company Act, 2002, sec 182 (1)]

The new Company Act also expands the scope of the accountability of directors to include their accountability to employees and assigns equal importance to the interests of both parties. Section 183 of the Act states:

(1) "The matters to which the directors of the company are to have regard in the performance of their functions include, in addition to the interests of members, the interests of 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 the company by its directors"

Consistent with vision 2025, the establishment of the Business Registration and Licensing Agency (BRELA) under the Government Executive Agency Act No. 30 of 1997 is an attempt to promote the private sector and entrepreneurship in the country in line with the new philosophy of a market-based system. BRELA is a semi-autonomous agency, under the Ministry of Industries and Trade, charged with the responsibility of facilitating and regulating business activities in the country. The responsibilities of the agency include: registration of both local and foreign companies; registration of business names; registration of trade and service marks; granting of patents; overseeing copyrights and neighbouring rights administration in Tanzania; issuing business and industrial licenses.

The four forms of companies that are recognised under Tanzanian company law are private companies, public companies, foreign companies and state-owned corporations. Private companies are defined as those that restrict the right to transfer shares, limit the number of its members to fifty and prohibit inviting the public to subscribe for any shares or debentures in the company (Cap. 212 sec 27 [1(a-c)]. The shares of private companies are not tradable on the stock exchange.

Public companies are those without a maximum limit on the number of shareholders but required to have a minimum of seven shareholders to be allowed to operate. These companies can be listed on the stock exchange, as their shares are freely transferable. In this respect, they are required to issue a prospectus, which is an invitation to the public to subscribe to shares on issue. It is these types of corporations that are listed on the Dar es Salaam stock exchange.

The third category of companies recognised under BRELA is foreign companies, these are companies operating in Tanzania as branches of companies incorporated outside Tanzania. They are not viewed as Tanzanian companies. The final category of company is a form of private company in which the government holds more than 50% of the voting shares. The Corporations Act of 1992 applies to these corporations. This form of corporation was the most important between 1967 and 1992 but is currently diminishing as privatisation continues.

## 2.6 Conclusion

Tanzania is a developing economy with agriculture its mainstay. Other sectors of the economy are gradually beginning to make a significant contribution to the economy. Two systems of economic coordination have existed in this country over the past forty-three years of independence: a centrally-coordinated system and then a market-based system. The developments in 1967 led to the adoption of policies that sought to encourage the evolution of an egalitarian society based on state-ownership of the major means of production including corporations.

Developments in the late-1980s have changed the course of events. The

economic reforms that were introduced in 1986 have the objectives of promoting and encouraging competition, and reducing the role of the state in economic activities giving individualism more room to thrive. This type of economic coordination is advocated in classical/neoclassical liberalism[30].

The implications of such change for corporate governance is the evolution of large shareholders. The majority of privatised corporations have controlling shareholders. The company ordinances (Cap. 212), currently provide the framework in which corporations are governed. This framework promotes a liberal, shareholder-oriented system of corporate governance. This is because the framework recognises shareholders only in the key decision-making organs of the corporation: annual general meetings and boards of directors.

[30] The Pastoral Easter letter of 2003 pointed out that individualistic attitudes are increasingly becoming part of the behaviour of the Tanzanian society; see Rai, April 24th –30th, 2003: Corruption, which is now said to have affected the whole social fabric, as shown by the report on the state of corruption in Tanzania (URT, 1996), is a manifestation of individualistic tendencies.

# CHAPTER 3 CORPORATE GOVERNANCE DEVELOPMENT AND THEORIES

## 3.1 The concept of a corporation

The concept of corporate governance is intertwined with the concept of a corporation. It is therefore useful to elaborate on how the concept of a corporation evolved in order to appreciate the issues about corporate governance. A corporation has been conceptualised in different ways. In law, a corporation is viewed as a fictitious person created by law; in other conceptualisations a corporation is viewed as a governance structure. There also exist views in which a corporation is a bundle of contracts (Monks and Minow, 2002). A corporation can also be viewed as a social institution (Bradley et al., 1999). The definition applied in this research is specified in Section 3.7.2.

The concept of a corporation evolved in different contexts and hence, different circumstances shaped its evolution. Subsequent developments with regard to the concept of a corporation tend to reflect the circumstances in which it initially evolved. The concept of the corporation first evolved in Western Europe from where it spread to the rest of the world (Tricker, 2000; Grant, 2003). In the early 17$^{th}$ century, corporations existed in Europe, albeit as entities that mostly served the public good such as hospitals and universities. However, some of the notable companies were trading companies chartered during this era (Tricker, 2000; Grant, 2003).

The concept that emerged in the 19$^{th}$ century was through the notion of a joint stock company (Tricker, 1994; Scott, 1996; Tricker, 2000). An 1844 Act in England allowed corporations to define their own purpose, giving them a free hand to engage in business for profit; and a second Act in 1854 gave shareholders limited liability which protected their personal assets from the consequences of a corporation's activities (Chapter 2). The invention of the corporation with limited liability was a major innovation in terms of mobilising the capital which was required to fund activities in an emerging economy then thriving on the industrial revolution and urbanization (Tricker, 1994).

The surge of business incorporation during the industrial revolution was driven by the need for large amounts of capital (Grant, 2003). Limited liability enabled the raising of the considerable amounts of capital required to finance the construction of railroads, town utilities, street lighting, iron-based manufacturing, dock facilities and other major developments. As the corporation emerged to address the problem of capital arising from individuals, those who provided the capital came to be known as shareholders and it was recognised that their private capital transformed the company into their property (Scott, 1996; Clarke and Clegg, 1998).

A corporation with limited liability also served as a form of owning a business

which had not hitherto existed. Tricker (2000), and Monks and Minow (2002), point out that before the joint stock company emerged the only forms of ownership were sole traders, partnerships and unlimited or unincorporated companies. These exited throughout Europe and North America during the early years of 19th century.

Colonial influences helped to spread the concept of the corporation, and the connected aspect of corporate governance, throughout the world. The British colonial influences, through the common law system, was instrumental in introducing this concept in various parts of the world such as the South Africa, US, New Zealand, Australia and other Commonwealth countries (Tricker, 1994; Djanov et al., 2003). For this reason, corporate governance practices in these countries reflect the early British experience with this concept. The corporation as known today in the US and the Commonwealth countries clearly originated in England (Grant, 2003).

In Germany and other continental European countries, also referred to as social democracies (Roe, 2003), and Japan the concept of a corporation emerged from a situation characterized by the involvement of the state and banks in industrial firms on a long-term basis for the development of capitalism (Scott, 1996). In contrast to the UK and the US, where capital was initially accumulated largely in the hands of individual entrepreneurs, in Germany and other continental European countries there was little capital in the hands of individuals (Gilpin, 2001). In these circumstances, the banks became the principal sources of the large amounts of investment capital required to expedite industrialisation. Laws and regulations promoted by the government in Germany (such as codified laws that reduce uncertainty and create a stable business climate) successfully encouraged a high saving rate, rapid capital accumulation and economic growth (Gilpin, 2001). In these contexts, corporations have come to be viewed as social institutions that pursue some socially-sanctioned goal (Fisher and Lovell, 2003). These differing environments in which corporations have evolved have shaped the evolution of corporate governance, and hence the two perspectives that currently shape its debate.

## 3.2 Perspectives on corporate governance

Corporate governance in general is conceptualised within two different perspectives: the liberalist/contractarian one and the communitarian one (Dore, 1993; Bradley et al, 1999). The scheme that is applied to differentiate the two perspectives is presented in Table 3.1. The scheme shows the assumptions about human nature, the firm, legitimisation, social welfare and decision norms which are seen as the distinguishing dimensions. The scheme also addresses assumptions about feared alternatives, the role of managers, internal control of organisations and the objectives considered legitimate for an organisation to pursue. The distinction usually reflects the types of market economies: the competitive Anglo-Saxon model and the cooperative model which

applies to Germanic countries (Rhenish model) and Japan (Crouch and Macquand, 1993).

**Table 3.1**
**Perspectives on corporate governance**
*Modification of Bradley et al., (1999) and Fisher and Lovell (2003)*

| Assumption | Liberalist perspective | Communitarian perspective |
|---|---|---|
| Status of the perspective | For its advocates, it is the only game in town, not merely the most efficient but also acceptable. For some, the pure model must be tempered by interventions to (a) minimize problems of short-termism or (b) correct power imbalances. For others, the neo-classical model is a corrupting chimera which acts as a cover to camouflage the interests of the powerful. | Refers to the business relationships in countries such as Japan, Germany, Sweden and the Netherlands (the model might vary within these countries, but these can largely be grouped together). The interests of employees groups, non-equity finance, and sometimes the state, are represented alongside the interests of equity shareholders on senior decision-making boards. |
| Human Nature | Utilitarian individualism. | Human holism. |
| The firm | An economic organization defined as an aggregation of individuals coordinated by a nexus of contracts. | A social, political, historical and economic entity, which exists in a context in which the economic serves the social. |
| Legitimating | Liberty which is achieved via competition. | Justice, which is achieved through cooperation. |
| Social welfare | Invisible hand, market driven. | Need fulfilment and community based. |
| Decision norms | Individual choice. | Individual choice within a societal context. |
| Feared alternative | Government interference and diktat, leading to government control. | Exploitation, alienation and anomie. |
| Manager's role/duty | Portrayed as functionalist, technicist and value-neutral. | Managers are regarded as trustees of a number of different stakeholders. |
| Internal control | Pricing of contractual exchanges. | Trust prevails among those in embedded relationships. |
| Role of law | Promotion of ex-ante contractual freedom. | Promotion of ex-post distributive justice. |
| Number of objectives of agents | One: to achieve/maximise the interests of equity shareholders. | A mix of equity shareholder, employee and non-equity finance (lenders) although the long-term economic interests of the organization are important. |

| Assumption | Liberalist perspective | Communitarian perspective |
|---|---|---|
| Status of financial targets | Regarded as the organization's primary objective, because they will reflect the efficiency with which resources are employed. | Important but greater attention is paid to the medium to longer-term implications of decisions than appears to be the general case in the liberalist perspective. |
| Status of employees | Employees are viewed as resources to be used by the organization in its quest to satisfy shareholder interests. | Employees are viewed as one of the key stakeholders, and their representation is guaranteed on some of the organization's senior decision-making boards, e.g. supervisory boards in Germany. |
| Values | Competition increasingly seen as the bulwark against power balances. Efficient resource allocation facilitates profit maximization behaviour. | Those of shareholders, employees, non-equity financiers and (possibly the state) are likely to dominate. |

### *3.2.1 The liberalist perspective*

The liberalist perspective of corporate governance reflects societal views regarding the coordination of economic activities in the classical/neoclassical liberalist perspective discussed in Chapter 2. This perspective respects self-determination - the rights and interests of an individual are assumed to reign supreme over those of society. These individual rights and interests are also projected at the level of a corporation and should be respected and protected. These rights and interests are attached to the individuals' contribution to the capital of the corporation. Since the corporate form began as a means for mobilising financial resources to carry out the business of the enterprise, acceptance of the risk involved gave the contributing individuals the right to enjoy the benefits of corporate activity (Grant, 2003).

The cornerstone of the liberalist perspective is the assumption that human beings are selfish and are driven by the desire to maximize their personal satisfaction, and hence the notion of utilitarianism and individualism (Bradley et al., 1999). This perspective can be found in the work of Coase (1937, see also Section 3.7.1), who argued that firms exist to minimize the costs of trading in external markets. The firm is viewed as a nexus of contracts, which are negotiated and executed by an entrepreneur in the pursuance of economic goals. Other stakeholders are free to enter into contracts with the firm's management. The role of the legal and regulatory framework is to ensure that these contracts are enforced (Bradley et al., 1999). For this reason, this perspective is also called the contractarian perspective (Chapter 2).

The entrepreneur (individual) is party to all contracts, negotiates separately with each of the firm's stakeholders and has the exclusive right to sell or disband the

organization (Bradley et al., 1999). Since the entrepreneur is a self-interested individual who uses the firm to pursue his economic interests, the liberalist perspective necessarily holds an instrumental[31] view of the firm.

As indicated in Table 3.1, the liberty achieved through competition in the market place is invoked to legitimatise the individual rights and interests. Social welfare is maximised through the invisible hand which coordinates economic activities. The invisible hand is considered to work more efficiently in free markets; i.e. markets in which government interference is minimal (Clark, 1998). However, views have been expressed within this perspective that advocate a role for government in minimising the problem of short-termism and correcting the balance of power among the market participants (Chapter 2). In general, free markets are argued for as they provide possibilities for exercising individual choice to achieve the maximum individual utility. In this respect, Miliband posits that:

> "In this model, markets and the economic systems they make up are sovereign self-equilibrating mechanisms driven by utility maximising rational, self-interested motives of independent actors in the market place. All commodities are bought and sold in the markets of many sellers and multiplicity of buyers with price movements regulating the system and bringing supply and demand into harmony" (Miliband, 1993).

The above comment implies that individual choice as a decision norm is best achieved within a free market. In modern corporations, in which separation of ownership from control has taken place, corporate managers have replaced the entrepreneur (Berle and Means, 1932). These managers are however required to work, in the best interest of the entrepreneur, as functionalists. Those are technical people who must pursue a single objective in organisations: to maximise shareholder wealth. Friedman argues that the only social responsibility of the corporation is to make profit for its shareholders and this is the objective that managers as agents of shareholders, must address (Fisher and Lovell, 2003; Roe, 2003). Thus, the financial interests in the corporation are regarded as the primary objective and reflect a criterion for measuring the efficiency with which resources are being employed (Rubach and Sebora, 1998).

The assumptions of individualism and self-interest in the liberalist perspective imply a conflict of interests between shareholders on the one hand and managers on the other (Bradley et al., 1999). In this respect corporate governance is viewed as a broad theory that is concerned with aligning management and shareholder interests (Sloan, 2001; Grant, 2003). It implies that shareholders' interests are the ends towards which it must be exercised. This is reflected in the definitions of corporate governance that are commonly provided within this perspective as indicated by following selected

[31] The instrumental view suggests that a corporation has no use beyond its functional use as an instrument through which wealth can be maximized (Fisher and Lovell, 2003).

definitions.

1. “Corporate governance is an umbrella term that includes specific issues arising from the interaction among senior management, shareholders, boards of directors and other corporate stakeholders” (Cochran and Wartick, 1988).

2. “Corporate governance is the system by which companies are directed and controlled” (Cadbury, 1992).

3. “Corporate governance seeks to deal with systems, mechanisms and modalities of exercising power and control over the corporation’s behaviour and performance” (Monks & Minnow, 2000).

4. “Corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment.” (Shleifer and Vishny, 1997).

5. “Corporate governance refers to institutions including laws, regulations and acceptable business practices which, in a market economy, govern the relationship between corporate managers and entrepreneurs on the one hand and those who invest resources in a corporations on the other” (Oman et al., 2003).

The definition that Cochran and Wartick (1988) provide appears to recognise a number of entities in the governance of the corporation. However, the focus is on the relationship between management and boards to ensure that shareholder interests are protected. Consideration of third parties is limited to the observance of the laws that protect the interests of such parties (Bradley et al., 1999). The definition provided by Cadbury (1992) does not make clear which parties are expected to exercise direction and control of the corporation. However, given that this definition is provided in the context of the UK, in a study that investigated financial aspects of corporate governance, shareholders are clearly the constituencies being referred to.

The legal framework in the UK (which has a number of similarities with that of the US) indicates that the only constituency in corporate governance is made up of the shareholders (Dore, 1993). Monks and Minow (2002) contend that the primary parties in corporate governance are shareholders, directors and managers. While shareholders are regarded as owners, the directors and managers are treated as agents of the shareholders. In the liberalist perspective, corporate governance refers to the various mechanisms which help to ensure that these interests are realised (Denise, 2001; Sloan, 2001).

### *3.2.2 The communitarian perspective*

The communitarian perspective represents an alternative market-based system of corporate governance (Tricker, 1994; Bradley et al., 1999; Monks and Minow, 2002).

This perspective reflects concerns for the common good and attempts to defend society-based approaches to governance processes including that of corporations. The key distinguishing feature of this perspective is the inclusion of a number of different constituencies in the decision-making processes of corporations (Hopt and Leyens, 2004). Two separate theories are applied to support and justify the communitarian perspective: the normative stakeholder theory and instrumental stakeholder theory (Letza et al., 2002).

The normative theory emphasises the intrinsic value in stakeholding, and views stakeholders as "the end". Clarke and Clegg (1998) imply this approach in what they term the philosophical element of stakeholding. They point out that this element requires everyone in society to be involved in the governance of corporations. Clarke and Clegg (1998) posit that "stakeholding 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 economy or corporation.

The normative theory has its origin in the social conception of the corporation, which dates back to the later part of the $19^{th}$ century. Based on the fundamental value and moral order of the community, the social entity theory views the corporation as a social institution in society. Since the corporation is involved in a number of aspects of social life, and affects a large number of people in terms of both welfare and potential risks, a public corporation should have particular social obligations such as fairness, social justice and the protection of employees (Mintzberg, 1984). For this reason, corporate governance must address the needs of a number of stakeholders (Weimer and Pape, 2000; Fisher and Lovell, 2003; Hopt and Leyens, 2004). The term stakeholder refers to a broad spectrum of business constituents that must be considered in the decision making process (Grant, 2003). Stakeholders are categorised into two board classes: the contractual and the community stakeholders (Charkham, 1992, cited by Clarke and Clegg, 1998). Contractual stakeholders have explicit contracts with the firm while community stakeholders have implicit ones.

The instrumental stakeholder theory focuses on how stakeholders' value can be applied to improve corporate performance and efficiency. It treats stakeholders as "means to an end". This theory legitimises the claims of stakeholders on the grounds of stakeholding as an effective means to improve efficiency, profitability, competition and economic success. This view is expressed by Campbell who posits that "I support stakeholder theory not from a leftwing reason of equity, but because I believe it to be fundamental to understanding how to make money in business" (Letza et al., 2002). These authors argue that as the cooperation of stakeholder groups such as employees, customers, suppliers, lenders, stockholders and management are increasingly and vitally important in determining business success and corporate survival, corporate strategy

must ensure that stakeholder interests are incorporated into, rather than ignored in, corporate strategy (Freeman and Evans, 1990). A number of recent theories adopt an instrumentality orientation in advocating stakeholding. Freeman and Evans' (1990) stakeholder theory, as a business strategy, has an instrumental orientation. Turnbull's (1997) corporate governance theory, based on information technology (cybernetics), also has an instrumental orientation. The inclusion of stakeholders in governance as argued for by Michael Porter in order to improve US competitiveness is also reflective of instrumentalism (Clarke and Clegg, 1998).

Since the firm is viewed within the social entity perspective as a social institution that is connected, in an organic fashion, with social, historical, and political life, the question is asked as to how its economic activities serve society. That a firm owes a sense of social responsibility to employees, to consumers, and to the general public constitutes an appropriate attitude to be adopted by those in business (Bradley et al., 1999). In this respect, the premises provided in Table 3.1 for the communitarian perspective are different from those in the liberalist perspective. Human holism is one of the key assumptions: individuals operating within society are shaped by the society they live in. As a result, the interest of society must take precedence over individual interests. Society can only survive if it promotes values that each person in society can recognise: the self is defined by society.

The instrumental stakeholder perspective holds the same claim as the social entity theory with respect to constituency representation in the decision-making processes of corporations. It reflects the belief that a corporation should serve multiple stakeholder interests rather than shareholder interests alone. The communitarian perspective holds that justice and cooperation, rather than competition, are fundamental for the welfare of the society (Dore, 1993). The fulfilment of the needs of individuals, shaped by the community, is seen as an important dimension. While individuals are allowed to make choices, such choices are made within the context of the larger society rather than focusing exclusively on the individual. It is feared that if individuals are allowed to freely exercise choices, independent of the community, exploitation is likely to result (Clark, 1998).

Managers operating within a communitarian perspective are required to take into account the interests of a range of stakeholders in the decision-making processes (Weimer, 1995). These managers are viewed as the stewards of corporate assets for the benefit of stakeholders, rather than as agents working for the interest of shareholders as in the previous perspective (Tricker, 1994). A key challenge in this perspective is the inadequacy of stakeholders' participation in the governance process (Keasy, 1997, Blair, 1995 cited by Letza et al., 2002, Bradley et al., 1999), which usually leads to the use of power by some stakeholders as they attempt to exert influence over decision-making processes (Weimer, 1995). Reflecting the multiplicity of interests, authors writing from this perspective have defined corporate governance as:

1. “The process by which corporations are made responsive to the rights and wishes of stakeholders” (Demb and Neubauer, 1992).

2. “The total of structures, arrangements and conventions that is determinant for the manner in which and the effectiveness with which a corporation, by means of interaction between stakeholders, characterized by stimuli and deterrents is managed and supervised” Moerland (1997 as cited by Pape, 1999).

3. “The exertion of influence by stakeholders on the managerial decision making processes” (Weimer, 1995).

These three definitions show that unlike the liberalist conceptualisations of corporate governance, in the communitarian perspective it is considered that the interests of a wide range of stakeholders are important and viewed as the ends towards which corporate governance must be exercised.

### *3.2.3 Operational research definitions*

The definitions in Section 3.2.2 clearly indicate a diversity in the interpretation of corporate governance. Clarke (1993) contends that corporate governance means different things to different people. The implication of such different conceptualisations is that when a corporation is conceptualised as a property of the shareholders, it is assigned a narrow role in society: to maximise the economic interests of owners. Its corporate governance is also restricted to meeting shareholders (i.e. owners) interests. Conversely, when a corporation is conceptualised as a social institution, the roles of the corporation are increased as well as the number of entities involved in its governance.

The ongoing reforms in Tanzania, which have re-introduced the neoclassical system of economic coordination, have edged corporate governance towards the liberalist perspective in which shareholder interests are viewed as being of primary importance (Chapter 2). This implies that corporate governance is assigned a narrow role of protecting and furthering these interests. This is reinforced by the British common law system inherited at independence (Chapter 2). Based on these considerations, for the purpose of this research, corporate governance in the current setting of Tanzania is defined as:

**The mechanisms which motivate those who have the decision-making role regarding the operations of the corporation to make decisions which lead to the maximization of shareholder wealth.**

The definition applied in this research is related to the mechanisms which encourage senior management to make decisions and pursue strategies that lead to the attainment

of the interests of shareholders. The definition implies that the interests of other stakeholders are considered only within the framework of maximising shareholder wealth. In addressing the issue of corporate governance, particular concepts are used in this research and hence need to be operationally defined. These include ownership, control, conflicts of interest, monitoring, incentives, bonding and the market for corporate control.

Ownership refers to the ownership of an asset, which confers the rights to make decisions over the use of that asset. Control refers to the exercise of use of an asset. The notion of separation of ownership from control of corporations refers to the decoupling of rights to make decisions over the use of an asset from the actual exercise of such right. Conflicts of interest refer to the situation where two or more parties do not have interests that coincide.

Monitoring refers to the solutions to conflicts of interest between principals and agents, which involves specifying in advance the observable measures of characteristics of that performance that will be rewarded or punished and the actual observation and measuring of the agent's performance, and the reward or punishment of the agent according to the outcomes of their decisions (Moldoveanu and Martin, 2001).

Incentives refer to the pecuniary and non-pecuniary rewards/punishments which motivate an agent to act in a particular way rather than another (Jensen and Meckling, 1976). Bonding refers to the contractual specification of the decisions to be made, or action to be taken, by the agent under certain conditions.

The market for corporate control means the mechanisms by which firms are matched to management teams and owners, who can then allocate firm's resources more efficiently to maximise shareholder wealth (Brealey et al., 1995).

## 3.3 Models of corporate governance in practice

A number of dimensions are usually applied to distinguish four broad models of corporate governance that have evolved within the broader framework of the two perspectives discussed previously. Dore (1993), Weimer and Pape (2000), and Bradley et al., (1999) have identified a number of dimensions for distinguishing among the models of corporate governance. These dimensions, however, allow only a stylisation of the models and tend to ignore the complexities within them (Tam, 1999). These dimensions include the view of the concept of the firm, stakeholders who are able to exert influence over managerial decision making processes, the board system, the importance of the stock exchange, the presence of the active market for corporate control, relative ownership concentration, the use of executive remuneration and the nature of relationships that the institutional environment encourages. Table 3.2 shows how these dimensions as found to apply to the various models; broadly identified as the

market/outsider (Anglo-Saxon), the network/group (Germanic countries and Japan) and the Latin models.

The view of the firm addresses the way in which the firm is viewed within a particular model. Two views generally exist: the instrumental view and the institutional view. In the instrumental view the firm is considered as an instrument of shareholders for maximising their wealth. The institutional view sees the firm as a social unit that serves the interests of a large number of stakeholders. The prevailing view has implications for which stakeholders are able to exert influence over decision-making processes. This is only shareholders in the instrumental view, and a number of stakeholders in the institutional view.

The board system refers to the general board arrangements which can either be one-tier or two-tier systems. In a one-tier system the companies form a single board of directors, while a two-tier system implies that corporations form two separate board of directors. Establishment of a single or two boards has implications for decision making process in terms of separation of the decision approval from decision implementation as discussed under each model. The importance of the stock exchange refers to the significance of the stock exchange in the economy. The Federation of International Stock Exchanges (FIBV, 1996 cited by Pape 1999) provides two indicators of the importance of the equity markets to the national economy: the capitalization of domestic companies as a percentage of the Gross Domestic Product (GDP) and the ratio of new equity capital that is raised through public offerings as a percentage of the Gross Fixed Capital Formation (GFCF).

The presence of an active market for corporate control indicates the existence of active capital markets which facilitate change of management and ownership through takeover activity. The relative ownership concentration refers to whether the corporation is owned by a few or many. The use of executive performance-based remuneration reflects the use of performance-based compensation to encourage managers to make shareholder wealth-oriented decisions. The nature of the relationship refers to the whether corporate investment decisions are influenced by short-term or long-term considerations.

**Table 3.2**
**Taxonomy of governance corporate systems**
*Source: Tricker 1994; Weimer and Pape, 2000*

| | **Market/outsider model** | **Network/insider model** | | **Latin model** |
|---|---|---|---|---|
| | **Anglo-Saxon** | **Germanic** | **Japanese** | **Latin** |
| Countries | US, UK, Canada, Australia, New Zealand, South Africa and the Commonwealth countries | Germany, Switzerland, the Netherlands, Austria, Scandinavia | Japan | France, Spain, Italy and Belgium |

| | Market/outsider model | Network/insider model | | Latin model |
|---|---|---|---|---|
| | Anglo-Saxon | Germanic | Japanese | Latin |
| Concept of the firm | Instrumental and shareholder-oriented | Institutional | Institutional | Institutional |
| Board system | One-tier | Two-tier (executive and supervisory board) | Boards of directors, office of representative directors, office of auditors: de facto one-tier | Optional (in France), in general one-tier |
| Stakeholder(s) | Shareholders | Banks, employees, in general oligarchic group | City Banks, other financial institutions, employees | Financial holdings, the government, families, in general oligarchic group |
| Importance of stock exchange | High | Moderate/high | High | Moderate |
| Active external market for corporate control | Yes | No | No | Low |
| Relative ownership concentration | Low | Moderate/high | Low | Moderate |
| Executive remuneration | High | Moderate/high | Low/moderate | High |
| Nature of relationship | Short-term | Long-term | Long-term | Long-term |

### *3.3.1 The Anglo-Saxon model*

The Anglo-Saxon model reflects the liberalist approach to corporate governance and applies to the US, the UK, Australia, New Zealand and Canada, South Africa and other members of Commonwealth (Tricker, 1994; Weimer, 1995; Bradley et al., 1999). Shareholder interests and their sovereignty are emphasised in the decision-making processes of corporations. This results from the view that a firm is a property of those who have invested capital and for the pursuit of their economic interests (Scott, 1996). In this sense, shareholders are the only stakeholders who exert influence over the managerial-decision making processes. Managers are viewed within the model as the agents of shareholders and are required to maximise shareholder value: the only objective they are required to pursue (Fisher and Lovell, 2003).

The success of corporations in the Anglo-Saxon model is measured primarily by returns on invested financial capital. Various approaches have evolved within this

model which are applied to encourage managers of corporations to promote the interests of shareholders including performance-related compensation schemes, transparent accounting standards, and development of effective boards of directors (Roe, 2003).

The ownership of corporations is generally widely dispersed in the Anglo-Saxon model, (Roe, 2003; Weimer and Pape, 2000). For example, private individual shareholders own over 20% of the companies in the UK, and institutional shareholders (investments funds) hold 67% of equity is listed corporations (see Table 3.3). Increasingly, changes are beginning to take place in the UK as institutional shareholders acquire significant stakes in corporations (Clarke and Clegg, 1998). However, the ownership by institutional shareholders of any individual firm tends to be insufficient to promote any identity with the long-term development of the firm. Ownership of shares in any company is only part of a portfolio. These shares are usually held on behalf of individuals and Figure 3.1 shows that the ownership of corporations is largely in the hands of individual investors either directly or indirectly through institutional investors.

The wide dispersion of ownership is usually linked to the existence of laws which effectively protect minority shareholders (Denise and McConnell, 2003). The protection of minority interests is particularly important in this group of countries, a fact that stems from the US market crash of 1929 (Grant, 2003). It is this dispersion of ownership that lies at the root of the Berle and Means (1932) argument (see Chapter 1), and translates into control of corporations by managers rather than shareholders (Minztberg, 1984). Also, in terms of ownership structure, foreign ownership constitutes only 12% of the total ownership of corporations in the UK, and cross ownership and bank ownership are rare (Monks and Minow, 2002).

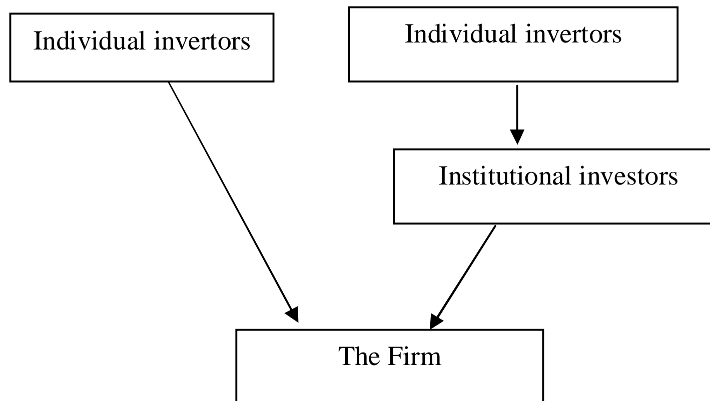
**Table 3.3**
**Ownership structure of UK companies**
*Source: Analytica in Monks and Minow, 2002*

| Shareholder | Ownership |
|---|---|
| Foreigners | 12% |
| Private Investors | 21% |
| Banks | - |
| Corporate | - |
| Investment Funds | 67% |
| Insurance companies | - |
| State and Local Government | - |
| Total | 100% |

The board system in the Anglo-Saxon model is one-tier, with decision management and decision control roles combined: executive and non-executive directors sit on the same board (Maassen, 1999). This combination reflects the original concept of business as founded on the entrepreneurial flair of the founders and hence the combination of decision-making and decision implementation roles in the same person. Recent developments involving the collapse of corporations are viewed as a failure in decision

control (Chapter 1). However, this combination is also viewed as advantageous because of the flexibility brought about by speedy decision-making leading to quick adaptation (Clarke, 1993). Changes that have been advocated within this model include increasing the number of non-executive directors to strengthen control over management (Cadbury, 1992). Separating the positions of board chairman and chief executive officer, as well as formation of various board committees, are important reforms being encouraged within the Anglo-Saxon model (Hopt and Leyens, 2004)

**Figure 3.1**
**The Anglo-Saxon (outsider) model**
*Source: Mayer, 1994, in Tam 1999*




Equity capital markets are well developed and are significant in the economies of Anglo-Saxon countries. In 1998, the market capitalization of domestic companies, as a percentage of GDP, was 146% in the UK; while the ratio of new equity capital through public offerings to the gross fixed capital formation was 13% (Weimer and Pape, 2000).

The market for corporate control is active in the Anglo-Saxon model. Mayer (1994; cited by Tam, 1999), posit that active markets for corporate control are the most important feature of corporate governance within the Anglo-American model, especially for listed companies, and hence the name “outsider” model. Developed countries in which the outsider model applies generally have highly developed capital markets for corporate control (Roe, 2003; Weimer and Pape, 2000). Laws and regulations also facilitate markets for corporate control. KPMG (1995, cited by Pape, 1999) contend that the number of defence techniques applied within this model is lower than that in other countries following other models.

The use of long-term performance-related executive compensation to align shareholder interests with those of managers is of great significance, and reflects a conflict perspective of corporate governance (Maassen, 1999; Pape and Weimer, 2000). The alignment of interests through the use of performance-related schemes is an attempt to persuade managers to think and act like the owners of the corporations (Roe, 2003).

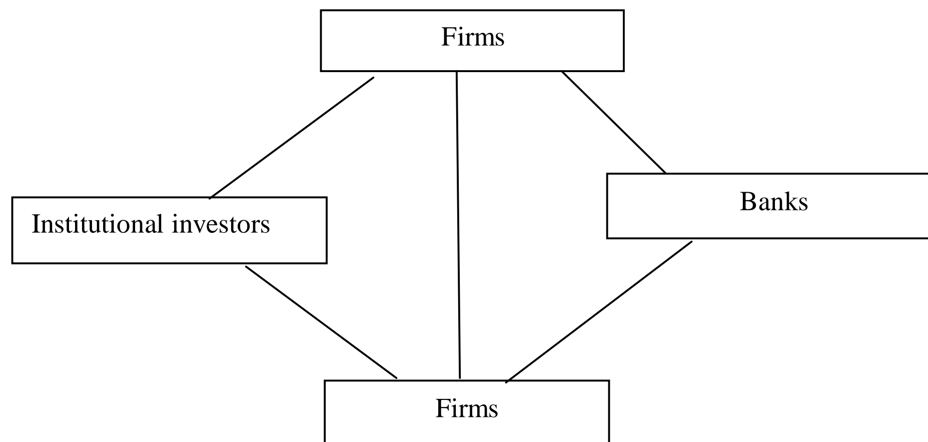
The nature of the economic relationship within this model tends to be short-term.

Empirical evidence on this characteristic is notably absent (Shleifer and Vishny, 1997), although the Anglo-Saxon countries do provide an institutional environment that supports market-oriented relationships (arms-length transactions), characterized by the possibility of quickly adapting to changing circumstances (Clarke, 1993). This nature of the relationship leads to a short-term orientation in investment decision-making processes (Sebora and Rubach, 1998; Gilpin, 2001).

### *3.3.2 The insider model*

Unlike the Anglo-American model in which attempts are made to address the issues stemming from the fragmentation of corporate ownership and executive domination of the corporate boards of directors, the Germanic and Japanese models have developed in different social and economic environments characterised by the participation of large firms and banks in the governance of firms (Scott, 1997; Sebora and Rubach, 1998). The systems aim to directly facilitate production efficiency and harmonize the interests of multiple stakeholders including employees of the company (Tricker, 1994; Scott, 1997). This reflects the communitarian approach to corporate governance founded on the notion of industrial democracy (Roe, 2003; Hopt and Leyens, 2004). Baum (1993) and Tam (1999) point out that large shareholders usually assume a more active role in corporate governance than in the Anglo-Saxon countries. This role transcends concerns about the mitigation of managerial shirking and misconduct. These large shareholders are usually large banks, institutional investors and large corporate firms which monitor and discipline management (Gilpin, 2001). Human capital and the employees' investment in developing firm-specific resources are given their due importance in these systems. Figure 3.2 depicts the insider model.

**Figure 3.2**
**The insider model of corporate governance**
*Source: Modification of Mayer, 1994 in Tam, 1999*



Cross-holding between firms is an important feature of the insider model where institutional shareholders and banks hold significant shares in firms (Gilpin, 2001). Cross-holding also occurs among firms and results in a network of firms brought together by mutual ownership. This creates an environment in which capital tends to develop a long-term orientation. Capital in the German and Japanese models is described as being "dedicated" (Clarke and Clegg, 1998). Dedicated capital is characterised by continued aggressive investment in existing business to boost productivity and upgrade capabilities, internal diversification into closely related fields, building upon and extending corporate capabilities, retention of ownership by principal shareholders over a long-period of time, close ties between banks and companies, with bank finance being the most important source of external finance (Porter, 1992 cited by Clarke and Clegg, 1998).

Although the Germanic and Japanese systems of corporate governance are usually categorised as insider models, they tend to exhibit distinct characteristics and for that reason they are discussed separately. The German system is discussed in detail as representative of the Germanic model. Other countries that have adopted the Germanic model include the Netherlands, Austria, Switzerland and the Scandinavian countries (see Table 3.3).

**The Germanic model**

In countries in which the Germanic model of corporate governance has been adopted, a firm is generally viewed as an institution (Pape, 1999). This institution is considered to have autonomy as a social entity, encompassing the interests of various stakeholders, including shareholders (Moerland, 1995a, cited by Pape 1999). This view is based on the social theory of stakeholder involvement in corporate governance. Stakeholders able to exert influence on the managerial decisions-making processes in the Germanic model include employees, lenders, and shareholders (Rubach and Sebora, 1998; Monks and Minow, 2002). The efficiency of the model is based primarily on the return on social capital (Rubach and Sebora, 1998; Roe, 2003).

Reflective of this institutional view of a corporation, the supervisory boards of directors are constituted by representatives of both shareholders and employees. In Germany, the law requires companies employing at least two thousand employees to have fifty percent of the directors on the supervisory board representing employees (Hopt and Leyens, 2004). In the Netherlands, the supervisory boards of large listed companies are required to have one-third of the directors representing employees (Maassen, 1999), and the remaining two-thirds representing shareholders.

Sebora and Rubach (1998) assert that through the representation of various interests in Germanic firms, an attempt is made to create harmony between capital and labour in the creation of wealth. "The system of co-determination at the level of a firm has made labour a partner in corporate governance in Germany" (Gilpin, 2001).

Employee participation in decision-making processes requires a company to inform employee representatives about important decisions and consult them in making personnel decisions. The form of consultation is determined in law through employee representatives on the supervisory board and through works councils (Oxford Analytica, a UK research firm cited by Monks and Minow, 2002). The works councils have a number of statutory rights on policy information, and must be consulted on and approve major financial re-organisations or takeovers before they are implemented.

Despite the wide powers that employees wield in the Germanic model, shareholders have a slight advantage in decision-making through the appointment of the chairman of the supervisory board who has a casting vote in the event of a tie in the vote. Shareholders can also dismiss members of the supervisory board with a three-quarters majority vote (Oxford Analytica, ibid). However, the power of shareholders in this approach does not equal shareholder power in the Anglo-Saxon model. For example, in Germany, the principle of one-share-one vote has not been followed generally, and the law provides less protection for shareholders (La Porta et al., 1997).

In Germany, the two types of equity usually issued by listed firms are common shares and preferred shares. The law permits both classes of shares to have reduced voting rights. Different classes of shares are also permitted in the Netherlands: preferred shares, non-voting shares, and priority shares. Priority shares are non-tradable but have prerogatives recognised in statues to nominate executive board members, and determine their compensation, the issuance of shares, and additions to reserves (Weimer, 1995).

The board system in Germanic countries is a two-tier one (Pape, 1999; Maassen, 1999; Hopt and Leyen, 2004). The board arrangements consist of a supervisory board, referred to in Germany as "Aufsichtsrat" and the executive boards "Vorstand". The system makes an effective separation between decision management and control as executive directors do not sit on the same board as supervisory board members (Maassen, 1999). The members of the executive board are appointed by the supervisory board, to which it is accountable, and is responsible for day-to-day management of the company (Weimer and Pape, 2000; Hopt and Leyens, 2004).

In terms of the ownership and debt structure of German-listed corporations, banks have been a major source of both equity and credit capital (Baum, 1993; Prowse, 1998; Monks and Minow, 2002). Cross-holdings are also common and certain levels of holdings have to be disclosed: firstly, if a holding exceeds 25%, with a further obligation to notify authorities if the holding exceeds 50% (Oxford Analytica, cited by Monks and Minow, 2002). Prowse (1998 citing Prowse, 1995) points out that typically the largest five shareholders hold 80% or more of equity capital in a German company.

Prowse also pointed out that Germany had a large proportion of listed companies with a single shareholder with more than fifty percent of the equity. In Germany, large shareholders, who are usually banks, are also allowed to vote with the shares of individual shareholders they hold in trust (Monks and Minow, 2002). More recent

research shows that the situation has been changing in Germany. Oxford Analytica (cited by Monks and Minow, 2002) shows that the average percentage held by the five largest shareholders in Germany was only 47%, the bulk of this by banks and other corporations. Private shareholders own about 20%, while the state and local governments own 7% (see Table 3.4).

Given the concentrated ownership structure of corporations in Germanic countries, the Berle and Mean hypothesis (Chapter 1) appears not to be valid in these contexts. Berle and Means argued that large modern corporations are characterised by fragmented ownership which, by implication, has resulted in weak shareholders. The Germanic countries present a situation in which large shareholders (banks and other firms) exist and do exert significant control and discipline management. The role that major banks play in the decision-making processes, as providers of credit as well as acting on behalf of shareholders who entrust their shares to the banks, is significant. Since banks can vote with these shares, on behalf of the shareholders, this gives them considerable power in decision-making (Gilpin, 2001). The strength of corporate governance in the Germanic countries is based on the participation of banks in corporate decision-making processes, as both providers of credit and representative of small shareholders (Baum, 1993, Prowse 1998; Clarke and Clegg, 1998; Sebora and Rubach, 1998).

**Table 3.4**
**Ownership structure of German companies**
*Source: Oxford Analytica, in Monks and Minow, 2002*

| **Shareholder** | **Ownership** |
|---|---|
| Foreigners | 20% |
| Private investors | 20% |
| Banks | 8% |
| Corporate | 39% |
| Investment funds | 3% |
| Insurance companies | 3% |
| State and Local Government | 7% |
| Total | 100% |

The importance of the stock market in the economies of Germanic countries is lower than in the Anglo-Saxon countries. In the study by Pape (1999), countries such as Sweden, the Netherlands and Switzerland have the equivalent of 41.7% of GDP in market capitalization, and 6.5% of gross fixed capital formation in terms of new capital raised through public offerings. In the case of Germany, the relatively low importance of the equity market reflects the typical sources of capital for firms, which have traditionally been banks and large institutional investors as opposed to the small private shareholders in the Anglo-Saxon model (Prowse, 1998; Gilpin, 2001).

As a result of the concentrated ownership, the market for corporate control is relatively inactive in Germanic countries (Monks and Minow, 2002). The Germanic

model of governance tends to trade off liquidity for control (Reneebug, 2000). Large shareholders are reportedly less willing to sell their shares than to small private shareholders. Prowse (1998), points out that there have been only four successful hostile takeovers in Germany since World War Two. The extent of takeovers, as a percentage of total market capitalization, in Germany was only 2.3% between 1985-89, as compared to 41.1% in the US, and 18.7% in the UK over the same period (Prowse 1995 cited by Prowse, 1998).

The absence of a market for corporate control is also reflective of the anti-takeover defence mechanisms that have traditionally existed in the Germanic countries (Monks and Minow, 2002). The legal barriers in Germany undermine the market for corporate control. The number of mechanisms, which discourage takeovers has been greater in Germanic countries than in Anglo-Saxon ones (KPMG, 1995 cited by Pape 1999). Competition through the market has not been viewed as a solution to the poor performance of corporations. In Germany, takeovers have been viewed as destabilising for business and hence been discouraged (Gilpin, 2001). Poor performance is corrected through the cooperation between large shareholders and the management of corporations, and hence the name cooperative model (Crouch and Marquand, 1993).

The use of long-term performance-related compensation in the Germanic countries is limited (Monks and Minow, 2002). Citing Abowd and Bognanno (1995), Pape (1999) contends that performance related compensation is little used in Germany, the Netherlands or Sweden. Connected to the communitarian assumption of cooperation, as opposed to competition, among different organisational stakeholders in the Germanic model of corporate governance, this model has evolved an institutional environment that encourages a long-term view in the investment decision-making process (Clarke, 1993; Roe, 2003). German management is less restricted by shareholder concerns about annual returns on their investments than their counterparts in the US or the UK. This has enabled German management to pursue long-term plans (Gilpin, 2001).

Changes are beginning to occur within the Germanic model of corporate governance (Gilpin, 2001). Oxford Analytica reports that, in early 1997, leading representatives of the German financial community, including delegates from industry, financial services, investments and politics, founded the Finanzplatz - a task force devoted to promoting Germany as a financial centre. The aim was to attract foreign capital to Germany. The Finanzplatz persuaded foreign investors by showing that owning voting shares was easier in Germany than it first appeared (Monks and Minow, 2002). The government supported the Finanzplatz efforts through the introduction of a Control and Transparency Law (KonTraG) which exposed German firms to takeover for the first time and freed up the voting system in 1998. Changes introduced by this law include the elimination of voting caps and multiple voting rights, barring cross-held shares from voting for supervisory board candidates, and reducing banks' voting

powers. In addition, a disclosure of supervisory board members' board positions in other companies has become mandatory.

Takeover activities are becoming an acceptable practice within the Germanic countries. In 1999, Orange, a UK firm, was taken over by a German firm Mannesmann. Mannesmann was, in turn, taken over by Vodafone a UK-based company in 2000. These waves of takeover activities are indications of the significant changes that are taking place within the Germanic model of corporate governance. The tax reform that seeks to abolish the punitive rate of capital gains tax on equity sales (it has been 50%) has significant implications for corporate governance in Germany. For example it will make rolling back their cross-holding in German firms attractive to companies that hold large stakes which they could not formerly dispose off.

Further changes have been introduced through a code of corporate governance that was introduced in January 2000. The code includes requirements for: improved disclosure, making voting easier, encouraging pay for performance and enhanced professionalism of the supervisory board and making the board more accountable to shareholders. The code recommends that an outgoing CEO should not become a member of the supervisory board. The code also recommends that directors failing to attend more than half of board meetings in a given year should be identified in the annual report (Oxford Analytica, cited by Monks and Minow, 2002). The establishment of various board committees is also increasingly becoming an important feature of corporate governance within the Germanic model (Hopt and Leyens, 2004).

While these reforms are deep, and are changing the Germanic model of corporate governance more towards the Anglo-Saxon model, its communitarian orientation is not expected to disappear over night. The duty to society which German corporations are required to address cannot be removed, at least without considerable resistance from society (Monks and Minow, 2002). Employee representation on the supervisory board is viewed as a phenomenon that will continue for sometime but that is likely to change in the future. For example, co-determination is not part of the reform agenda in Germany (Hopt and Leyens, 2004)

**The Japanese model**

The institutional concept of a corporation prevails in Japan. Dore (1993) posits that, in Japan, a firm is viewed as a community or a nation. This conceptualisation is demonstrated in practice by the presence of interlocking networks, the *kereitsu,* consisting of the top 200 Japanese firms (Weimer, 1995; Gilpin, 2001). The objective of following such a model is to promote social capital (Rubach and Sebora, 1998). The model is constructed along Western (i.e. American) theories, a practice that goes back to World War II. For example, the board of directors in theory represents the interests of shareholders and is intended to control management. Management, in turn, is accountable to the board. However, the Japanese board has developed its own identity

that reflects the character of Japanese society (Tricker, 1994). The Japanese model recognises multiple constituencies in corporate governance as opposed to shareholders alone in the Anglo-Saxon model.

> "In Japan collective stakeholder conceptions are deeply embedded in corporate thinking in practice, from the *keiretsu* principle of related companies, to *Kaizen,* continuous improvement, to the *kanban* of just-in-time production and the suppliers it depends upon: the importance of relationships are paramount" (Yoshimori, 1995 cited by Clarke and Clegg, 1998).

Managers are viewed as the stewards of stakeholders as opposed to the agents of shareholders (Dore, 1993). Directors have traditionally been former managers of the same company (Monks and Minow, 2002). The power of the company president is an important feature of the board of directors in a Japanese corporation. The company president and the board of directors, whose chairman is usually a retired president or retired government official, hold the formal authority. Board meetings are infrequent and decisions are rubber-stamped. (Oxford Analytica, cited by Monks and Minow, 2002). The company president has significant powers to influence decision-making processes, and his power is limited mainly by social group mores – the company is viewed as an integrated social unit - and by his dedication to the overall health and growth of the company.

Important stakeholders in the Japanese model include employees, the shareholders, banks and the large customers. The influence of employees is related to the cultural tradition of "familyism" and the practice of lifetime employment which also guarantees steady promotion as one grows older up to the level of management (Dore, 1993). However, this system is changing. Large corporations such as the Honda Motor Corp., NEC Corp., Nippon Steel Corp. and a number of others have re-organised in ways that attempt to balance the old consensus system, involving employees as part of the whole, and new approaches which offer greater flexibility and faster responses to changing market conditions.

Similar to the Germanic model of corporate governance, banks play a significant role in influencing managerial decision-making processes and this results in effective corporate governance (Monks and Minow, 2002). The city-banks are at the centre of *Kereitsu* – a network of related companies. Their power is closely linked to the equity and credit finance they provide to the corporations. Ownership in Japan is relatively concentrated, though to a lesser degree than the ownership structure in Germany. Concentrated ownership is associated with cross-holdings between banks and non-financial companies, and firms tend to have directors on each other's boards (Oxford Analytica, cited by Monks and Minow, 2002; Gilpin, 2001).

The Japanese model of corporate governance has a one-tier board of directors similar to those found in the UK or US; and this reflects the influence of the Anglo-

Saxon model through the legal system. The governance structure of Japanese firms comprises the general assembly of shareholders, the board of directors, the office of representative directors and the office of auditors (Aoki, 1981 cited by Weimer, 1995). All these parties have different responsibilities. The formal responsibility of the board of directors is to make corporate decisions (Monks and Minow, 2002). The office of representative directors is responsible for executing the decisions of the board of directors. The role of the office of the auditors is to supervise the activities of both the board of directors and the representative directors. In the formal separation of the office of the auditors from both the board of directors and the representative directors, the Japanese system resembles that of Germany. However, it also partly resembles the Anglo-Saxon model in that the board of directors is elected and can be dismissed by the general assembly of shareholders.

The importance of the stock markets for the Japan economy is higher than in Germany but lower than in the UK or US. There is no active market for corporate control, a fact considered to be connected to the Japanese culture of consensus as opposed to competition. Hostile takeovers are considered a curse (Moerland, 1995a, in Monks and Minow, 2002).

The Japanese model of corporate governance encourages a long-term view in the investment decision-making process much more than the Germanic model does. This phenomenon is assisted by both the existence of *kereitsu*, which creates the institutional environment, and lifetime employment (Kester, 1992; Dore, 1993; Gilpin, 2001). Performance-based executive remuneration, to align the interests of management and shareholders, is not widely used (Oxford Analytica, in Monks and Minow, 2002).

As with the other models of corporate governance, the Japan model of corporate governance is also changing (Gilpin, 2001). The Corporate Governance Forum in Japan introduced a corporate governance code for Japan in 1998. Oxford Analytica, posits that this code takes a more "holistic" view of the firm reflecting the Japanese communitarian approach to organisations. However, it is argued in the report that shareholders, being providers of equity capital, have a special position. The report underscores the need for a sense of corporate solidarity with social harmony. The code also introduced more outside directors to the board than previously, independent audits, pay and nomination committees. Prior to this, the majority of Japanese firms had no board committees. The Forum urged the Tokyo Stock Exchange to incorporate the code into its listing rules. The Forum itself monitors progress on the implementation of the code.

The phenomenon of hostile takeovers is also becoming common in Japan. For example, in January 2000, the M&A fund launched Japan's first hostile take over bid for an ailing property developer, Shoei. The offer was unsuccessful, but it was applauded. In early 2000, the German Pharmaceuticals firm Boehringer Ingelheim made a US$190 million an over-the-counter bid for a Japanese drugs firm, SSP. The German firm, which already held 20% ownership, wanted full control of the company. This bid

was also not successful because society was seen as not yet ready for this phenomenon. Also the recent development, in September 2004, when the Japanese banking sector saw the two large banks; Sumitumo Mitsui Financial Group and Mitsubishi Tokyo Financial Group, bid to takeover the UJ bank points to the changing Japanese perception of takeover activities[32]. These events are clear indications that changes are taking place within the Japanese model of corporate governance.

**The Latin model**

The Anglo-Saxon and the German/Japanese models of corporate governance can be viewed as representing the extreme positions on the perspective continuum discussed in Section 3.2. The Latin model is positioned between the two models, since it tends to display characteristics of both the Anglo-Saxon model and the Germanic/Japanese models. The Latin model is applied in France, Spain, Italy, and Belgium. In terms of the dimensions in Table 3.2, the concept of the firm in France, a representative country, lies between the instrumental-shareholder Anglo-Saxon view and the Germanic institutional-stakeholder view (Weimer and Pape, 2000).

In France, the state plays a significant role in the development of the economy, a practice that is linked to the tradition of encouraging the finest minds in French society into the Civil service through the educational system of the *Grandes Ecoles*. Since World War II, when the state stepped in to rebuild France economy, the French intellectual elite, represented by both civil servants and industrial managers, has been involved in industry, making serving industry and serving the state almost identical (Monks and Minow, 2002). The involvement of the state in the economy, a practice referred to as *dirigisme,* through ownership affects corporate governance. The government owns substantial holdings in the car, steel, insurance and banking sectors and has a monopoly in most public utilities, rail, coal, tobacco, radio and television. The state also indirectly influences privately-owned companies through its influence over the major banks which provide most of the French capital, and most of them run by a former government official (Monks and Minow, 2002).

In the Latin model, shareholders are the salient stakeholders. However, they do not feature as prominently as in the Anglo-Saxon countries, despite having their sovereignty recognized in the French model much more strongly than in Japan. For example, shareholders can appoint and dismiss the management board through a 50% majority vote (Weimer and Pape, 2000). They can also, under French law, remove directors at their own discretion. However, in practice, the influence that can be exerted by independent shareholders is low.

Under French law, companies can either opt for a single-tier board with a combined chairman and chief executive officer, or a two-tier board with executive and

---

[32] Financial Times, August, 25th 2004

supervisory boards and separate chairmen (Monks and Minow, 2002). The authority of the company president is a characteristic of French boards. This is claimed to reflect the French tendency to concentrate power (Weimer and Pape, 2000). A code of best practice was issued in 1995 and 1999 by a committee chaired by the ex-Société Générale chief, Mark Viénot, and hence the names Viénot I and II. Viénot II gave companies the right to opt for a single-tier board but with separated leadership roles. The majority of listed companies in France have opted for the one-tier system due to its flexibility (Wemer and Pape, 2000; Oxford Analytica, in Monks and Minow, 2002; Hopt and Leyens, 2004).

The ownership structure in Latin countries is characterized by financial and cross-shareholding, government control and family control (De Jong, 1989; Moerland, 1995a both cited by Pape, 1999). Table 3.5 shows the number of companies that are controlled by the different entities among the top fifty French companies. 24 % of the fifty leading corporations are controlled by the state, 34% by management, and 28% by families. Families (with outside management) and holding companies control 6% and 8% respectively. 23% of the ownership of corporations in France can be attributed in part to the founding families. Family control is even more important in Italy (Weimer and Pape, 2000).

**Table 3.5**
**Ownership of the top 50 companies in France**
*Source: Oxford Analtica in Monks and Minow, 2002*

| **Shareholder** | **Number of firms** | **Percentage** |
|---|---|---|
| State-controlled | 12 | 24% |
| Management controlled | 17 | 34% |
| Family controlled and managed | 14 | 28% |
| Family controlled but with outside management | 3 | 6% |
| Subsidiaries | 4 | 8% |
| Total | 50 | 100 |

The stock market does not play an important role in the economy of Latin countries. In France, the relatively low importance of the stock market in the economy reflects changes in the French political situation over time. The role of the market for corporate control is also low in other Latin countries. However, the number of hostile takeovers is higher than in the Germanic countries (Moerland 1995a cited by Pape, 1999). Examples include the successful bids for Elf Acquitane by TotalFina (in France) and for Telecom Italia by Olivetti (in Italy), (Weimer and Pape, 2000). The minor role of the market in corporate control is attributed to ownership concentration in these countries. The OECD estimates that the average percentage of a company's shares controlled by its five largest shareholders is 48% in France and nearly 87% in Italy (Weimer and Pape, 2000). There are also regulatory restrictions on the transferability of shares in France.

The use of performance- related executive compensation is generally low common in Latin countries. France is an exception since the percentage of executive compensation tied to performance is similar to that found in some of the Anglo-Saxon countries, i.e. the UK and Canada. Dore (1993), Crouch and Marquand (1993), Clarke and Clegg (1998) posit that the nature of relationships encouraged by the institutional environment in Latin countries tends to promote a long-term view in the investment decision-making process.

### *3.3.3 Corporate governance in developing and transition economies*

Corporate governance systems in developing countries are still evolving and are considered to be in a state of flux (Tam, 1999; Garrod, 2000). Garrod (ibid) asserts that often economic and political reforms take place simultaneously which makes the choice of an effective system of corporate governance difficult. The OECD (1999) reports that in most transition economies where the state was the majority owner of business enterprises, the institutional and behavioural legacies of the old system on the emerging decision-making, information and motivational structure of corporate governance are important elements with respect to the prevailing corporate governance practices.

In terms of evolving their systems of corporate governance, developing economies have adopted a mixture of aspects of the corporate governance structures found in developed markets (Tam, 1999). This is usually facilitated by the legal systems which tend to reflect the legacy of the linked colonial past between developing countries and developed Western market economies (CACG, 1999; La Porta et al., 2000). It is for this reason, that corporate governance systems in these countries reflect their linked colonial past. This also implies that the four models of corporate governance discussed previously will have been reproduced in other parts of the world.

Tam (1999) points out that China is promoting corporate governance structures similar to those found in developed market economies. This is facilitated by the legalistic approach that has been adopted based on rules borrowed from the mature market economies of the US, Hong Kong, Germany and Taiwan. However, China is generally considered to be a country where the enforcement of law is weak.

The approach to corporate governance that has been adopted in China appears to be common in the developing world. Lin (2000) points out that most developing countries have similar institutional arrangements and laws to those found in the West. However, such arrangements are not as effective in these countries. Djankov et al. (2003) attribute this ineffectiveness to the fact that laws in developing countries were transplanted rather grew as than responses to local environments. They contend that transplanted laws may not be effective because they may not reflect local practices.

The question as to whether an imported system will be effective when it is transported into a setting in which the supporting contingencies are weaker or different, that Tam (1999) poses in the context of China, is valid for a large number of developing

countries. As corporate governance practices tend to reflect the underlying cultural values, transplanted legal systems are often inadequate in promoting effective corporate governance (Djankov et al., 2003; Berglof and Claessens, 2004). The legal systems in developing countries tend to suffer from a number of weaknesses including underdevelopment, archaic laws and poor contract enforcement. Other problems faced by developing countries with respect to corporate governance include a lack of accounting and auditing and disclosure standards adequate for the level of transparency and monitoring necessary for effective corporate governance (Clarke and Clegg, 1998).

Further problems include uncompetitive product markets, insider-controlled firms with senior management appointments often made on the basis of political or kinship ties showing that the managerial job markets are underdeveloped (Lin, 2000). These countries are also characterised by weak debt markets due to their uncompetitive banking systems (Hoa, 2000). Equity markets and institutional investors are too limited to serve as a market for corporate control or for evaluating firm performance through investors' entries and exists (Prowse, 1998). Although developing/transition economies generally share a number of characteristics, they do reflect varying degrees of market development.

The challenges facing developing countries elsewhere largely confront Africa as well. The African environment is characterised by the existence of state-owned corporations, the prevalence of corruption and low financial intermediation. The governance of state-owned corporations is characterised by the appointments of directors and senior managers by governments (Chapter 2), and these have traditionally not taken place in a transparent way (Okeahalam and Akinboade, 2003).

Important corporate governance developments in Africa include the privatisation of state-owned enterprises and the development of codes of best practice in some countries. For example, in Kenya, South Africa and Tanzania principles of effective corporate governance have been developed. Training and awareness-raising, sponsored by the World Bank and the Commonwealth Secretariat, have been extended to a number of countries including Botswana, Senegal, Mali and Mauritius. This initiative is aimed at assisting these countries to set up mechanisms to develop effective corporate governance. Despite these developments, there remain a number of problems: underdeveloped capital markets such that minority shareholders are unable to influence corporate governance, corruption, crony capitalism associated with privatisation, poor protection of investors, ineffective boards of directors, and the lack of well developed financial information gathering agents such as financial analysts (Okeahalam and Akinboade, 2003). These challenges imply that concerted efforts are required to address corporate governance problems in the African context.

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. For example, in the context of Tanzania, the IMF and the

World Bank, under whose tutelage the market-based system of economic coordination has been adopted, exert significant influence over the evolving system. The disjuncture between the state and civil society, characterised by weak civil institutions of representation, may result in a system that reflects non-local interests or conceptualisations of corporate governance issues. Mndolwa et al. (2003) point out that the preparation of the Company Act 2002 in Tanzania relied heavily on foreign consultants and did not provide local stakeholders with the opportunity to contribute to the development of the Act. This means that the Act may not address some of the local requirements for an effective system to evolve.

The underdeveloped nature of corporate governance environments in developing and transition economies is also paradoxically viewed as an advantage because of the flexibility that still exists, and which developed markets currently lack (Lin, 2000). It is argued, for example, that these countries can influence the type of corporate governance that best serves them by designing ex-ante, and configuring purposively and simultaneously, ownership patterns, the corporate landscape and financial architecture most conductive to effective corporate governance (Lin, 2000).

The option being suggested should be deemed unrealistic. The pressure to adopt particular approaches/systems of corporate governance, usually facilitated by multinational organisation (e.g. World Bank and OECD), suggests that the possibility of real choice is an illusion. The influence of globalisation, and the dependency structures that have developed over time between developing and developed countries, pose a further practical challenge. For example, the privatisation of state-owned corporations, which has implications for evolving corporate governance practices because of the changes in ownership structure is usually performed under pressure from the World Bank. It is usually the World Bank that funds such initiatives in developing countries.[33]

**The emerging Tanzanian model**

The dimensions used in distinguishing the different models discussed previously can be applied to characterise the emerging model of corporate governance in Tanzania. The concept of the firm is undergoing reassessment towards a shareholder-instrumental orientation. The ongoing reforms, which embrace notions of the liberal market economy, are strongly geared toward this view. The shareholders are the only constituency permitted to participate in the key affairs of a company in Tanzania such as the appointment of directors and voting at shareholder meetings. The principle of one-share-one-vote is recognised in the company ordinances (Cap. 212). However, in practice, votes may be cast by a show of hands[34]. In this case, the decision depends on the support of the majority based on a head count rather than on the number of shares

[33] In Tanzania, the government privatisation agency has been mainly funded by the World Bank

[34] This approach is usually applied when the decision involved is not considered to have strategic implications such the acceptance and approval of minutes of the previous annual general meeting.

held.

The company ordinances permit the issuance of different classes of shares, equity shares, preference shares, and redeemable preference shares (ibid sec. 62). These classes of shares carry varying rights in influencing the decision-making processes of the company. The company ordinances also allow companies to vary the rights attached to the different classes of shares subject to court approval.

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' remunerations are also decided upon during these meetings. In practice, directors propose remunerations to shareholders at the annual general meeting, who then debate and approve them. Directors are empowered to propose auditors and determine the auditors' fees (ibid sec 132). However, auditors are required to report to shareholders at annual general meeting (ibid sec. 134). In practice, management proposes names of the auditors to directors who forward them to shareholders for confirmation. In terms of director accountability to shareholders, directors are required to present at annual general meeting audited accounts i.e. profit and loss account and the balance sheet (ibid sec. 123).

The board system reflects the British one: a one-tier board in which decision management and control roles are combined. As in other countries, the management of the company is vested by law in the board of directors (Mace, 1971). In practice, the board of directors appoint 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.

Ownership of corporations in Tanzania tends to be concentrated, with single shareholders owning over fifty percent of the equity capital of corporations (Chapter 2). A large number of corporations in Tanzania, including listed companies, have such concentrated ownership (see Table 2.4). Foreign ownership is also significant in a number of corporations. Both the concentration of ownership and the ownership by foreign firms reflect the privatisation strategy of relying on strategic investors (Chapter 2). Ownership by banks is not significant. Although banking laws and regulations permit banks to invest in company shares, restrictions do exist, and they are required to meet specified conditions set out by the Central Bank of Tanzania[35]. Cross-holdings

---

[35] Banks cannot invest more than 25% their core capital in equity, and cannot invest more than 10% of this amount in one company. Also equity investment in a single company, other than a bureaux de change and a credit company, should not exceed 5% of the equity of the investee company (Credit concentration and other exposure limits regulations, 2001). Core capital as defined in the Banking and Financial Institutions Act of 1991 means permanent shareholders' equity in the form of issued and fully paid-in shares of common stock, non-redeemable and non-cumulative preferred stock, capital grants plus disclosed reserves less goodwill or any other intangible assets.

have also not been reported in Tanzania.

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 currently only seven companies are listed on the Dar es Salaam stock exchange – Tanzania Breweries Limited (TBL), Tanzania Cigarette Company (TCC), Tanga Cement, Dar es Salaam Airport Handling Company (DAHACO), Tanzania Oxygen Limited (TOL), Tanzania Tea Packers (TATEPA), and recently Kenya Airways.

Until 2003, foreigners were not allowed to buy and sell shares on the Dar es Salaam stock exchange. Following the introduction of relevant regulations, these restrictions have been eased. 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 depth[36] of the stock market.

An active market for corporate control is currently nonexistent in Tanzania. There have been no hostile takeover 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 company ordinances (Cap. 212 sec. 63) as well as by the listing regulations.

Information on the nature of the relationships being encouraged by the institutional environment is currently not available. However, considering the direction of the Anglo-Saxon model, on which the Tanzanian system is modelled, the current form of ownership and operating environment- where wealth maximisation is encouraged-implies a short-termism in investment decisions.

## 3.4 International initiatives on corporate governance

The collapse of large corporations with the devastating consequences on society including the loss of jobs and investments in the industrialized countries and in Asia has led to increased recognition of the importance of corporate governance for the socioeconomic development of countries (Chapter 1). This realisation has motivated a number of initiatives aimed at responding to the corporate governance challenges worldwide. These initiatives are being carried out both at national and at international levels. Internationally, these initiatives are being spearheaded by multilateral organizations including the World Bank, the Organisation for Economic Cooperation and Development (OECD) and the Commonwealth Association for Corporate

[36] 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).

Governance (CACG). The formulation of principles of effective corporate governance is a manifestation of these initiatives (Chapter 1).

The principles formulated by the OECD and CACG have provided a broad framework for a large number of countries to develop their own specific principles of corporate governance (Monks and Minow, 2002; OECD, 1999; 2004). The broad membership of the OECD and CACG organizations suggest that these principles reflect the views of a large number of countries with respect to the correct approach for addressing the challenge of corporate governance.

The OECD and CACG principles are minimum benchmarks against which member countries can compare their systems and carry out country-specific initiatives (OECD, 1999; 2004). A number of countries have developed their own principles of best practice that address the issues of corporate governance in their own countries. For example, the Peters Committee and the Tabaksblad Committee developed recommended principles for corporate governance in Dutch organizations in 1997 and 2003 respectively. The King's Committee issued principles of corporate governance for South Africa in 1994 and 2002.

While these principles are important, their limitations need to be recognised. Turnbull (1999) posits that these principles, which carry notions of codes of best practice and which are being promoted by prestigious organisations such as the OECD or CACG or national stock exchanges, can be misleading. She contends that they tend to be portrayed as though they were ethically correct and righteous. She further points out that even if companies follow these principles, there is still no assurance for shareholders that the business is either a good investment or ethical. Turnbull (1999) proposes that these principles should be understood as minimum acceptable practices as this will alert investors to the possibility of superior governance standards.

The issue of ethical correctness as raised by Turnbull (1999) can be challenged. The principles constitute broader frameworks which can be specified and extended in various ways as countries choose. Their application is based on country preference with respect to the way in which corporate governance practices can be improved. In their revised version of principles, the OECD (2004) also mentions the need to reflect ethical dimensions in corporate governance processes. The OECD recommends that the interests of the wider society should be the focus of corporate governance initiatives.

### *3.4.1 The OECD principles for effective corporate governance*

The principles for effective corporate governance issued by the OECD in 1999 and updated in 2004 are organised under six headings: ensuring the basis for an effective corporate governance framework, the rights of shareholders, equitable treatment of all shareholders, the role of stakeholders in corporate governance, disclosure and the responsibility of the board of directors. The first principle, introduced in the revised set of principles released in 2004, addresses the corporate governance framework and

institutional structures. Each of the major components will be discussed below.

**Principle i: ensuring the basis for effective corporate governance framework**

This principle was treated separately in the revised set of principles, and requires countries to promote transparent and efficient markets, the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities (OECD, 2004). The principle requires a corporate governance framework to be developed with a view of its impact on the overall market participants and the promotion of transparent and efficient markets. The principle largely appears to encourage accountability among those institutions that have a bearing on corporate governance. A clear division of responsibilities among authorities is needed to ensure that the public interest is served. The issue of resources and the integrity of supervisory, regulatory and enforcement authorities are also articulated in this principle.

**Principle ii: the right of shareholders and key ownership functions**

The principles of good corporate governance recognize the property right of shareholders and attempt to explicate them: the rights to secure methods of ownership, convey or transfer shares, obtain relevant information on the corporation on a timely and regular basis, participate and vote at general meetings, elect members of the board and share in the profits of the corporation. Embedded in the rights of shareholders is the concept of ownership of the corporation by its shareholders. The ownership rights give rise to a number of other rights.

The right to information about the corporation is aimed at facilitating decision-making with respect to control of the corporation. The buying/selling of shares reflects the acknowledgement of the control that can be exercised through the market for corporate control and presupposes the existence of such a market. Principles ii encourages member countries to remove barriers to the transferability of shares and other restrictions that hamper the operation of the market for corporate control. This reflects the Anglo-Saxon view of corporate governance.

Participation in the election of the board requires transparent procedures that permit shareholders to elect directors who will protect and advance their interests. This is also reflective of the traditional Anglo-Saxon view of corporate governance in which directors are considered as agents of shareholders.

In general this principle is aligned with the liberalist perspective of corporate governance in which shareholders are sovereign and are entitled to exercise ultimate control over corporations. However, there is a weakness inherent in this principle: mentioning the extensive rights is not the same as effective corporate governance (Frederick, 1999). In some countries, extensive shareholder rights are provided, but the ability of shareholders to actually influence the company is limited (OECD, 2003). In other words, it is not sufficient to specify rights, actual mechanisms for realising these

rights are required.

**Principle iii: the equitable treatment of shareholders**

The OECD (1999; 2004) principles state that: "the corporate governance framework should ensure the equitable treatment of all shareholders, including the minority and the foreign shareholders". In this respect, the principle calls for the enactment and enforcement of laws that provide adequate protection of shareholder rights. Investor protection flows from the first principle. Rights can only be meaningful if they are protected. This principle appears to reflect the possibility of conflicts of interest between minority shareholders and company insiders- management, directors and possibly large shareholders who may collaborate to appropriate private benefits of control (Denise and McConnell, 2003). Consequently, a governance framework should provide effective protection of these vulnerable interests.

**Principle iv: the role of stakeholders in corporate governance**

The broad membership of the OECD includes countries that subscribe to the various perspectives of corporate governance (the liberalists and the communitarians). The principles recognise that not only shareholders are important for the survival of a corporation, other stakeholders play an important role as well. Frederick (1999) notes that this principle proved to be the most controversial during the development of these principles. However, a compromise between the two perspectives was reached which recognises the essential role of stakeholders as providers of inputs and whose cooperation is essential for the continued survival of the corporation. However, new governance rights for stakeholders were not created, nor were they reduced where they already existed: "the corporate governance framework should assure that the rights of stakeholders that are protected by law are respected".

It is also noted that stakeholders should obtain redress when their rights are violated. Also, the corporate governance framework should evolve mechanisms that enhance stakeholder participation. For example, employees' interests should be protected and they should have the right to access information. This principle points to the fundamental differences in the corporate governance models discussed in Section 3.2.

**Principle v: disclosure and transparency**

This OECD principle underscores the importance of transparency. Disclosure is considered an important aspect in attaining transparency, which is an important requirement in attaining effective corporate governance. The disclosure of all material matters regarding the corporation, including financial reports, corporate objectives, material issues involving other stakeholders, major owners and voting rights are articulated in this principle. The importance of applying high quality accounting and audit standards is also emphasised.

This principle addresses the problem of the information asymmetry which exists between insiders in the company (management and directors) and shareholders of the company and other stakeholders. The principle is meant to encourage corporate insiders to disclose material information that is useful in evaluating their performance as well as in making other decisions that determine the future of the enterprise. Whereas this perspective largely reflects the outsider orientation of corporate governance, it is also inclusive in that other stakeholders are recognised as deserving information for governance purposes.

**Principle vi: responsibility of the board**

The OECD principles also address the role of the board of directors by broadly outlining what the board should do and what it requires to effectively execute its responsibility. The independence of board members was recognised in widely-held companies as well as in closely-held ones. In widely-held companies, independent directors are viewed as a solution to the "agency" problems inherent in the Berle and Means hypothesis (Chapter 1). The traditional view of directors, as monitoring management, is reflective of the conflict perspective of corporate governance. Principle vi requires directors to be effective overseers of management performance and provide accountability to shareholders as well as to other relevant organisational constituencies.

The view that directors can and should add value which is beginning to emerge (Stiles and Taylor, 2002), is reflected in the principles. The board is required to play a significant role in directing the company and a checklist of what a board requires to accomplish the tasks expected of it is provided: accurate, relevant and timely information. Directors are also called upon to act with due diligence while exercising impartiality with respect to classes of shareholders and stakeholders (i.e. act with fairness towards all stakeholders). The principles further outline the key board functions related to effective monitoring of management performance. These are:

(i) Reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans;
(ii) Setting performance objectives, monitoring implementation and corporate performance and overseeing major capital expenditure, acquisitions and divestitures;
(iii) Selecting, compensating, monitoring and when necessary, replacing key executives and overseeing succession planning;
(iv) Reviewing key executive and board remuneration, and ensuring a formal and transparent board nomination process;
(v) Monitoring and managing potential conflicts of interest of management, board members, and shareholders, including the misuse of corporate assets, and abuse in related party transactions;
(vi) Ensuring the integrity of the corporation's accounting and financial reporting

systems: independent audit, appropriate systems of control in particular systems for monitoring risk, financial control, and compliance with the law;

(vii) Monitoring the effectiveness of the governance practices under which it operates, and making changes as required, and overseeing the process of disclosure and communications.

The OECD through this set of principles is advocating a number of factors that underpin the effectiveness of the board of directors in effectively discharging the activities identified (OECD, 1999; 2004). These factors include board independence, separation of the roles of chairman and the establishment of independent board committees. These factors are treated in detail in Chapter 4.

### *3.4.2 CACG principles of effective corporate governance*

In 1999, the CACG released a set of principles for corporate governance for the Commonwealth countries (CACG, 1999). The principles are aimed at realising a number of outcomes including an improvement in the profitability and efficiency of Commonwealth countries' business enterprises; improving the capacity to create wealth and employment; and ensuring the long-term competitiveness of Commonwealth countries in the global market place, the stability and credibility of the Commonwealth financial sectors both nationally and internationally.

These principles are also concerned with the relationship between business enterprises and their various stakeholders: shareholders, managers, employees, customers, suppliers, labour unions, communities, and providers of finances. The board of directors is focused upon, in the CACG principles of corporate governance, as the principal mechanism for addressing corporate governance issues. These principles reflect the shareholders' supremacy as the primary beneficiaries of corporate activity and as a legitimate constituency. The principles are organised under fifteen interrelated subjects calling for the board to:

**Principle i**

Exercise leadership, enterprise, integrity and judgment in directing the corporation for continued prosperity.

**Principle ii**

Ensure that, through a managed and effective process, board appointments are made that provide a mix of proficient directors who can bring independent judgment to bear on the decision-making process.

**Principle iii**

Determine the corporation's purpose and values, determine the strategy to achieve its

purpose and implement its values in order to ensure that it survives and thrives, and ensure that procedures and practices are in place that protect the corporation's assets and reputation.

**Principle iv**

Monitor and evaluate the implementation of strategies, policies, management performance criteria and business plans.

**Principle v**

Ensure that the corporation complies with all relevant laws, regulations, and codes of best practice.

**Principle vi**

Ensure that the corporation communicates with shareholders and other stakeholders effectively.

**Principle vii**

Serve the legitimate interests of the shareholders of the corporation and account to them fully.

**Principle viii**

Identify the corporation's internal and external stakeholders and agree a policy, or policies, determining how the corporation should relate to them.

**Principle ix**

Ensure that no one person or block of persons has unfettered power and that there is an appropriate balance of power and authority on the board which is, *inter alia,* usually reflected by the separation of the roles of chief executive officer and chairman, and by having a balance between executive and non-executive directors.

**Principle x**

Regularly review processes and procedures to ensure the effectiveness of internal systems of control so that the decision-making capability and the accuracy of its reporting and financial results are maintained to a high level at all times.

**Principle xi**

Regularly assess its performance and effectiveness as a whole and that of the individual directors including the chief executive officer.

**Principle xii**

Appoint the chief executive officer and at least participate in the appointment of senior management, ensure the motivation and protection of the intellectual capital intrinsic to the corporation, ensure that there is adequate training in the corporation for management and employees and a succession plan for senior management.

**Principle xiii**
Ensure that the technology and systems used in the corporation are adequate to properly run the business such that it remains a meaningful competitor.

**Principle xiv**
Identify key risk areas and key performance indicators for the business enterprise and monitor these factors.

**Principle xv**
Ensure that the corporation will continue as a going concern for its next fiscal year.

The issues that come into consideration in the CACG principles are similar to those considered under the OECD set of principles of corporate governance which are broader in scope. Since the one-tier board system is acknowledged in member countries, the independence of the board is of paramount importance. The mix of directors recommended, i.e. a combination of executive and non-executive directors is reflective of this position. A leadership structure, as an important aspect underlying board effectiveness in the control function, is also advocated.

**OECD and CACG principles of corporate governance: a reflection**
The perspectives on corporate governance discussed previously are reflected in the development of two sets of principles for corporate governance being promoted by the OECD and CACG. The OECD principles take a middle path in terms of not being exclusively shareholder-oriented as shown by the recognition of other stakeholders in governance structures such the board of directors. These principles reflect the diversity of countries involved in the development and adoption of such principles: they are broader both in terms of scope and in terms of constituencies that are recognised in corporate governance processes. They address the governance framework, the board of directors, a key governance mechanism, as well as the role of various stakeholders. These principles encourage changes within the frameworks of the existing models. They also tend to encourage market-oriented approaches to the governance of corporations and reflect the influence of Anglo-Saxon countries in the development of such principles.

The CACG principles are more-strongly inclined towards the shareholder model and take a traditional view of directors as representatives of shareholders. The CACG

principles are intended to be adopted by countries that have a similar legal framework (Common Law tradition) which is assumed, at least in the principle, to provide for some of the issues addressed in the OECD principles. The CACG principles largely address the role of the board and the need for it to adopt a leadership position in a number of areas. This reflects a belief that corporate governance problems in such countries are largely connected to the failure of the board to play its monitoring role effectively. This reflects the conceptualisation of corporate governance problems in terms of weak shareholders and the need for effective boards.

Both sets of principles address factors that determine the effectiveness of the board in the control function: the board constitution, independence, board leadership structure, board committees and access to information by directors.

The effects of the OECD and CACG principles on corporate governance reform around the world are significant. They have formed the framework for the various national codes that have been developed in several countries. However, this poses a challenge, particularly to developing countries. Developing countries eager to attract foreign investments run the risk of adopting these principles in a way that may not address adequately the existing local situations. In this respect, the comment by Turnbull (1999) has particular resonance: adoption may not necessarily translate into effective corporate governance. These principles need to be adapted to the local situation of these countries.

### *3.4.3 Recent developments in corporate governance*

The collapse of Enron, WorldCom and other major corporations in the US in 2002 has led to a number of initiatives aimed at strengthening corporate governance in that country. These initiatives include the enactment of the Sarbanes-Oxley Act of 2002 and the jailing of highly-paid executive officers (Corporate responsibility, cited by Grant, 2003). The Sarbanes-Oxley Act of 2002 is an important attempt to improve regulatory oversight of the securities industry, and to instil the ideals of corporate governance. It seeks to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws and for other purposes (Grant, 2003).

The Act calls for changes in financial reporting and disclosure systems, and places restrictions on how public companies and their auditors relate to each other. New measures include a new public oversight board, more stringent requirements for auditor independence, i.e. a restriction on non-audit services extended by external auditors, new disclosure requirements, stronger criminal penalties for securities fraud and increased corporate responsibility for financial reports including personal responsibility by chief executive officers for the accuracy and completeness of financial reports as well as demonstration of an ethical culture (RHI, 2003; Grant, 2003).

The introduction of the Sarbanes-Oxley Act has prompted a number of listed companies in the US and elsewhere to revise their financial reporting and accounting

practices and to update their corporate codes of ethics (AMA, 2003). Due to accounting irregularities, it was expected that 250 companies in the US would restate their financial positions in 2003 (Grant, 2003). With respect to ethics, private companies and non-profit making organisations have also been taking steps to avoid the ethical issues that have beset listed companies in the US.

The Sarbane-Oxley Act also affects companies from other countries which are listed in the US. This Act has forced European companies and countries to adopt US procedures and regulations (International Herald Tribune, 25th September. 2003). The Act contains a number of "extraterritorial" provisions that require foreign companies listed in the US to comply with it, particularly with regard to auditors. This attempt is being resisted in Europe. However, a number of European companies listed in the US are implementing the requirements of the Act. This suggests that American business practices may be spreading to other parts of the world.

One of the recent important corporate governance developments in the US is the introduction of the post of the chief governance officer (CGO) in a number of listed companies. AMA has found that out of 52 listed companies involved in their survey, 33% indicated that they have hired or appointed a chief governance officer. This practice is spreading to other types of organisations. For example, 12% of the 52 privately-owned companies and 31% of 116 non-profit companies involved in the AMA research had also appointed a chief governance officer (AMA, 2003).

The responsibilities of the chief governance officer include providing boards of directors and investors with company information, helping develop charters that outline board responsibilities, evaluating the board's performance and assuring compliance with federal and stock exchange requirements (International Herald Tribune, 16th August, 2003). Traditionally, these tasks have been performed jointly by company secretaries, and investor relations, finance and accounting departments. The introduction of the CGO position represents a centralisation of these functions.

The practice of appointing a company CGO is in its early stages and therefore likely to evolve in terms of responsibilities as well as reporting relationships. Currently, the CGO is required to report to the company secretary and the board of directors directly through its committees.

Alongside the introduction of the CGO, companies have also developed their own codes of ethics. AMA (2003) reports that 79% of the listed companies in the US have developed codes of ethics. 19% of them have developed separate codes for their principal financial officers. Companies are also developing their own principles of corporate governance (e.g. General Motors and Eastman Kodak). This suggests attempts to continuously improve corporate governance practices by corporations.

## 3.5 The convergence of corporate governance models

### *3.5.1 The influence of globalisation on corporate governance models*

Corporate governance is being shaped by the globalisation of industry (Bradley et al., 1999). The globalisation of industry refers to an evolving pattern of cross-border activities of firms involving international investments, trade, and collaboration for purposes of product development, production, sourcing and marketing (Clarke and Clegg, 1998). Clarke and Clegg contend that these international activities enable firms to enter new markets and exploit their technological and organizational advantages to reduce costs and risks. Underlying the international expansion of firms, and in part driven by it, are technological advances, the liberalization of markets, and an increased mobility in the factors of production. National economies are becoming more closely integrated as firms spread their operations and assets across borders.

The phenomenon of globalisation brings about greater economic efficiencies and welfare. It also brings more intense competition, greater need for adjustments and more demands on national and international policy. Dimensions of globalisation include: internationalisation of financial markets, internationalisation of corporate strategies, diffusion of technology, and related research and development, as well as knowledge worldwide and the transformation of consumption patterns into cultured products with consumer markets all over the world (Petrella, cited by Clarke and Clegg, 1998). Other dimensions include the internationalisation of the regulatory capabilities of national societies into the global political economic system and the diminished role of national governments in designing the rules for global governance.

These developments have implications for corporate governance. They influence the local or national environment in which firms operate. The globalisation of product markets brings about more intensive competition in the home country and thus increases the level of competition to which locally-produced products are subjected (Clarke and Clegg, 1998).

Similarly, the globalisation of financial markets implies that local business can access capital that foreign investors provide. This is a positive development. However, it does bring about previously unknown challenges. For the recipient country, the local system is challenged- they are required to cope with the demands of international capital[37], and shareholders in the country of origin are presented with monitoring challenges. Bradley et al. (1999) contend that the proliferation of financial products, the globalisation of capital markets and the rise of institutional investors make the assessment of risk difficult. Cross-border disclosure rules and regulations are underdeveloped and not standardised. Consequently, investors have to make complex

[37] For example, in Germany, the adoption of a code of corporate governance arose from international pressure (Monks and Minow, 2002)

assessments with limited information which in turn limits the extent to which managers can be brought under the critical eye of keen investors.

Globalisation of capital has also brought challenges to national governments' ability to regulate business. Multinational firms may block or influence the way in which legislation is developed in order to protect their interests (Bebchuck and Roe, 1999). The attempt by P & O Nedloyd, a shipping multinational, to block a Shipping Agencies Bill in Tanzania is an example of efforts to protect self-interests[38]

The influence of globalisation is reflected in the debate on the possible convergence of models. The traditional debate on corporate governance has centred on the insider bank-centred governance model of Japan and Germany, and compared this with the market-centred governance model of the UK and US. During the 1990s, the Japanese model of corporate governance based on relationships was compared favourably to that of the US, which was heavily market-based. The Japanese model was considered superior to the external-control market because managers were less subject to short-term pressures from the market. Critics of Japanese model have pointed out that the model can entrench poor managers (Gilpin, 2001). The discussion on the various models currently found in practice indicates that these models are increasingly changing, which has led to the debate on the prospect of model convergence.

### *3.5.2 The debate on the convergence of corporate governance models*

Two perspectives are emerging in the debate: one perspective posits that systems will never converge; the second believes that they will slowly converge. It is held that differences in the systems will persist and that:

> "The one thing that seems certain is that the existing diversity and complexity of forms of corporate enterprise and patterns of corporate governance will continue, and very probably, increase. Alternative paradigms will be needed to improve effectiveness of governance to influence the healthy development of corporate regulation and to understand the reality of the political processes by which companies are governed, rather than the structures and mechanisms through which governance is exercised. In any development it will be important to avoid the polar extremities of governance based on an expensive bureaucracy or regulation and the adversarial class of vested interests. Governance powers and processes need to provide for the many different constitutional bases of modern enterprise and to reflect the reality of power over that entity, balancing independence and objectivity with executive commitment and motivation" (Clarke and Clegg, 1998).

Each system of corporate governance has strengths and weaknesses (Gilpin, 2001). The

---

[38] See the Gurdian, 16th April, 2002.

Anglo-American model is dynamic and market orientated; with highly, fluid capital that seeks out business opportunities internationally, particularly in innovative and new industries with the promise of high returns (Clarke and Clegg, 1998). The volatility of finance which leads to the focus on short-term gains and the neglect of longer term concerns of improving companies in mature industries, where returns are modest, represents a key shortcoming of this model. In contrast, the communitarian models of Germany and Japan are committed to long-term industrial strategies with stable capital investment structures and robust representative governance procedures. The stability and security of the relationships in the German system has caused a degree of rigidity in the face of new competitive threats. In Japan, the speculative boom provoked by industrial wealth revealed the inadequacy of secretive and sometimes corrupt practices (Clarke and Clegg, 1998).

Shleifer and Vishny (1997) assert that effective corporate governance is based on an appropriate combination of legal protection of investors and some form of concentrated ownership. The US and the UK rely more on strong legal protection (Prowse, 1998) and effective boards of directors (Roe, 2003) than the German and Japanese models which are characterised by weaker legal protection but higher concentration of ownership in the hands of banks who provide effective governance (Denise and McConnell 2003; Roe, 2003). Denise and McConnell (2003) note that despite variations in legal protection, a minimum level of legal protection e is required for an economy to have an effective corporate governance system- a level they argue is not met in many of the world's economies.

Rajan and Zingales (2000 cited by Denise and McConnell) hypothesise that, while relationship-based models can overcome some of the problems associated with the lack of investor protection, the long-term ability of firms to raise capital and allocate it efficiently will be better served by market-based models. Bradley et al. (1999) posit that a liberalist model of corporate governance, such as that observed in the US, allows for flexibility and therefore allows firms to better adapt to dramatic changes.

Denise and McConnell (2003) conclude that there is a likelihood that an evolution towards stronger legal protection of investors in many countries would lead to improved corporate governance models and greater economic growth. However, they caution that the likelihood of such an evolution occurring is less clear. Coffee (1999) hypothesises that corporate evolution is likely to follow the path of least resistance and that evolution in corporate law faces many unpredictable obstacles. This resistance is likely to come from controlling shareholders. Bebchuck and Roe (1999) conjecture that the controlling shareholders of the world will fight to protect their private benefits of control which accompanies their concentrated equity ownership. Attempts to improve laws that protect minority shareholders threaten those private benefits of control. Thus, the convergence of governance models through the legal systems seems unlikely.

From the perspective that views models as converging, two forces that will lead

to convergence are considered to be in play: functional and through the codes of corporate governance The source of the models converging is likely to be through functional convergence (Coffee 1999; La Porta et al., 2000). According to these authors, functional convergence occurs when individual investors and/or firms adapt ways that create stronger governance, despite a lack of appropriate legal structures. That SGL and Mercedes Benz, two German companies, adopted Anglo-Saxon systems of corporate governance are examples (Chapter 1). Investors can opt to invest their money in firms that are domiciled in more investor-friendly regimes. Bradley et al. (1999) posit that there are indications of insider models adopting some of the elements of the outsider models. The codes of best practice supported by international organisations are viewed as contributing to the convergence of the models (Denise and McConnell, 2003).

The changes in the systems of corporate governance indicate that the systems are evolving away from their traditional forms. A combination of factors will shape their new forms. The adoption of principles of corporate governance sponsored by such organisations as OECD and CACG, the forces of globalisation and the implementation of various reforms in countries such as Germany and Japan with respect to corporate governance will contribute to this process. The sources of the current differences are so fundamental that they will contribute considerably in shaping the direction of change in each system.

## 3.6 Theoretical perspective on corporate governance

Stiles and Taylor (2002) identify seven theoretical perspectives that can be applied in studying corporate governance: the transaction cost economics theory, agency theory, managerial hegemony theory, class hegemony theory, resource dependency theory, stewardship theory and stakeholder theory (see Table 3.6). The theories reflect assumptions embedded in the two broad perspectives of corporate governance. Transaction cost economics and agency theories reflect the liberalist perspective of corporate governance (Stiles and Taylor, 2002). These two theories are seen as complimentary (Williamson, 1981). They are put in the category of organisational economic theories belonging to the neoclassical liberal perspective of economic coordination (Eggertsson, 1990).

The managerial hegemony theory addresses itself to the board which it describes as a “de jure”, but not the “de facto”, governing body of the organisation. Corporate management assumes the real responsibility of running and controlling the organisation (Scott, 1997). The board of directors is a legal fiction dominated by management. This makes the board an ineffective organ for supervising and exercising control over management (Mace, 1971). The managerial hegemony theory also reflects the liberalist assumptions. The self-serving tendency of managers is reflective of the individual utility maximising behaviour. This theory points to the paradoxical position of the board

in that the power delegated to it by shareholders is actually exercised by management (Demb and Neubaeuer, 1992).

The class hegemony theory, which developed from sociological research mainly in the US, is generally Marxist in origin (C.W.Mills, 1956; Nicols, 1969 cited by Stiles and Taylor, 2002). According to Bazerman and Schoorman (1983 cited by Stiles and Taylor, 2002), this research identified a cohesive upper class within the US characterised by self-consciousness and consensus on social issues. The theory is based upon power shared by an elite class at the head of large corporations and posits that boards of directors are a mechanism by which this elite seeks to perpetuate itself as well as strengthening itself through interlocking directorates (Clarke and Clegg, 1998). The assumptions of classical/neoclassical liberalism are implicit in the class hegemony theory. Pursuance of interests of a particular class rather than of society as a whole is consistent with liberalist assumptions.

The stewardship theory invokes the notion of a company and its governance based on the applicable company law (Tricker, 1994). This theoretical underpinning is a normative one based on the belief that the directors to whom authority is delegated will exercise stewardship. The theory is predicated on the belief in the just and honest man who acts for the good of others. Clarke (1993) cites Japan as a context in which the representation of other stakeholders in the company decision-making organs is considered unnecessary as long as management pursues long-term growth which will benefit the interests of all parties, shareholders included. The assumptions of trustworthiness and justice are reflective of communitarianism. Stewardship theory appears to be appropriate for explaining corporate governance within the communitarian paradigm (Tricker, 1994). This theory is also applied in the liberalist sense for its promise to better service the interests of shareholders.

**Table 3.6**
**Theoretical perspective on Corporate Governance**
*Source: Adapted from Stiles and Taylor (2002)*

| Dimension | Theoretical perspective | | | | | |
|---|---|---|---|---|---|---|
| | Agency and transaction cost | Managerial hegemony | Class hegemony | Resource dependence | Stewardship | Stakeholder |
| Board Role | Ensure match between managers and shareholders | Board "a legal fiction" | Perpetuate elite and class power | Reduce uncertainty; boundary spanning | Ensure the stewardship of corporate assets | Inclusive pursuit of stakeholder interests |
| Theoretical origin | Economic and Finance | Organisation theory | Sociology | Sociology | Organisation theory | Politics, law and management theory |
| The underlying general perspective | Liberalist | Liberalist | Liberalist | Liberalist / communitar-ian | Reflects views in both but mainly communitaria n | Valid for both perspectives, mainly communitaria n |
| Represent-ative studies | Jensen and Meckling (1976), Fama and Jensen (1985), Kosnik (1987), Williamson (1981) | Mace (1971) Lorch and MacIver (1989) | Mills (1971) Useem (1980) | Pfeffer (1972), Pfeffer and Salanick (1978) | Donaldson and Davis (1991) | RSA (1995), Blair, (1995), Freeman and Evans (1984) |

## 3.7 The theoretical research basis

The operating context in Tanzania is being transformed in terms of shifting from the communitarian view of economic coordination towards the neoclassical liberal perspective (Chapter 2). This shift represents a change in the assumptions underlying the organisation of society, including corporate governance and an acceptance of the assumptions made in the liberalist perspective. This suggests that theoretical perspectives originating from the liberalist perspective of corporate governance will provide an apt medium for investigating corporate governance practices in Tanzania. The choice made is to apply transaction cost and agency theories, because the basic assumptions in these theories, as will be reviewed in Section 3.7.1, are valid for Tanzania. In addition, the approaches to improve the effectiveness of corporate governance that are currently being encouraged internationally are based on these theories. For example, the OECD and CACG principles of corporate governance discussed previously are largely reflective of these theories, even though elements of stakeholder theory are also discussed.

### *3.7.1 Transaction cost economics theory*

The transaction cost theory is generally traced to the work of Ronald Coase (1937), "*The Nature of the Firm*". Coase points out that economic organizations exist to minimize transactions costs of trading in markets. In this respect, a firm is viewed as a governance structure for minimising the cost of trading in the market (Stiles and Taylor, 2002). In terms of this theory, the decision to organize a transaction either through the market or the hierarchy (firm) depends on the efficiency of both forms of coordination in minimizing the cost of that particular transaction. The transaction cost economics theory focuses on the cost of a transaction defined as the costs that arise when individuals exchange ownership rights to economic assets and enforce their exclusive rights (Eggertsson, 1990).

The transaction cost economics theory is applied in the neo-institutional economics approach to the study of economic organisations, and departs from the traditional theory of the firm in which assumptions of rationality and perfect information are made. March and Simon (1958) have shown that the assumptions of rationality are not valid. Although the transaction cost theory departs from the assumptions of perfect information, it retains the rationality assumption, and considers the economic outcomes in organisations in the context of the rational man model where information is imperfect (Eggertsson, 1990).

The execution of transactions is considered costly because it involves a number of activities: the search for information about the distribution of price and quality of commodities and labour inputs, the search for potential buyers and sellers and for relevant information about their behaviour and circumstances, the bargaining required to find the true position of buyers and sellers when the price is endogenous, the making of a contract, and the monitoring of contractual partners to see whether they abide by the terms of the contract. Other activities include the enforcement of a contract, and the collection of damages when partners fail to observe their contractual obligations, and the protection of property rights against third party encroachment (Eggertsson, 1990).

Transaction cost theory is premised with two key assumptions: bounded rationality and opportunism. The notion of bounded rationality was applied by Simon and March (1958) to criticise the traditional economic theory of the firm and proposed a behavioural theory. The concept is defined as: the limited capacity of human beings to formulate and solve complex problems. It arises from human limitations in competence, knowledge and information processing capabilities. Cyert and March (1963) contend that the notion of a rational man could only apply in a situation where full information is available about all states of nature so as to be able to make optimal decisions. Full information would eliminate uncertainty which inhibits the establishment of the "correct choice" in a particular situation.

Opportunism is defined as self-interest with guile or cheating. Because

individuals are interested in maximising their own utility, they can engage in behaviour that affects information, i.e. distorting the information they provide, and the misrepresentation of intentions (Williamson, 1987).

To manage transactions involving opportunistic participants, contracts need to be written in perfect ways. However, due to bounded rationality and transaction costs, writing complete contracts which cover all states of nature is impossible because one has to search for relevant information and thus incurs transaction costs (Williamson, 1981). Further, people's capacity to process information is limited, and uncertainty arising from the lack of information about the future means that contracts cannot be written perfectly. In addition, the enforcement of contracts is also costly since it involves the use of state 'apparatus of violence' such as the police and courts of law. Hart (1995) posits that incomplete contracts would not be a problem without opportunism. Opportunistic behaviour can occur ex ante and ex post. Ex-ante opportunistic behaviour occurs only when there is asymmetrical information and a small number of participants in the exchange (small number bargaining). Ex-post opportunistic behaviour occurs after the transaction has been concluded.

The dimensions of a transaction that are specified are asset specificity, uncertainly and frequency of the transaction. Asset specificity, which arises when the value of an asset within the ongoing relationship exceeds the value of the asset outside the relationship, forms the basis for governance mechanisms. Examples of asset specificity include: human learning or leaning by doing, site specificity such as that arising between adjacent coal mine and power station, the use for a special purpose, of physical capital in order to minimize the out-of-pocket costs of production. Equity capital is treated as possessing some specificity (Williamson, 1987).

When the asset specificity of a particular transaction is high, it can be expected that such a transaction will be carried out within the firm rather than across the market. Once parties to a transaction have invested in relationship-specific assets, the parties are no longer fully protected by the market from opportunistic behaviour by the other party because the market no longer provides perfect substitutes for the other party. Asset specificity worsens the problems associated with incomplete contracts because, in these situations, the extent of opportunistic behaviour which will be tolerated before ending the relationship and deviating the asset to the next best use is much greater.

The potential for investing in relationship-specific assets increases the demand for governance procedures, to mitigate the effect of opportunistic behaviour when non-contractual events occur. The major focus in transaction cost economics is the design of organizational relationships, including governance procedures that affect investments in relationship-specific assets given the inevitability of incomplete contracts. In essence, governance procedures set the rules of the negotiation game, which must be played out when a contingency which is not covered in the contract arises.

In terms of corporate governance, the transaction in question is an investment in

a corporation that is not met with payment but with a promise of future return (Dyck, 2001). The relevance of transaction cost theory in corporate governance is related to the limitations in using contracts faced by company shareholders (equity capital providers) if they want to bind managers. The board of directors is a mechanism that has arisen to address problems that arise from opportunistic behaviour by managers (Williamson, 1981).

Transaction costs limit the role of the board in protecting the interests of shareholders because, it is argued, that the interests of other stakeholders are protected by separate contracts between the firm and those stakeholders which do not usually protect shareholders (Williamson, 1981). These contracts form the basis of the claims by these stakeholders in the event of the firm being disbanded. Being residual claimants, shareholders remain unprotected if the firm is liquidated. As a result, the board of directors is argued to have, as its proper role, the protection of shareholder interests. Transaction cost theory has some limitations in relation to corporate governance. The theory does not address itself to the manner in which the board should be organised to be effective in protecting shareholder interests.

### *3.7.2 Agency theory*

Agency theory, developed by Michael Jensen and William Meckling (1976), has been fruitfully applied in examining the nature of the relationship in a firm that exists between the principal and the agent (Bradley et al., 1999; Denise 2001). The firm is viewed as a "nexus of contracts between different stakeholders of the organisation" Jensen and Meckling (1976). The principal-agent relationship provides benefits since it allows specialisation between shareholders, as risk bearer, and management in the management of the firm. In an agency relationship, the principal hires and retains the agent because of the agent's specific talents, knowledge and capabilities to increase the value of an asset. This encourages efficient allocation of resources. However, the agent enjoys only part of the outcomes of his efforts (Denise and McConnell, 2003). In order to increase the value of that asset, all or some of the principal's decision-making rights over that asset must be transferred to the agent for a period of time. This contractual relationship is defined as:

> "A contract under which one or more person(s) the principle(s) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent". If both parties are utility maximisers, there is a good reason to believe that the agent will not always act in the best interest of the principal (Jensen and Meckling, 1976).

Agency theory is premised on the classical liberalist Lockean notion of private property and reflects a Hobbesian view of self-interested human nature: the deceitful, untrustworthy and indolent individual (Clark, 1998). The theory is based on

assumptions of goal incongruence between the principal and the agent (Jensen and Meckling, 1976). It focuses on the relationships that are masked by the basic structure of the principal and the agents who are engaged in a cooperative effort, but have differing goals and differing attitudes toward risk (Alchian and Demsetz, 1972). When an agent pursues risky projects, although they may lead to an increased value of the asset, such a move threatens the job security of the agent. He is therefore not interested in such projects because they are seen as risky.

Because the agent’s preferences or goals differ from the principal's, the agent has an incentive to deviate from the principal’s interests. It is usually assumed that the interest of the principal is to maximise wealth (Denise, 2001). The agent, on the other hand, is interested in a variety of issues such as career goals, large salary, corporate jets, plush offices, and expense account meals (Jensen and Meckling, 1976). Given this conflict of interests, the agent, if left alone, will pursue his own interests to the detriment of the principal’s. A basic factor in the survival and success of the corporate form of organisation is the control and monitoring of agency problems (Fama and Jensen, 1983).

Jensen (1983) contends that there are two valuable, but largely separate, agency sets of literature both of which have the contract between the principal and the agent as the focus and share assumptions about human nature and information. The principal-agent literature is generally mathematical and non-empirical and the other, the positive theory of agency, is less mathematical and more empirically-oriented.

Eggertsson (1990) asserts that the principal-agent literature generally focuses on modelling the effects of three factors on contracts between parties linked in the hierarchical form suggested by the term principal-agent: the structure of the preferences of the parties to the contract, the nature of uncertainty and the information structure in the environment. The positive theory of agency generally concentrates on modelling the effects of additional aspects of the contracting environment, and the technology of monitoring and bonding. It is concerned with designing governance mechanisms that address the agency problem that stems from the goal conflict between the principal and the agent. Because it is empirically oriented, the positive agency theory can be fruitful in suggesting practical solutions to the agency problems in corporate governance for this research.

The basic feature of agency theory is that decision rights are involved: decision management rights and decision control rights (Fama and Jensen, 1983). Decision management rights include the right to initiate a decision and the right to implement that decision. The decision control rights include the right to ratify, i.e. give final approval to a decision. They also include decision-monitoring rights, which refer to a number of sub-rights: the right to measure the performance of the agent, and the right to reward or punish an agent according to the outcome of his decision. The delegation of decision management rights creates an environment in which the agent has more information

about the outcomes of his efforts (Hart, 1995). This leads to information asymmetry between the principal and the agent. Information asymmetry between the agent and the principal implies that the principal cannot fully measure the outcomes of the agent's efforts. For this reason, agency costs can be minimised but not eliminated (Hart, 1995).

Agency problems exist in two different forms: the failure of managerial competence and the failure of managerial integrity (Moldoveanu and Martin, 2001). Failure of managerial competence refers to unwitting mistakes made in executing managerial responsibilities. These can stem from adverse selection in a situation where the principal cannot ascertain if the agent accurately represents his ability to do the work for which he is hired and paid for. The failure of managerial integrity refers to wilful behaviour on the part of managers that reduces the value of the firm's assets. This arises from moral hazards and reflects the traditional incentive problem highlighted by Adam Smith (Chapter 1).

To address agency costs, a number of mechanisms are applied: country laws, contracts (bonds), incentives and monitoring (Jensen and Meckling, 1976). Contracts are used as a mechanism to resolve ex-ante problems caused by the non-alignment of the interests of shareholders and those of managers. These contracts specify relationships between shareholders as principals and managers as agents; between shareholders (principals) and directors (agents); between directors (principals) and managers (agents). The contracts can be explicit or implicit.

Implicit contracts are those that are based on unspoken mutual expectation, cultural norms, individual roles, organisational common law or culture while explicit contracts are those based on written representations that are legally binding, such as corporate by-laws, shareholders agreements, subscription agreements, and employment contracts (Moldoveanu and Martin, 2001). Although contracts can be used to address problems ex-ante, it is impossible to write perfect contracts. This is because of the transaction costs involved and bounded rationality.

The monitoring solutions by shareholders, especially major ones, constitutes an important mechanism for encouraging managers not to deviate from shareholder interests. Where ownership is fragmented, the board of directors is viewed as an alternative mechanism (Jensen, 1993; Denise, 2001; Denise and McConnel, 2003; Berglof and Claesens, 2004). This indicates that monitoring by shareholders depends on the ownership structure. Debt is also a source of monitoring. Lenders can be effective monitors and help reduce the conflicts of interest between debt providers and management.

Incentives can also be applied to reduce agency costs. They are used to align the interests of shareholders with those of management. The role of markets in corporate governance is also discussed under the agency theory. Competitive markets play a significant role in disciplining poor managerial performance. These markets cover products, labour and capital (Jensen and Meckling, 1976).

**Transaction cost economics and agency theories compared**

Williamson (1987) identified similarities and differences between transaction cost economics and agency theories. The two theories are similar in respect to managerial discretion and behavioural assumptions: bounded rationality and opportunism. In agency theory, the term moral hazard is used rather than opportunism, as used in transaction cost theory. The purpose of economic organizations is to: "craft governance structures that economize on the bounded rationality while simultaneously safeguarding the transactions in question against the moral hazards" (Williamson, 1987).

The notion of efficient contracting is central to both theories. Transaction cost economics examine a contract as an ex-post governance structure within which the integrity of the contract is decided; agency theory, on the other hand, examines it from the point of view of aligning and bonding ex-ante interests. In both theories, similar recommendations are made with respect to minimising of transaction and agency costs respectively. These theories also share the notion of the endogeneity of the board of directors and the idea that a board of directors arises endogenously as a control instrument to protect the interests of shareholders against the deviant behaviour of managers. Both theories justify the board, as representing shareholders, on the grounds of private ownership rights which shareholders have over corporations as well as on them being residual claimants.

Transaction cost economics and agency theories also have differences concerning the unit of analysis, the organisational issues they address and the types of costs involved. The unit of analysis in transaction cost economics is the transaction (Williamson, 1987); whereas "the individual agent is the elementary unit of analysis" in agency theory (Jensen and Meckling, 1976). In terms of the types of cost involved, agency theory includes: monitoring, the bonding costs, and the residual loss (Jensen and Meckling, 1976). Transaction cost theory emphasises the ex-post costs, including administration costs, the haggling costs incurred if bilateral efforts are made to correct misalignments and the running costs associated with governance. It also includes the bonding costs of effecting the secured commitments.

Different organizational issues are addressed in the two theories. Agency is concerned with dispute resolution, whereas dispute avoidance and the machinery for processing disputes are central to transaction cost economics. Williamson (1987) posits that, rather than assume that disputes are routinely submitted to and efficaciously settled by the courts, transaction cost economics maintains that court orderings are very crude instruments and that most court disputes could be resolved by avoidance, self help and similar arrangements.

The two theories also complement each other in a number of ways (Hart, 1995). Agency theory introduces mechanisms to prevent the agent pursuing his interests to the detriment of the principal's; such as contracts (bonding) and interest alignment through the use of incentives. Transaction costs introduce the notion of incomplete contracting

due to bounded rationality and the costs of enforcing contracts. In this way, transaction cost explains the limitation of these mechanisms for inducing the candidate to pursue the interests of the shareholder. Bounded rationality makes the bonding solution inefficient. In addition, moral hazard or opportunism leads to manipulation of the information used to determine the incentives that the agent deserves for observing the contractual terms.

Criticisms have been raised against both transaction cost and agency theories. Perrow (1994) criticised the theories for making "low" assumptions about human nature. Perrow asserts that humans can be trustworthy. Despite this criticism, the two theories continue to be applied to investigate corporate governance practices. The empirical studies that have used this approach include Baysinger and Butler (1985); Stapledone (1995); Canyon et al. (1995); John and Senbet (1998).

## 3.8 Effective corporate governance

From a liberalist perspective, corporate finance and corporate governance are closely connected. The function of effective corporate governance is to improve a firm's ability to access finance at a lower cost and generally improve its performance by enhancing the efficiency with which resources are allocated within the firm (OECD, 1999; CIPE, 2002; Claessens, 2004). The issues of information asymmetry and the incentive problems, which are key concerns with respect to the effectiveness of corporate governance, are also closely connected. Information is required for addressing the incentive problem, seen as the lack of motivation on the part of managers to make decisions that maximise shareholder wealth.

The ability of a firm to attract investments depends on the effectiveness of its corporate governance since this encourages investors to be confident that their investments will be protected and rewarded appropriately. This depends on the incentives for those entrusted with resources to allocate them efficiently. Since incentive problems are the main issue, the efficiency with which corporate governance addresses this problem is a key measure of its effectiveness. The continuous mobilisation of resources, and their efficient allocation, result from the existence of conditions that correct management actions that do not lead to maximisation of shareholder wealth. Transaction cost economics and agency theories, which form the basis of the empirical part of this research, propose general mechanisms for addressing incentive problems. These mechanisms operate both within and beyond the firm.

## 3.9 Conclusions

The way corporations evolve shapes the way they are viewed by society which, in turn, determines the way corporate governance evolves. Where a corporation evolved in a

situation characterised by individual contributions to the firm's capital for the pursuance of their economic interests, as in the case of the Anglo-Saxon model, an instrumental view of the corporation tends to evolve. When this view is accepted by society, it becomes the right of those who contributed capital to own the corporation, and society protects this right by means of laws.

In situations in which individual shareholder rights are protected there is a tendency for shareholding to become widespread. This, in turn, is associated with active markets for corporate control and the use of performance-based compensation as with the Anglo-Saxon model. This suggests that if ownership is widely spread shareholders cannot monitor management but will still find other ways to encourage managers to pursue their (shareholder) interests.

Where a firm develops in a context that is characterised by contributions to its capital by a number of different constituencies as in the case of Germanic and Japanese models, an institutional view of the corporation tends to develop. These consituencies acquire rights which society protects by means of laws. Even when a structure is imposed from outside society, over time the application of this structure will be shaped by the view of the corporation that prevails in the society in question. This has been shown by the Japanese model which evolved in its unique way despite the influence of the US-oriented legal system. This implies that corporate governance tends to be aligned with the view of the corporation, and that societal views of corporations are critical in the evolution of appropriate corporate governance. This conclusion has implications for the debate on globalisation. Although globalisation appears to encourage the convergence of models, this conclusion suggests that while the frameworks or structures may converge there will still be differences in the way these framework/structures are utilised.

In situations where ownership is generally concentrated, as in Germany and Japan, there tends to be non-active markets for corporate control. The use of performance-based compensation is also non-existent or limited. This suggests that, where ownership is concentrated, owners do not find it necessary to use performance-based incentives because they can, and have the motivation to, monitor and discipline management as shown by the Germanic and Japanese models of corporate governance.

Transaction cost economics and agency theories propose general mechanisms that are applied within the models of corporate governance. These mechanisms are also discussed in the principles of corporate governance recommended by the OECD and the CACG. However, the discussion of the models of corporate governance shows that the effective application of these mechanisms requires an alignment with the view of the firm that prevails in a given society and the circumstances pertaining in that particular context. This means that for the purpose of this research, these mechanisms should be further discussed and assessed as to how, in relation to effective corporate governance, they apply to the Tanzanian situation.

# CHAPTER 4 DEVELOPMENT OF THE RESEARCH MODEL

## 4.1 Mechanisms for addressing incentive problems

Various mechanisms are applied within the models of corporate governance to encourage managers to pursue goals that are considered desirable within the models discussed in Chapter 3. Within the liberalist perspective of corporate governance, the objective of corporate governance is to minimise the divergence of interests between shareholders and managers. If this divergence is not addressed, it leads to agency costs which reduce shareholder wealth. In this respect, mechanisms are viewed as effective if they encourage those who have decision-making roles in the operation of the company to make decisions that maximise shareholder wealth. Such mechanisms proposed in transaction cost economics and agency theories operate both outside and within the corporation (Weston et al., 1999; Denise, 2001; Stiles and Taylor, 2002; Denise and McConnell, 2003). The mechanisms that operate outside the firm are the legal and regulatory frameworks and competitive markets. These are taken by organisations as a given framework since they cannot easily change them (Dyck, 2001).

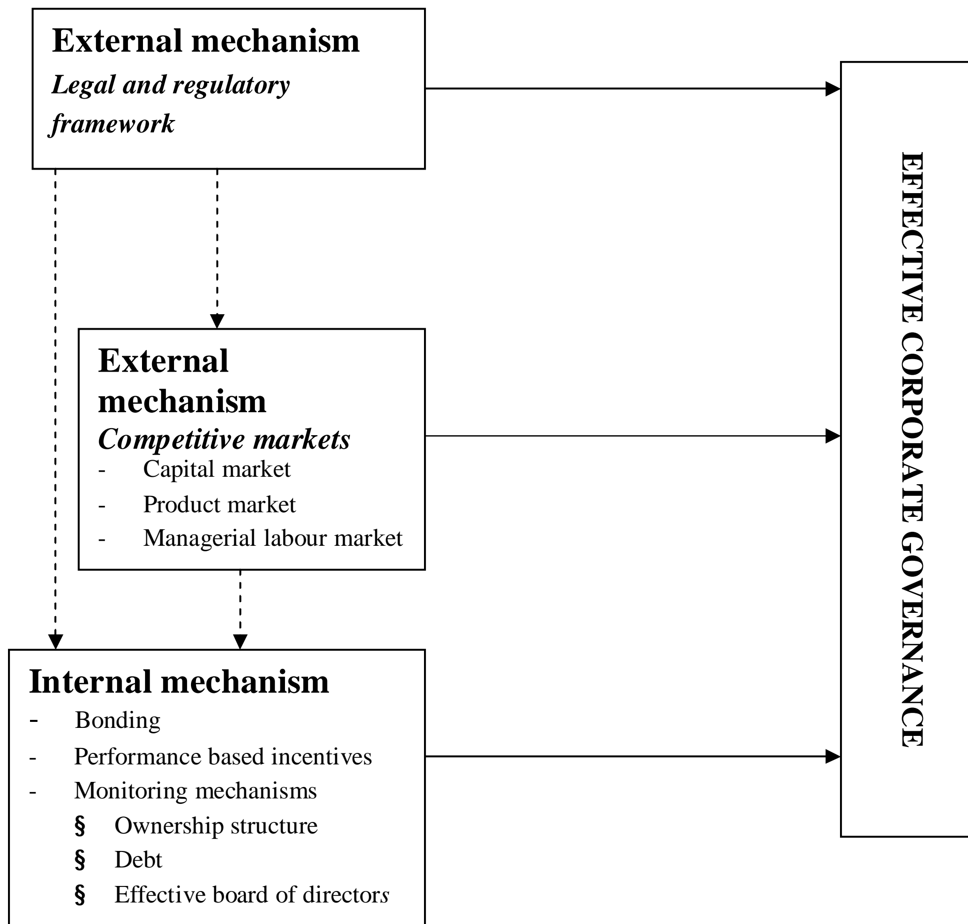
Mechanisms operating within the firm are bonds (contracts), performance-based incentives and monitoring mechanisms such as the board of directors, debt and the ownership structure (Jensen and Meckling, 1976; Williamson, 1981; Jensen, 1993; Denise, 2001; Denise and McConnell, 20003). These are determined by organisations and can be varied to suit the circumstances of each organisation (Dyck, 2001). Internal mechanisms are, in principle, more flexible than external mechanisms and can be varied by shareholders as circumstances dictate. Himmerlberg et al. (1999 cited by McColgan, 2001) argue that firms will tend to use different mechanisms depending on the characteristics of the firm’s operating environment. Since the operating environment varies for each firm, the mechanisms that are optimal for one firm may not be optimal for another. Agrawal and Knoeber (1996 cited by McColgan, 2001) posit that if one specific mechanism is applied to a lesser extent then others may be used more extensively resulting in equally efficient decision-making with respect to shareholder interests.

The two broad categories of mechanisms described in the corporate governance literature form the constituent elements of the general model of corporate governance for this research as is depicted in Figure 4.1. These mechanisms can also be viewed as concepts that require operational definitions. The concepts in the general model are confronted with the Tanzanian context to determine which are relevant to the Tanzanian situation with respect to effective corporate governance. The appropriateness of the various mechanisms for assessing the effectiveness of corporate governance in Tanzania

is evaluated to determine the extent to which they effectively address the first research sub-question in Chapter 1, formulated as:

What are the concepts available in the current body of knowledge that are appropriate for assessing the effectiveness of corporate governance in Tanzania?

**Figure 4.1**
**General model of corporate governance**




*Legend: the full arrows indicate determining relationships while the dotted arrows indicate influence relationships*

Both external and internal mechanisms determine effective corporate governance. External mechanisms further influence internal mechanisms. The legal and regulatory framework influences the way in which internal mechanisms operate. For example, the laws and regulations in a country influence the functioning of boards of directors. In Germany the boards of directors of large corporations are required by law to include both employees and shareholder representatives (Chapter 3). The duties of directors are

also stated in corporate laws of countries. For example, the corporate law in various countries states that corporations are to be managed by directors (Mace, 1971; Monks and Minow, 2002). Also bonding mechanisms rely on the laws and regulations, particularly their enforcement (Berglof and Claessens, 2004).

The legal and regulatory framework influences the functioning of competitive markets. In Tanzania, laws and regulations such as the Fair Trade Practices Act are meant to encourage competition. These laws are specifically aimed at preventing the domination of the market by a single firm or a small number of firms. Competitive capital markets also influence the way in, and the effectiveness with, which internal mechanisms operate. They put pressure on directors to exercise effective control of management (Denise, 2001).

The external and internal division of the mechanisms is conceptually useful for focusing on each of the mechanisms and assessing its effectiveness in addressing the incentive problem (Prowse, 1998; Denise, 2001; Stiles and Taylor, 2002).

Denise (2001), and Denise and McConnell (2003) discuss two criteria that can be applied to assess the effectiveness of a specific mechanism: the extent to which it narrows the gap between the managers' and the shareholders' interests, and the extent to which it impacts on corporate performance and value. The first criterion is arguably plausible from the agency perspective because the essence of corporate governance is to encourage managers to serve the interests of shareholders by narrowing the gap between the interests of shareholders and management (Jensen and Meckling, 1976; Hart, 1995).

The second criterion is problematic because the performance and the value of a corporation are outcomes of corporate activity which are influenced by various factors in addition to the effectiveness of governance mechanisms (Lorch and McIver 1989; Donaldson and Davis, 1991; Denise, 2001). These factors include the level of competition in a particular industry and the general performance of the country's economy. In this respect, making a direct link between corporate governance and the performance of a corporation is not correct. In this research, the extent to which a mechanism reduces the divergence of interest between shareholders and managers will be used to indicate the effectiveness of a specific mechanism in reducing the incentive problem. This criterion is applied to identify those mechanisms that effectively address the incentive problem in the Tanzanian situation.

### *4.1.1 External mechanisms*

**The legal and regulatory framework**

The legal and regulatory framework is the basic mechanism outside the firm and refers to the laws and regulations that govern the establishment and cessation of firms and their operations in a country (Denise, 2001). The legal and regulatory framework also includes stock exchange rules, laws pertaining to the protection of minority

shareholders and laws against corruption. Laws and regulations are determined at the societal level (Dyck, 2001) and represent what is generally socially acceptable[39] (Dore, 1993). The function of laws and regulations with respect to corporate governance is to provide a framework within which various organisational constituencies can relate to one another. They describe the relationship that must exit between management and the various stakeholders (Scott, 1997). In Anglo-Saxon countries, the legal and regulatory framework defines the relationship between shareholders and directors.

The legal and regulatory framework also influences the effectiveness of other mechanisms and in particular the way they evolve. For example, the ownership structure is largely influenced by the effectiveness of the legal and regulatory framework. Berglof and Claessens (2004) posit that the ownership structure is a response to the effectiveness of the legal and regulatory framework. La Porta et al. (1997) and Roe (2003) point out that depending on the applicable laws and regulations, as well as their enforcement, corporate governance may be enhanced through the protection of capital providers (shareholders and creditors). La Porta et al. (1997) find that national differences in ownership structure, capital markets development, financing and dividend polices are related to the degree to which investors are legally protected from expropriation by insiders. They find that in countries where the protection of minority shareholders is effective that the ownership of corporations tends to be widely spread.

The importance of the legal and regulatory framework for encouraging managers to pursue shareholder interests is increasingly being recognised. In terms of encouraging managers to pursue shareholder interests, Dyck (2001) posits that 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 a promise is violated there is no clear penalty they can impose. In extreme situations the lack of investor protection can lead to no investment at all in corporations. Dyck (2001) points out that the prospect of linking violations of promises to future penalties can lead those in control of investor resources (managers) to honour their promises, i.e maximise shareholder wealth. For this reason, laws and regulations that are enforced by the state constitute an important source of penalties when contracts are violated.

Legislative practices also address the incentive problem by encouraging self-control by managers. For example, the Cadbury report made recommendations with which listed companies in the UK are encouraged to comply, and they are required to provide explanations if they do not comply with them. The implementation of these recommendations encourages managers to make decisions that lead to the maximisation of shareholder wealth. The OECD principles of effective corporate governance have emphasised the need to develop a corporate governance legal and regulatory framework

[39] Laws and regulations developed under governments that came to power through military coup d'état are an exception.

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 the relevant laws and regulations (OECD, 1999; 2004).

Although the influence of laws and regulations is recognised, their effectiveness in encouraging managers to make decisions that maximise shareholder wealth is contestable. Jensen (1993) 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".

Jensen also points out that the legal and regulatory framework is intertwined with the political system and thus, depending on the relative influence or power of various constituencies, the law may serve to exacerbate the agency problems between managers and shareholders. He gives an example of barriers that reduce the effectiveness of the legal and regulatory framework in addressing the incentive problem. In the US, in 1998, 41 of the 50 US states had in place various anti-takeover statues, all of which explicitly increase management's power when under threat of an unwanted (hostile) takeover. A hostile takeover implies a potential conflict of interest between managers and shareholders (Jensen, 1993). In addition, there are transaction costs of using the courts to enforce contracts (Williamson, 1987; Chapter 3 of this research).

The US is considered to have the most effective legal and regulatory framework in the world (La Porta et al., 1997). Yet, it has failed to prevent conflicts of interests between shareholders and managers. The collapse of Enron and WorldCom in 2002, and a number of other companies, point to the inability of the legal and regulatory framework to prevent managers from pursuing their own interests at the expense of shareholders. The recent developments in the US in which regulators and law enforcers have sought to jail people and the introduction of the Sarbane-Oxley Act in 2002 are attempts to increase the effectiveness of the legal and regulatory framework (Chapter 3). However, the long-term effect of these developments in preventing further corporate collapses precipitated by failures in managerial integrity cannot yet be determined.

The legal and regulatory framework for corporate governance in Tanzania is generally regarded as weak because of the poor enforcement of laws and regulations (URT, 1996). In addition, some laws are outdated (Chapter 2). However, this is not a problem unique to Tanzania. Poor laws and regulations, and the poor enforcement of existing laws and regulations, are generic problems in developing countries (Lin, 2000; Berglof and Claessens, 2004). The connection of laws and regulations to the political system (Jensen, 1993) makes them unreliable in terms of disciplining managers in these economies (Berglof and Claessens, 2004). This is also related to the problem of "vested interests" (Chapter 2). In Tanzania, the problem of corruption undermines the rule of

law and makes the use of the law a costly option (Warioba, 2003; Chachage, 2003)[40]. The Presidential Commission in Tanzania, chaired by Justice Warioba, stated in the report on the *"State of Corruption in Tanzania"* that:

> "Our 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 have succumbed to this scourge leaving the public with no refuge" (URT, 1996)

This report identified a large number of areas in which corruption is deeply rooted. With respect to the judiciary, it observed that:

> "Court clerks demand bribes in order to open files, expedite their delivery and to hide those of accused persons. Personal secretaries and typists accept bribes in order to produce copies of judgement for various crimes. Regarding Magistrates, corrupt offers are made in order to be given soft sentences, to reduce penalties, to withdraw charges, to give bail and to order Court Injunctions.….State Attorneys accept bribes when prosecuting cases; to authorise the signing of contracts, which are against national interests; and to give legal opinions in favour of those giving the bribe. Moreover, independent advocates give bribes to Magistrates and Judges to obtain favourable judgements for their clients.

The problem of corruption that is being experienced in Tanzania is common to a large number of countries in Africa (Okeahalam and Akinboade, 2003). Gathinji (2002) observes that, in Kenya, corruption is a serous problem that makes practicing effective corporate governance difficult. This indicates that the legal and regulatory system cannot be relied upon to encourage managers to pursue shareholder-wealth maximising strategies because it does not provide a credible threat that violation of the promises will be efficiently punished in such contexts.

**Competitive Markets**

Three types of markets are discussed as potentially able to address the incentive problem: capital markets, product markets and managerial labour markets (Manne, 1965; Jensen and Meckling 1976; Hart, 1995).

*(i) Competitive markets for corporate control*

---

[40] In Tanzania, the war on corruption is generally regarded as not having been successful (Rai, October 30th –November 5th, 2003; Rai, December, 4th- 11th , 2003

Capital markets play an important role in corporate control. A capital market refers to one for long-term capital, both equity and bonds (debt capital). Capital markets are divided into primary markets and secondary markets. The primary market is the new issues market, i.e. for selling and buying new securities or shares. The secondary market deals with existing securities. In corporate governance, the secondary market is of more importance because it is in this market that corporate governance can be exercised through "*exit*". Exit occurs when investors or shareholders end their membership of a corporation as shareholders by selling their shares. It has the potential to bring about change in the ownership of the corporation and hence change in its control.

Manne (1965) posits that the market for corporate control which operates through the capital market can discipline inefficient managers. In this market, managers or teams of managers compete for the rights to manage corporate resources (Jensen and Ruback, 1983). The market for corporate control disciplines inefficient management in three different ways; through proxy fights, takeovers and through mergers. Proxy fights involve a proposition by a dissident shareholder against the slate of candidates proposed by management who then persuades others to vote for his slate of candidates (Hart, 1995). In some countries such as the US, management proposes names of potential directors to be voted on by shareholders at the annual general meeting (John and Senbet, 1998). Proxy contests involve a certain level of struggle between incumbent management and dissidents.

Gaining control of a corporation through a proxy fight is difficult in a corporation with dispersed shareholders due to significant free-rider problems[41]. Small shareholders lack an incentive to think about whom to vote for since they may think their votes will make no difference. There are other barriers to gaining control via proxy fights. For example, the law may allow management to use company funds to promote their preferred candidates (Hart, 1995), whereas a dissident shareholder has to use his own resources to promote his slate. For a shareholder seeking to promote his own slate of directors, this option may be difficult because of the costs involved.

With respect to takeovers, there is a debate on the exact way in which the market for corporate control encourages managers to pursue strategies that maximise shareholder wealth. Butler (in Smith, 1996) asserts that it is the threat of a takeover, not the actual takeover, that serves to align the managers' interests with the shareholders' interests. The fear of being taken over acts as an incentive for managers to make decisions that maximise shareholder wealth. The opposing view posits that the market for corporate control is efficient because of actual takeovers of corporations. This occurs through the takeover of a poorly managed organization by a management that believes it can manage the firm better, or when assets are believed to be undervalued and where the new management believes that the organization's assets can be sold

[41] The free rider problem refers to the collective inaction by shareholders with respect to monitoring management.

separately at a higher price (Hart, 1995).

Both perspectives on the way the market for corporate control addresses the incentive problem are valid. However, they focus on different stages of the problem. By being a threat or enabling change of management, the market for corporate control encourages managers to make decisions that lead to the maximisation of shareholder wealth (Fama and Jensen, 1980). With respect to an actual takeover, the direct purchase of a company involves the acquisition of the requisite number of shares from the stock market. Shares can also be purchased through a tender offer made by the party wanting to acquire control of the corporation[42]. Purchasing shares from the market can be complicated by the free-rider problem in a widely dispersed company: small shareholders who believe that their decisions will not affect the outcome of the tender offer may not bother to tender their shares (Hart, 1995). This problem can be avoided where large shareholders exist because they provide a possibility for negotiations (Manne, 1965).

In the case of an actual takeover, third parties may gain by purchasing the firm's shares at a price above the market price but below the value of the firm were it managed better. However, it is the potential capital gains (appreciation in the share price) inherent in the stock that is usually considered to provide the greater motivation for corporate control, and this can be realized if the company is managed more efficiently. The lower the share price is, compared to what it could be with more efficient management, the more attractive the shares become to those who believe the management of the company can be improved to realise an increased value. The difference between the buying price of shares and their selling price constitutes the benefit of acquiring a firm.

Mergers are another way through which the market for corporate control operates. Mergers involve corporations acquiring other corporations, and use shares as a medium of exchange rather than cash in settling the purchase consideration (Manne, 1965). This is because shareholders of the to-be-merged corporations become shareholders of the new corporation that is established after the merger. Mergers typically require the approval of those already in control of the corporations. As a result, merger negotiations can be demanding and time consuming.

The efficient operation of the market for corporate control is determined by: the availability of information, rules governing takeover activity and the availability of a third party interested in taking over other firms. Manne (1965) points out that the existence of a high positive correlation between corporate managerial efficiency and the market price of company shares is important. If such a correlation exists, the corporate control market theory posits that managers who do not maximize the value of their firms will be taken over by third parties (Manne, 1965). If an existing company is

[42] In a tender offer, an offer is made to buy current shareholder shares at a specified price. The objective is usually to gain control of the company. This offer is usually made by another company and usually at more than the market price of the shares

poorly managed the market price of the shares will decline compared to the shares of other companies in the same industry or compared to the market as a whole. In this respect, the low share price facilitates efforts to take over high-paying managerial positions and provides useful indicators that trading in the shares of the company whose shares are selling at a low price, will lead to some gain

Without sufficient sources of information to facilitate the inclusion of all managerial effort in the share price, the market for corporate control cannot be an effective mechanism for minimising incentive problems. In countries in which the markets for corporate control play key roles in corporate governance, there are networks of information providers such as brokers, financial analysts and credit rating agencies. These institutions are important for an efficient economy (Berglof and Claessens, 2004). The Anglo-Saxon countries are characterized by such a a network of information gathering agents, including the media, brokers, and specialised financial advisers, all of whom help in factoring performance-related information into the share price (World Bank, 2000). The market for corporate control is, compared to other countries where such a network is less developed, more effective in the Anglo-Saxon countries.

The OECD and CACG principles of effective corporate governance encourage countries to develop markets for corporate control (Chapter 3) because they will contribute to enhancing the efficient allocation of resources within the corporation and the economy as a whole. This implies that markets for corporate control are socially useful.

The critics of the market for corporate control contend that the efficiency of the market for corporate control is questionable due to the problem of limited information (Smith, 1996). In this respect, the notion of the efficiency market hypothesis (EMH) is discussed in terms of which three states of informational market efficiency are identified: weak form efficiency; semi-strong efficiency; or strong form efficiency. Under the weak form of the EMH, current prices of shares and bonds (financial assets) reflect all the information that buyers and sellers have been able to obtain on the past trading of such assets- their price history and past volume of trading (Rose, 1997). Moreover, this past price and trading information is publicly available and obtainable at negligible cost. No single buyer or seller of stocks, bonds or other financial assets can earn excess profits beyond those that are normal for the amount of risk taken in trading on this historical price and volume information.

The semi-strong form of EMH contends that the current prices of stocks, bonds and other financial assets reflect all the publicly available information affecting the value of these assets including information about past prices and volume, the financial condition and credit rating of the issuer; any published forecasts, the condition of the economy and all other relevant information. All buyers and sellers are assumed to be rational and to use all publicly available information to help them value financial assets. No one buyer or seller will therefore find opportunities for exceptional profit by trading

on any publicly available information.

The strong form of the EMH contends that the current prices of financial assets capture all the information, both public and private, that is relevant to their value. This includes information processed by "insiders" such as the officers, directors and large shareholders of the corporation issuing stocks, bonds and other financial assets. This includes information from accountants, attorneys and journalists who work with the company and have access to privileged information.

Research has confirmed the weak form and semi-strong form of the EMH in practice (Rose, 1997). However, research on the strong form of EMH has provided mixed and hence inconclusive results. The implication of the three forms of information market efficiency is that share prices will tend to include only publicly available information. Private information is not reflected in the share price implying that markets cannot generally reflect all the managerial efforts. Peter Drucker posits in writing of the market for corporate control that:

> "The stock market is surely the least reliable judge of managerial performance or at best only one judge and one that is subject to so many influences that it is practically impossible to disentangle what of the stock appraisal reflects the company's performance and what reflects caprice affects, the whims of securities analysts short-term fashions and the general level of the economy and of the market" (Drucker, cited by Smith, 1996)

Drucker posits that managerial performance is difficult to measure as it is affected by various factors. It is difficult to isolate managerial performance from the subjective judgement of financial analysts.

The tendency in the market for takeover activities to cease during particular times is also a source of inefficiency in the market for corporate control. For instance, the market for corporate control tends to be inactive during recessions (Prowse, 1998). When there are long periods in which the threat of takeover is diminished, it ceases to provide a motivation for management to make decisions that maximise shareholder wealth; i.e. its effectiveness diminishes. This leads to the conclusion that the market for corporate control, as an effective mechanism for encouraging managers to make decisions that maximise shareholder wealth, may be unreliable.

Managerial inventions can limit the effectiveness of the market for corporate control (Monks and Minow, 2002). Such inventions are poison pills, voting caps, and anti-takeover rules[43] which may be part of the securities laws in some countries. The

---

[43] Poison pills refer to a device used by the company to make itself less attractive as a takeover candidate. These securities provide their holders with special rights exercisable only after some time, e.g. ten days following the occurrence of a triggering event such as a tender offer or when a certain percentage of shares has been accumulated. Voting caps refers to an issue of preferred stock with super-majority voting

effective functioning of the market for corporate control relies on rules and regulations that allow takeovers. If the rules do not allow takeovers, as in the case of Germany before the reforms (Chapter 3), the market for corporate control will not provide the requisite discipline.

In terms of this research, the question is to what extent is the market for corporate control an effective mechanism in Tanzania? The conditions for the emergence of a competitive capital market are in their early stages of development. Mechanisms through which the market for corporate control operates such as proxy fights and mergers have not been experienced in Tanzania. This can be explained by history. During the central planning era, when business enterprises were owned by the state, the market for corporate control could not develop because it did not fit with the philosophy of socialism. Major corporations were owned by the government, which provided capital and exercised governance of these corporations (Chapter 2). However, because of the reforms currently being implemented, conditions for the development of a market for corporate control are being established. The establishment of a stock market to facilitate "entry" and "exit" of shareholders by the purchase and disposal of shares is an important development in this respect.

With respect to information gathering agents, which form an important element of an efficient market for corporate control, there are currently six brokers/share dealers at the exchange. Also, the reporting of financial matters currently only takes place on a limited scale. An effective market for corporate control requires the existence of an active capital market (Powse, 1998), and this does not currently exist in Tanzania.

*(ii) Competitive product markets*

Product markets also constitute a disciplining mechanism for wasteful or inefficient managers. Jensen (1993) asserts that if a firm cannot sell its products at a profit in the market place, it will not survive. Gilson and Roe (cited by Smith, 1996) posit that the most elegant monitoring mechanism is intense product market competition. A competitive product market will discipline managers more vigorously than any board can do. The product markets provide incentives for managers who hope to survive over the long term, and inflict the ultimate punishment of exit or bankruptcy as the last resort on companies that fail to heed the signals (Jensen, 1993). Since managers are afraid of their firms going bankrupt they will strive to make decisions that address shareholder interests. Thus, the ultimate discipline of the market comes from the threat of bankruptcy of corporations whose managers do not heed the signals from the product markets.

Although the product market is believed to play a significant role in disciplining

---

rights to target firm's shareholders; at a trigger point, the acquirer's preferred stock losses its voting rights. Anti-takeover rules refer to a variety of rules that make takeovers unattractive.

wasteful managers, it is not without impediments. Jensen (1993) has pointed out the first major problem - the speed at which the product market acts to discipline poor managers. While the product market is quick to send signals regarding a firm's non-competitive position, the real disciplining effect of product markets may not be felt for a long time (Jensen, 1993). Jensen observes that product markets are slow to act as a control device, and when they do so it can be too late to save much of the enterprise. In addition, managers can circumvent the disciplining effect of the product market through diversification strategies. When managers acquire lines of business with different product life cycles, they insulate themselves, either intentionally or unintentionally, from the discipline of the product market (Jensen, 1993). In this respect product markets do not provide effective deterrents to non-shareholder wealth maximising behaviour of managers.

In terms of this research, the applicability of product market discipline in the context of Tanzania is currently limited, but growing as a result of the liberalisation policies which are encouraging competition. Competition in the informal sector is significant (Tripp, 1997) but not among the large corporations. This reflects the legacy of socialist policies, which encouraged monopolist tendencies among large state-owned corporations (Chapter 2). This means, to a large extent, that competition is likely to come from outside the country following the relaxation of import restrictions (Lipumba, 1992). As local markets continue to be flooded with imported products, the product market will grow in importance and provide discipline for poor managerial behaviour in the long term.

Notwithstanding this, problems involving the avoidance of the market discipline by managers also occur in Tanzania as evidenced by TBL-KIBO case (Chapter 1). Product markets rely on laws, such as anti-trust laws, to operate effectively. In this respect the poor enforcement of laws as discussed by Lin (2000) in developing countries is also a major barrier with respect to the discipline of the product market. In addition to the general problems of product markets in disciplining managers, as discussed in the literature the lack of enforcement of laws and regulations, including the anti-trust laws that would strengthen competition, means that the product market discipline is currently limited in Tanzania.

*(iii) Managerial labour market*

Fama (1980) argues that the importance of the managerial labour market is in aligning the interests of managers and shareholders, asserting that the primary disciplining of managers comes through the managerial labour market. This market operates both inside and outside the organisation (Jensen and Meckling, 1976). The monitoring within the firm consists of managers monitoring each other, both higher and lower in the hierarchy (Jensen and Meckling, 1976). The monitoring of management that takes place outside the firm comes from managers attempting to move from one company to

another (Jensen and Meckling, 1976).

Weisbach (1988) and Warner et al. (1988) provide empirical evidence on the effectiveness of the labour market in encouraging managers to maximise shareholder value. They find that it is only the very poorest performing managers that are likely to lose their jobs and that it generally takes a prolonged period of poor performance to result in forced top executive turnover. Jensen and Murphy (1990) and Kaplan and Reishus (1990) also posit that the managerial labour market punishes only the poorest performing managers. Gilson (1989 cited by McColgan 2001) points out that external labour markets use evidence from past performance in defining job opportunities and compensation levels for company executives. Kaplan and Reishus (1990) find that managers in companies that reduce dividends are less likely to receive roles as outside directors in other companies as they are perceived as poor performers. This evidence shows that competitive managerial labour markets can encourage managers to maximise shareholder wealth, however, they do not act quickly and are comparable with product markets in terms of speed.

Lin (2000) has pointed out managerial labour markets are not competitive in developing countries. Nepotism and favouritism in the appointment of managers characterises corporate governance in developing countries (Chapter 3). This is the case in Tanzania, as shown by the problems with state-ownership of corporations (Chapter 2). The legacy of this system still exists (Kihiyo, 2002). This problem is also faced in a large number of the African countries (Okeahalam and Akinboade, 2003). This assessment shows that, in addition to the general weaknesses discussed in the literature, the managerial labour market also faces limitations in the current situation in Tanzania.

The functioning of the three markets with respect to corporate governance is generally problematic. The fact that significant market failures have occurred, particularly during the 1990s and recently in 2002 in the US and the UK, confirms the view that markets are not that effective in addressing incentive problems. This also applies to developing countries. In general, external mechanisms in the case of Tanzania do not offer credible promises for addressing the incentive problems, as the case in other countries with underdeveloped institutional environments (Lin, 2000; Berglof and Claessens, 2004).

### *4.1.2 Internal mechanisms*

***Bonding***

Bonding refers to the contract with managers in which they indicate that they will continuously pursue actions that maximise shareholder wealth (Denise, 2001). Bonding requires detailed contracts to be drawn up which show the courses of action that managers should take in different situations. This approach is inadequate for removing incentive problems and hence ineffective in fully encouraging managers to pursue shareholder-oriented goals. This is because bounded rationality and transaction costs make writing comprehensive contracts that specify every eventuality impossible (Chapter 3). Contracts rely on the existence of laws and regulations, and the effectiveness with which such laws and regulations are enforced (Berglof and Claessens, 2004). This means that, if laws are not enforced, as is the case in developing countries, contracts cannot force managers to make decisions that maximise shareholder value. In addition to the generic limitations of bonding, the problem of the poor law enforcement in Tanzania, which has been discussed in the previous sections, places major limitations on the bonding solutions.

***Performance-based incentives***

In agency theory, one of the solutions to the conflict of interest between shareholders and management is to use performance-based incentives or compensations. The board of directors can set up a management compensation scheme that ties the interests of the shareholders to those of the managers in order to make them think like owners (Jensen and Meckling, 1976; Roe, 2003). McColgan (2001) posits that the structure of executive compensation contracts can have a large influence on aligning the interests of shareholders and management. Higher incentives should lead to better company performance (Jensen and Meckling, 1976).

Compensation can take different forms: basic salary, accounting-based performance bonuses, executive stock options and long-term incentive plans (McColgan, 2001). Generally, compensation influences both the choice of the place of work for managers as well as the amount of effort they exert to achieve particular levels of performance. Baker et al. (1988 cited by McColgan, 2001) posit that the level of pay determines where managers work, but the structure of their compensation contract determines how hard they work. In terms of corporate governance, effective compensation contracts should provide management with sufficient incentive to work hard and maximise shareholder wealth.

Executive salaries are likely to be determined by a number of factors: the managerial labour market, the size of the firm, and the manager's position on the corporate ladder. Basic salaries are generally considered to be not that effective in

encouraging managers to make shareholder-wealth maximising decisions. Jensen and Murphy (1990) contend that the equilibrium in the managerial labour market will prevent large salary cuts for poorly performing managers. This is because salary cuts below a certain minimum provided in the market are not possible. There are also likely to be equilibrium salary levels for managers in different industries which most companies will wish to stay in line with. This leads to the conclusion that basic salaries do not provide sufficient incentive for managers to make wealth-maximising decisions.

Bonuses based on accounting measures of performance provide a better mechanism for aligning manager's interests with those of the company's shareholders. However, paying executives on the basis of accounting variables provides an incentive for management to directly manipulate the accounting system and favour projects with short-term accounting returns at the expense of long-term positive NPV[44] projects (Healy, 1985 cited by McColgan, 2001; Jensen and Murphy, 1990).

Weisbach (1988) provides empirical evidence on the effectiveness of bonus-based compensation in aligning interests. Weisbach (1988) finds higher accounting earnings in the year prior to the removal of a CEO. This suggests that managers can be tempted to manipulate accounting information to project better performance. In the case of Enron, the management manipulated records by classifying expenses as capital expenditure. DeChew and Sloan (1991 cited by McColgan, 2001) report that research and development expenditures frequently decline prior to the retirement of a CEO. A tendency also observed is that managers often become concerned with short-term results rather than long-term performance. The results point to the conclusion that bonuses based on accounting measures of performance are not a sound mechanism for achieving interest alignment.

Performance-based incentives for managers can also take the form of executive stock options which provide managers with the right to buy company stock (shares) at a fixed price at a future date. This is generally viewed as the most effective means of tying the interests of managers to those of shareholders. Stock options are usually viewed as a substitute for managerial shareholdings. The attraction of stock options is that the profit the manager can make upon exercising the right to bring increases as the value of the firm increases. Managers are therefore encouraged to maximise the firm value and hence the interests of shareholders because they too benefit from the increased value.

Long-term incentive plans constitute the fourth mechanism for aligning the interests of shareholders with those of management. McColgan (2001) points out that these plans take different forms, including awarding company stock upon the achievement of some long-term performance criteria such as earnings per share (EPS),

---

[44] NPV refers to Net Present Value and is defined as the difference between the present value of cash flows generated by a project and the initial outlay. This is one of the commonly used criteria in deciding whether to invest in projects.

growth above a given percentage after a particular number of years (in the UK) and restricted or multi-year bonus plans (in the US). As with stock options, they are termed "equity-based compensation" and are usually granted at zero or a nominal exercise price.

Both stock options and long-term incentive plans have limitations. A major limitation is linked to managerial risk aversion. Since managers are more risk-averse than shareholders, they are unlikely to pursue risky but value-maximising projects (Chapter 3). In addition, the value of stock options and long-term incentive plans are connected with the market price of stock. However, as discussed under the corporate control market, the factoring of managerial performance into the share price is problematic.

The major problem with the use of performance-based incentives is the presence of hidden information (Hart, 1995). Hidden information is information that is available only to the agent, i.e. management. This is usually partly addressed by management's initiative to disclose that information about their performance which is key in determining share price. However, this information may be subject to manipulation by management to portray a good picture of their performance. This calls into question the efficiency of incentive-based approaches.

The use of performance-related compensation is higher in the liberalist models of corporate governance (i.e. the Anglo-Saxon ones), which are characterised by more efficient markets and widely spread ownership, than in the communitarian ones (i.e. the Germanic and Japanese ones). With respect to the Tanzanian context, it must be determined the extent to which performance-based compensation encourages managers to make decisions that maximise shareholder wealth in Tanzanian firms. As observed previously, basic salaries and bonus are inherently problematic. Stock options and long-term incentive plans rely on true market pricing of shares in efficient capital markets. The conclusion in Chapter 3, that performance-based compensation tends to be applied in situations where ownership is fragmented and where active markets for corporate control exist, suggests that this mechanism may not be effective in Tanzania because the situation is different. Berglof and Claessens (2004) posit that performance-related incentives in developing countries are not effective mechanisms because large shareholders exist who can easily hire and fire management when it does not perform.

***Monitoring mechanisms***

Monitoring solutions involve observing the actions of management and judging them as to whether they maximise shareholder value. Denise (2001) points out that monitoring solutions require effective monitors who present a credible threat to management. Shareholders could perform this monitoring function effectively (Denise, 2001). However, there are two related problems such that shareholders cannot undertake this task effectively, or at all: free-rider problems and transaction costs (Hart, 1995). The

free-rider problem is a collective action problem which arises from a large number of dispersed shareholders holding only a small proportion of the equity capital and therefore lacking the incentive to monitor management. The presence of transaction costs in monitoring reinforces the free-rider problem (Hart, 1995). Monitoring involves gathering information and taking action, both of which are costly and time consuming. In large corporations, the monitoring function is performed by the boards of directors, the large shareholders (hence the importance of the ownership structure) and by debt capital providers (Denise, 2001).

*(i) Ownership structure*

The ownership structure refers to the identity of equity holders and the size of their holdings (Vishny and Shleifer, 1986). A certain degree of ownership dispersion is a prerequisite of liquid stock markets but it results in a collective action problem, as individual investors have no incentive to engage in the direct monitoring of managers (Becht, 1999). Becht asserts that the ideal solution to this problem consists of three elements. First, a mechanism for concentrating voting power and thereby allowing direct monitoring. Secondly, concentrated shareholding should not tie up large share blocks and destroy liquidity; and thirdly, those that command the voting power must have the right incentives to engage in monitoring (Becht, 1999). For the purpose of this research, only the first and third elements are relevant since they address the incentive problem because they pertain to the exercise of control over management decisions.

Governance by shareholders relies on controlling, or block shareholders who have both the incentive and the ability to engage in the monitoring of managers (Hart, 1995; Denise 2001; Berglof and Claessens, 2004). Control exercised by shareholders is termed in this research, shareholder control. Shareholder control implies that inefficient management can be easily changed (Carlsson, 2003). Clarke and Clegg (1998) posit that large shareholders constitute an effective mechanism for preventing managers from pursuing their own selfish interests at the expense of shareholders.

The ownership of a firm can exist in two forms: ownership by management (including ownership by directors) and ownership by other, outside shareholders. Ownership by the company's management can serve to align the interests of the management and those of shareholders. Such ownership may come about in a number of ways: founder managers of a business may continue to own shares in a firm or it may arise through management rewards such as stock options and long-term compensation. When management interests do not coincide with those of shareholders, a higher equity concentration held by the management can provide management with greater freedom to pursue their own objectives without fear of reprisal. It can also entrench managers (Denise and McConnell, 2003; Berglof and Claessens, 2004). The ultimate effect of managerial ownership on the value of a firm depends on the trade-off between the management alignment with shareholders and the entrenchment effects.

Morck et al. (1988) suggest that certain levels of managerial ownership encourage managers to make decisions that maximise shareholder value. However, beyond that level (5% of equity capital), diminishing returns on managerial ownership begin to take place. Morck et al. (1988) contend that with 5-25% ownership by management an entrenchment effect tends to take place. In their study, they found that with 25% of equity capital ownership by management, boards of directors could reject a takeover proposal. Jensen and Warner (1988) express surprise that an inside stock option of 5% begins to give managers sufficient control power to cause the value of the firm to fall. They also note that the implication of effective control occurring at 25% is inconsistent with the findings of Jarrell and Poulsen (1988) who found that this effect of dual-class recapitalisation occurs when insider holdings are in the range of 30% to 55%. This suggests that the current evidence of managerial entrenchment is not conclusive.

Morck et al. (1988) assert that the predictions of the entrenchment effect are not clear-cut. They point out that entrenchment is not just a consequence of voting power; it is also affected by a manager's tenure with the firm, status as a founder, personality and by the presence of a large outside shareholder or an active group of outside directors. Morck et al. (ibid) also point out that diminishing returns might set in before 50% ownership is reached such that increases in shareholdings would not allow deeper entrenchment and entail a penalty in the market valuation, i.e. higher ownership by management begins to lead to a reduced share price.

The other important dimension of ownership structure is that characterised by concentrated ownership by outside shareholders. There are different views on the role of large shareholders with respect to corporate governance in organisations. Shleifer and Vishny (1986) develop a model for the role of the large shareholder in which the large shareholder monitors the firms' management and engages itself in proxy contests and takeover activity as needed. Stulz (1988) developed a model in which the large block holder manages to resist takeover attempts and thus causes the takeover premium and the firm's value to be higher.

These various views and predictions on the organisational roles of large shareholders motivated Holderness and Sheehan (1988) to empirically investigate the role of large shareholders. They analysed 114 NYSE or AMEX firms with majority shareholders. Majority shareholders were defined as individuals or entities owning at least 50%, but not all, of the common stock. The reason for this choice is that the effects of concentrated shareholding should be most pronounced in firms with majority shareholders. For a major shareholder, most of the wealth effects of management decisions are internalised, and monitoring by the board or by the external market for corporate control will not effectually restrain their behaviour. They can reject a takeover proposal and can even use their vote to force directors to pursue strategies they recommend.

Holderness and Sheehan find that majority holding is surviving as an

organisational form. 90% of the individual majority shareholders and representatives of 94% of the corporate majority shareholders are either directors or officers in their firms. The average majority holding is 64% (median 60%) for all firms in the sample, significantly greater than the 50% that assures voting control. The findings of Holderness and Sheehan (1988) show that majority shareholders do not only monitor management teams but also actively participate in management.

Majority shareholding plays a central role in management and is reflected by the management and board turnover following majority-block trading. When large blocks of shares are in the hands of a single or small number of shareholders, it encourages the holders to change management when need be and match the organisation with the prevailing competitive environment (Carlsson, 2003). Berglof and Claessens (2004) posit that large shareholders are the key mechanism of corporate governance in developing countries. The large shareholders that are emerging in Tanzania (Chapter 2) are also likely to monitor management.

*(ii) Debt*

Debt financing is intertwined with corporate governance issues as it impinges on managerial decision-making. It reduces the use of capital (Jensen and Meckling, 1976). The use of debt financing has implications for corporate governance since it determines the extent of control by creditors (creditor control). Jensen (1986, cited by McColgan, 2001) posits that the existence of debt in the firm's capital structure acts as bonding mechanism for the company's managers. Hart (1995) argues that debt limits how inefficient management can be, at least if the management wants to repay the company debt. Easterbrook (1984) posits that the external capital market monitoring, brought to companies by debt finance, forces managers to pursue value-maximising strategies rather than their own personal interests. In addition, lenders may also attach conditions to loans. Lenders typically have a prior claim to the assets of a firm in the last resort.

Debt can therefore underpin an implicit relationship, with significant lenders acquiring an informal say in management decisions. The bankruptcy costs of debt and the embarrassment arising from bankruptcy address the incentive issue by encouraging managers to become more efficient. The fact that lenders have an interest in the performance of a firm over the lifetime of the debt may facilitate a long-term relationship. For example, in the Germanic and Japanese models of corporate governance, long-term lending has facilitated long-term relationships between firms and banks. These relationships have also led to significant flows of information from corporations to banks which, in turn, have provided banks with knowledge, motivation and power to influence managerial decision-making processes (Baum, 1993; Sebora and Rubach, 1998).

Brennan (1995b) argues that the role of a firm's capital structure should be to ensure it has a socially-optimised liquidation level. Higher levels of debt increase the

probability of a liquidation decision by making default more likely (Haris and Raviv, 1991). Empirically, Franks et al. (2001) found that companies (in the UK) with high leverage and low interest coverage on their debt are more likely to experience forced turnover of top management. This suggests that debt can be an effective deterrent to inefficient management. However, debt financing has fixed costs. Higher levels of debt bring higher levels of debt-related agency and bankruptcy costs. Bankruptcy costs are the costs of the adjudication process which bankruptcy involves (Jensen and Meckling, 1976). They include the cost of calling meetings of creditors, carrying out a valuation of assets and distributing the proceeds of sales of assets if such exist. The optimal capital structure should be where the marginal costs of debt equal its marginal benefits- the point where a firm's value is maximised. A company's management determines the optimal level of debt depending on the company's operating environment. Increasing debt beyond the optimal level increases risk and reduces the value of the company.

In general, information on the use of long-term debt by firms in Tanzania and its effect on corporate governance is lacking due to the lack of research on this subject. However, anecdotal evidence suggests that parties have had problems recovering funds they lent to corporations due to difficulties in forcing them into bankruptcy (World Bank, 2002). It was discussed in Chapter 2 how, during the years of central planning in Tanzania, lending by banks did not follow commercial principles and banks could not force companies into bankruptcy to recover their investments. This was because both banks and borrowing firms were owned by the state. Following economic reforms, and the formal adoption of market-based economic principles; commercial considerations have become more important (Nyangetera, 1992). However, there are still challenges due to the poor enforcement of laws in Tanzania (World Bank, 2002). Inefficient legal and regulatory frameworks and outdated laws tend to make the debt discipline on management ineffective in developing countries (Berglof and Claessens, 2004). This leads to the conclusion that debt may not be that effective in disciplining management in the Tanzanian context.

*(iii) Effectiveness of boards of directors*

Company boards of directors have evolved as part of the market solution to the problem of contracting within organisations (Hermalin and Weisbach, 2001; see also McColgan, 2001). The board of directors has evolved as an important organ due to the separation of ownership and management (Hart, 1995; Roe, 2003). They are at the apex of the decision-control system of an organisation, large or small, in which decision agents do not hold a major share of the wealth resulting from their decisions (Fama and Jensen, 1983). The board of directors has been viewed as an institution within a firm whose role is to minimize agency and transaction costs (Baysinger and Butler, 1985). An effective board can address the issue of conflict of interests between shareholders and managers by exercising decision-control rights. The exercise of control encourages managers to

pursue shareholder wealth-maximising strategies (Jensen and Meckling, 1976; Williamson, 1981).

Morck et al. (1988) attempted to assess the effectiveness of the board of directors in disciplining management, and found that the board is not completely unresponsive to poor performance by management. They point out that when a firm significantly underperforms the rest of its industry, the probability of a complete turnover of the top management team increases. A board compares the performance of the firm with that of its industrial rivals and sometimes removes top managers if they cannot keep up with the rest of the industry (Morck et al., 1988). Boards of directors are generally regarded as a mechanism able to monitor management (Jensen, 1993; Denise 2001; Denise and McConnell, 2003). The OECD and CACG principles of corporate governance pay significant attention to the board of directors. Corporate governance reforms in a large number of countries, including Tanzania, are focusing on the role of the board of directors. This leads to the conclusion that it is an important mechanism.

### *4.1.3 Conclusions*

The foregoing discussions show that an underdeveloped institutional environment, poor legal and regulatory frameworks, underdeveloped capital markets, uncompetitive products and managerial labour markets, currently characterises the Tanzanian operating environment with respect to corporate governance. This means that conditions are not in place for external mechanisms to function efficiently and achieve effective corporate governance and this implies that effective corporate governance has to be attained through the application of internal mechanisms. However, those internal mechanisms that are directly reliant on external mechanisms, e.g. bonding and debt which rely on the legal and regulatory frameworks and performance-based incentives which rely on a competitive capital market, also have limitations in Tanzania. The internal mechanisms covering ownership structure and an effective board of directors appear, in the context of the country, to be the most effective mechanisms for addressing incentive problems in the current setting in Tanzania. To test this conclusion a pilot case study was conducted.

## 4.2 The pilot case study: the Friendship Textile Company (FTC)

A case study was conducted in order to verify the conclusion that in the context of Tanzania, the ownership structure and the board of directors are the principal mechanisms in determining effective corporate governance. The principal criterion used to select a company for a pilot case study was the presence of at least one large shareholder with control rights. The reason for this is that the role of the large shareholder in controlling agency problems will be discernible in such a situation (Shleifer and Vishny, 1986). The company should also be governed according to

company ordinance Cap. 212 (Chapter 2). The reason for this is that this research seeks to gain insight into corporate governance in companies governed under this framework. This framework is also currently the most important because all privately held companies are governed under this framework. As privatisation shifts the ownership of companies to private shareholders, this framework will become applicable to most companies in Tanzania (Chapter 2).

To select a company, a list of privatised companies, published by the Presidential Sector Reform Commission (PSRC) in 1999/2000, was consulted for companies that had been privatised and from this the Friendship Textile Company (FTC) was selected. Access to the company was also an essential consideration, and this company agreed to take part in the research when it was approached.

**Introduction**

The case study was conducted in the autumn of 2001. Data were was collected through open interviews and from internal documents. Open interviews were selected since they provided the possibility of gathering a wide range of data on the ownership structure and the board of directors. The interviews involved two senior managers - the deputy general manager and the human resources manager - and other company employees. The deputy general manager is an invitee to the board of directors, meaning that he attends board meetings. The human resources manager is the only Tanzanian manager in the company able to communicate with the Chinese management team to translate board resolutions into actions at the company. Other employees were also interviewed to obtain additional insights about the company. Insights about the company were also obtained through research by interns who were supervised.

**Background and profile of FTC**

The Tanzania-China Friendship Textile Company (FTC) Ltd is located in Dar es Salaam and was the first fully integrated mill in East Africa. It was established in 1968 as part of the overall import-substitution industrialization strategy adopted by the first post-independence government of Tanzania (URT, 2003). The company was established with capital loaned by the government of China to that of Tanzania. The loan was provided with soft conditions. The Tanzania-China Friendship Textile Company (FTC), initially known as Friendship Textile Mill (FTM), was established as a fully state-owned corporation.

In its years of operation through the mid-1980s the company's balance sheet was positive. Performance began to suffer in the late-1980s. This coincided with the general economic crises that faced Tanzania during that period (Chapter 2). As part of the general economic reforms, FTC was privatised in 1997. Its privatisation was realised through a joint venture agreement between the governments of Tanzania and China. The Tanzania-China relations played an important role in the privatisation of the company.

The Chinese government was given the "first right of refusal". Part of the reason for the Chinese government being given priority over ownership was that the loan from the Chinese government had not yet been settled. The joint venture arrangement provided for the loan to be converted into share capital.

The government of China vested its ownership rights with Changzhou province. Changzhou Province, in turn, vested these rights initially with a state-owned company - Dieqiu Dyeing and Printing Group Company - but later shifted them to Changzhou State Owned Textile Assets Operation Company Ltd. The reasons for this change could not be established during this research. The treasury registrar holds the remaining shares on behalf of the Government of Tanzania.

**Governance arrangements**

The corporate governance of this company takes place at various levels: the level of governments, and the level of the company itself. Communications between the governments of China and Tanzania take place through the responsible ministries. At this level, issues about the company are discussed in the context of co-operation between the two governments. Ministers from China on a visit to Tanzania will visit the company and ministers and other public officials in Tanzania will also visit the company. For example, in 2002, the Tanzanian Minister for Industries and Trade visited the company to discuss some of the concerns of employees who were planning to stage an industrial strike. The Regional Commissioner (RC) of Dar es Salaam has also been to the company to discuss these problems.

Consultative communications between the Government of Tanzania, through the Treasury and the Ministry of Industries and Trade and the province of Changzhou and the Changzhou State Owned Textile Assets Operation Company are also held. The firing of the Chinese manager in 1998 involved such a consultation. Other issues of strategic nature such as the raising of capital also involve similar consultations.

***Ownership structure and control***

Ownership of the company is concentrated. The company has two shareholders: the Governments of China and Tanzania. Prior to 1997, the Government of Tanzania was the only shareholder. The Government of China acquired 51% and Tanzania retained 49% of the equity capital when the company was privatised. The role of ownership in this company does not appear to be facilitating wealth maximization. The two governments consider FTC as a symbol of their cooperation and friendship first, above profit and wealth maximisation. This explains the situation that, despite FTC making losses since it was privatised, the two governments do not let it go bankrupt. This is because the bankruptcy of the company is viewed negatively since it would reflect negatively on the cooperation and friendship of the two governments.

The ownership concentration provides the two governments with the motivation

and ability to engage in active monitoring of managers. This was also shown through the replacement of the Chief Executive Officer of the company. The board was instructed to fire the CEO after information emerged that he was manipulating information to mislead the board and shareholders about the performance of the company. Such a quick and easy change of management, especially of the CEO, is an indication of effective corporate governance (Dyck, 2001).

***The board of directors***

The two shareholders appoint members to the board of directors. Five members constitute the board, two members appointed by the Government of Tanzania and three members appointed by Changzhou State Owned Textile Assets Operation Company Ltd. The two directors appointed by the Tanzanian government are senior civil servants from the treasury and the Ministry of Industries and Trade.

The deputy CEO is appointed by the Government of Tanzania and attends board meetings, but does not have voting power. This arrangement is provided for in the joint venture agreement. The deputy provides a check on the authenticity of information provided to the board of directors and protects the interests of the Government of Tanzania. The process that culminated in the firing of the Chinese CEO in 1998 was mainly sparked off by the deputy CEO. He presented, to the board of directors, information that contradicted what the CEO had provided. He revealed at the board meeting that the CEO was manipulating information to conceal the truth regarding the poor performance of company, and the reasons for it. The board made further investigations to confirm this fact, and finally reached a decision to fire the CEO.

The top leadership positions at the company: the board chairman and the CEO have been separated. The state-owned company in China appoints the chairman along with two other directors. The CEO reports to the board of directors and is usually appointed for a two-year term which is not renewable. The company that exercises the ownership rights of the Chinese government appoints the CEO. Each CEO usually brings his own team of other managers. This means that managers are usually only concerned with the short-term performance of the company.

The chairman lives in China and visits Tanzania occasionally to attend board and shareholder meetings when they are held in Tanzania. However, most of the meetings are held in China which means that the chairman visits Tanzania infrequently. The role of the chairman of the board consists of setting the date, the agenda, and deciding the venue for board meetings, and chairing the board meetings. The board of directors of FTC holds meetings on a quarterly basis but they can also be called as required. Information is sent to directors two weeks before a meeting to help them prepare.

***Results from the pilot case study***

The FTC case study reveals a number of issues. It shows that when large shareholders exist, that they can take action to address incentive problems. The firing of the Chinese manager was implemented immediately following the revelation of his aberrant behaviour. The results corroborate the findings of Carlsson (2003) who found that large shareholders correct poor managerial behaviour as it occurs. This confirms the assertion that large shareholders are a credible threat to management and address the incentive problems by taking corrective action when required. The case also reveals that effective monitoring of management requires relevant information. It shows the importance of checking the information that management provides for its relevance to the decisions at hand.

The case reveals that the effectiveness of the board of directors with respect to control is critical for addressing agency problems because, through deliberations, it can determine whether management is pursuing the interests of shareholders or not. It is also a device through which changes in management are effected. The board can also take initiatives to discipline management, which is consistent with the findings of Morck et al. (1988) discussed previously.

*Conclusion*

FTC is not a typical company in the current Tanzanian situation. However, the findings in this case do confirm the theoretical conclusion that the ownership structure and the board of directors are important mechanisms for addressing incentive problems in Tanzanian corporations. These findings imply that the ownership structure and an effective board of directors are the principle mechanisms that should be included in the research model for the main research. The case also indicates that the governance of state-owned corporations is influenced by considerations apart from profit motives. This is inconsistent with the general model of corporate governance which is being encouraged in Tanzania.

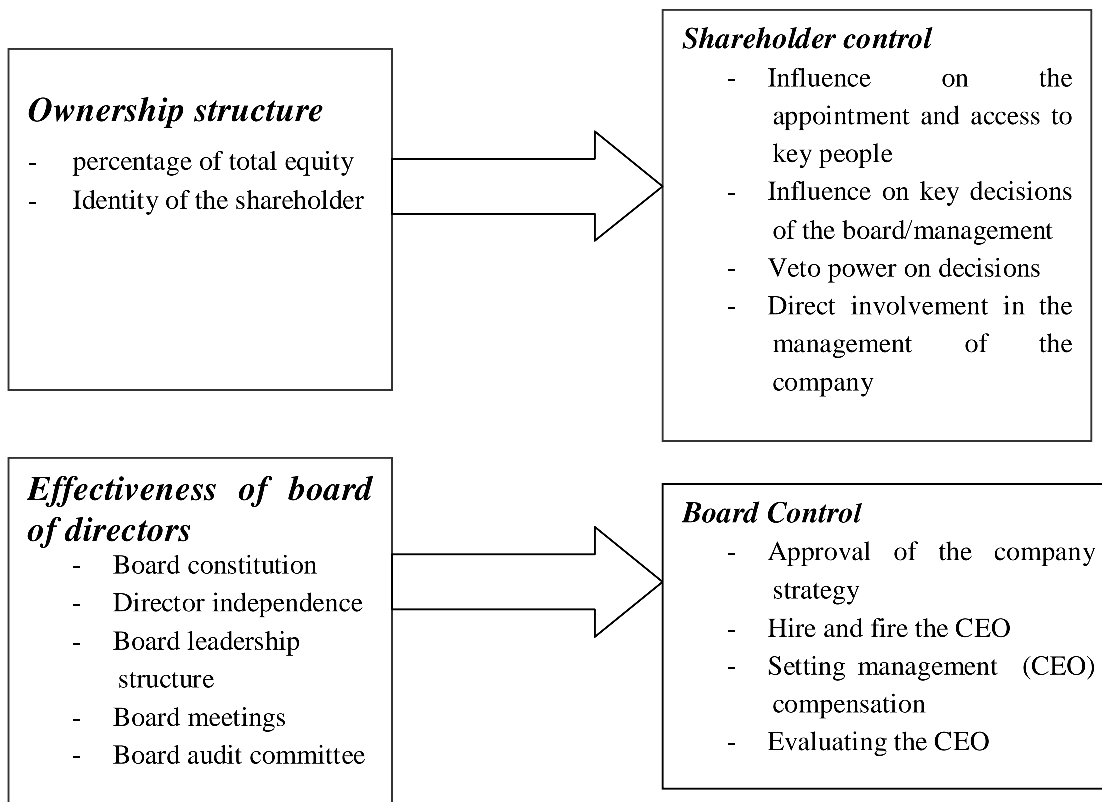
## 4.3 The research model

A research model is a construct of reality used for the purpose of establishing empirical data that can be used to explain a particular phenomenon. It can also be metaphorically described as a “window” for looking at reality, one that can make certain aspects of reality visible while hiding others. Such a model is necessary in order to focus attention on the selected aspects of reality and improve the efficiency of the research process (Verschuren and Doreeward, 1999). The model for this research consists of the elements of the general model in Figure 4.1 which have been selected for empirical investigation based on the literature review and the assessment of the Tanzanian context.

The review of the literature on corporate governance and the assessment of the

Tanzanian context show that ownership structures and boards of directors are the key mechanisms which address the incentive problems in this context. However, for the board of directors, it is its effectiveness with respect to control which is important for addressing the incentive problem. The pilot case study confirmed this conclusion. This means that ownership structures and boards of directors are two of the elements of the general model (Figure 4.1) that should be empirically investigated to answer the research question. These concepts are used to construct the research model shown in Figure 4.2. Further concepts connected to the ownership structure and the board of directors are introduced to enable the empirical investigation to be completed.

**Figure 4.2**
**The research model**




The incentive problem in Tanzanian corporations is addressed through the ownership structure and an effective board of directors. Both ownership structure and an effective board of directors (independent variables) are determinants of effective corporate governance. The ownership structure determines shareholder control while the effectiveness of the board of directors determines board control. The literature shows that when management decision control is performed by shareholders or the board of directors it is an indication that effective corporate governance exists (Jensen and Meckling, 1976; Fama and Jensen, 1980). Indicators of shareholder control are: their

influence on the appointment of and access to key people (chairman and CEO), influence over key decisions of the board and management, veto power and direct involvement in management. Indicators of board control are: its approval of company strategy, ability to hire and fire the CEO, setting the CEO's compensation, and evaluating the CEO, his activities and individual directors.

***Ownership structure***

The first measurement of ownership structure is the number of shares of equity capital held by one party relative to the total number of outstanding shares of equity capital (Shleifer and Vishny, 1986, Roe, 2003). Ownership structure determines shareholder control because concentrated shareholding leads to strong shareholders (Roe, 2003). Shareholders who hold significant shares of equity capital frequently monitor management because they have the incentive and the resources to do so (Denise and McConnell, 2003). The experience in the corporate governance system in Japan and Germany shows that large shareholders are usually actively involved in monitoring management and taking action when necessary. The case of FTC has also shown that large shareholders take corrective action by replacing management teams when they discover that incentive problems exist in Tanzania.

The other indicator of ownership structure discussed in the literature is the identity of shareholders. Banks and other institutional shareholders play a major disciplinary role in the Germanic and Japanese corporate governance models (Rubach and Sebora, 1998; OECD, 2004). If the corporation is profitable, banks tend to act only as monitors and protectors of outside interests. However, they will intervene in the governance of a corporation when the firms in which they have interest underperform (Chapter 3). Banks may also appoint directors to the boards of companies in which they invest, based on efficiency-related determinants of poor stock performance and low earnings (Rubach and Sebora, 1998).

Private individuals holding a large proportion of equity capital also take keen interest in the affairs of a corporation. Carlsson (2003) points out that the Wallenberg family in Sweden takes part in the governance of major corporations. They select senior management, and replace them when necessary. It is seen that it is the degree of ownership which motivates shareholders to engage in monitoring, rather than their identity. Since large shareholders are an important feature of corporations in Tanzania (Chapter 2), it can be expected that large shareholders will be exercising control of large corporations in this country.

***Shareholder control***

The concept of shareholder control reflects the control exercised by shareholders, either directly or through the board of directors. It is connected to shareholder rights such as those identified and promoted by OECD (1999; 2004). The concept is indicated by four

elements: influence over the selection of key people in the organisation; access to information; vote control; and direct influence on, or participation in, decision-making processes of the organisation. Denise and McConnell (2003) posit that shareholders can exercise control of an organisation through their influence on the appointment of "key" people in the organisation: the chairman of the board of directors, the chief executive officer (CEO) of a company and other directors. Herman (1981) states that the basic question in establishing who has the power over key decisions revolves ultimately on determining who has the power to name the top executives of the corporation. Thus, if specific shareholders appoint or influence the appointment of these key people in an organisation, it is an indication that they exercise control over management and hence control the company.

Access to significant information about the operation of a company by its large shareholders also indicates that these shareholders exercise control over management (Scott, 1997). Baum (1993), and Denise and McConnell (2003) point out that large shareholders do have access to information and that the information asymmetry between large shareholders and management is not significant. The FTC case study has shown that access to relevant information is a constituent part of shareholder control because it aids decision-making. The existence of mechanisms that facilitate the flow of information from the company to large shareholders is a key indication that the large shareholders exert control over management of the company.

More explicit control by large shareholders is indicated by vote control. Where the one-share-one-vote principle exists, shareholders holding more than 50% of the equity capital have control of the company through its votes. This allows them to exercise control of the company since control decisions are made on the basis of votes. This leads to pervasive control as management is concerned to address the interests of controlling shareholders. Direct participation in the decision-making process of the company by controlling shareholders is also indicative of their decision control. Shleifer and Vishny (1986) posit that large shareholders exert control by directly participating in the decision-making process of companies they invest in.

***Effectiveness of the board of directors***

The effectiveness of the board of directors with respect to control is important in reducing incentive problems. The effective execution of the control function by the board of directors depends on several factors. Koontz states that:

> Central to the effectiveness of any board is the composition of its membership. This problem has many facets - size, number of outside and inside directors, the age and retirement of members, individual qualifications, compensation, and other incentives. All these elements present difficult problems in practice (Koontz, 1967 cited by Tricker, 1994).

The above comment suggests factors that determine the effectiveness of the board in the control function. Cadbury (1992) and other national codes listed in Table 1.1 (Chapter 1) also point out factors that determine the effectiveness of the board of directors: board constitution, director independence, board leadership structure, board meetings, and the board audit committees. The OECD and CACG principles for effective corporate governance emphasise that these factors are the key determinants of the effectiveness of the boards of directors (Chapter 3).

**(i) Board constitution**

The board constitution covers three different aspects with respect to the effectiveness of the board: inside versus outside directors, board size and the age of board members (Tricker, 1994). An inside or executive director is an individual who is involved in the day-to-day management, and is a full-time employee, of the company. A non-executive director is an individual who is not involved in the day-to-day management and/or is not a full-time employee of the company or one of its subsidiaries, and is not a salaried employee of the holding company or the holding company's subsidiary. The constitution of the board determines the functioning of the board. Effective boards of directors with respect to board control have a larger number of non-executive directors than executive directors (Jensen, 1993; Tricker, 1994). The Cadbury committee states that every public company should be led by an "effective board" and that means that the board must be made up of a combination of executive directors and non-executive directors (Cadbury, 1992).

The combination of outsider and insider directors has been advocated for one-tier boards of directors (Maassen, 1999; OECD, 1999; 2004). This combination avoids a situation in which the same people execute both decision-control and decision-management roles. The initiative to encourage corporations to have more non-executive directors constitutes an attempt to strengthen board decision control and achieve more accountability to shareholders (Monks and Minow, 2002). Non-executive directors are expected to execute decision control, as executive directors cannot critically review their own decisions. It is for this reason that non-executive directors are considered to be well placed to protect the interests of shareholders, and hence the argument for more non-executive directors on the board relative to executive directors (Demb and Naubeauer, 1992; Eisenberg, 1967 cited by Kay and Silberston, 1995). This leads to the conclusion that a large number of non-executive directors, relative to that of executive directors, will result in a board more able to critically review management proposals and control management decisions.

In terms of board size, a number of researchers have found that large firms tend to have more directors than small ones (Koontz, 1967 cited by Tricker, 1994; Pfeffer, 1972). This is explained by the need for large firms to maintain more contacts with the external environment and the greater administrative burden in large firms. Boards of

directors are described as “boundary spanning agents”, i.e individuals who facilitate contacts between two or more organisations. They also facilitate communication with special interest or stakeholder groups who are connected with and affected by, the firm’s actions (Tricker, 1994). Large firms are complex organisations such that it is considered impossible for all board members to be aware of all the crucial aspects of their firm. For this reason, firms are increasingly establishing specialised committees to monitor specific activities. This has caused companies to increase the number of board members.

The question of optimal board size has not yet been satisfactorily addressed (Tricker, 1994). Vance (1983; Juran; Louden, 1966 both in Tricker, 1994) note that large firms have large boards, but they conclude that size is irrelevant for performance. Other researchers have found that if boards become too large they allow individual members to avoid responsibility as no one feels that they have enough impact to justify a major investment of time and energy. Herman (1981) posits that “large boards make for weak boards”.

Koontz (1967 in Tricker 1994) suggests that there is an optimal board size of between five and thirteen members. Less than five is considered insufficient to cover all the legal board responsibilities; more than thirteen becomes unwieldy with not everyone getting an adequate chance to participate. Other researchers have suggested that large boards are useful because they offer to the organisation a large pool of expertise and judgement. Changanti et al. (1985, cited by Donaldson and Davis, 1994) found in the retail business that a small board size was significantly correlated with business failures. Pfeffer (1972) pointed out that board size is a function of the firm’s needs to deal with important external constituencies. His empirical findings indicate that board size can partly be explained by firm size (measured as sales volume), the need to access capital markets and whether the firm is locally regulated.

Overall, the empirical studies suggest that the optimal board size is difficult to assess. However, there appears to be control problems with firms that have boards that are either too large or too small. More recent research indicates that board size does not influence firm performance. Mak and Yuanto (2002 cited by Denise and McConnell, 2003) have found evidence of a negative relationship between board size and firm performance in Malaysia and Singapore. Similar results have also been found in the US (Denise and McConnell, 2003), Finland (Eisenberg, et al., 1998) and the UK (Carline, et al., 2002 both cited in Denise and McConnell, 2003). This leads to the conclusion that board size is not a determinant of its effectivity since this depends on company specific circumstances.

The other aspect of board constitution is the age of directors. Koontz acknowledges and recommends a trend towards increasing mandatory retirement for boards of directors. This is based on the view that many corporate boards have consisted of a large number of older and not very productive members. This is confirmed in the

studies of Juran and Loden (1966 cited by Tricker, 1994). Cochran et al. (1984 in Tricker, 1994), who examined the relationship between the average age of board members and corporate performance, found evidence of a weak, negative correlation between board age and financial performance: i.e younger boards tended to be associated with more-profitable firms. Tricker (1994) concluded that although the trend is significant, it was meaningless in terms of the effectiveness of the board with respect to control. The age of directors is not an important criterion for board effectiveness as long as age does not significantly influence the functioning of the board.

**ii) Director independence**

The existence of non-executive directors is increasingly being viewed as an inadequate condition to ensure directors efficiently exercise decision control and protect shareholder interests (Monks and Minow, 2002). The argument underlying the non-independence of the non-executive director is that, if a director is a friend of the CEO, it is just as difficult for him to be objective as it would be for an employee when it comes to evaluating management performance (Lorsh and McIver, 1989). The notion that directors are credible people who can monitor management on behalf of shareholders depends on directors being able to bring independent judgment to bear on the board's decisions (Denise, 2001). The issue of director independence can be traced back to the 1970s when information about high-profile corporate crimes emerged. The Watergate affair caused a number of illegal corporate campaign contributions to come to light. These contributions were considered as signals of buying influence and favour from the US political system. A number of campaign finance reforms laws were introduced following this scandal (http://www.wpkn.org/campaignfiance, April, 2004). At the international level, corrupt practices where bribes were given to foreign officials in order to exclude competition were also exposed (Monks and Minow, 2002).

Commentators wondered why boards of directors, whose job was to prevent such crimes, had failed in controlling managers. Increasingly, such illegal acts have come to be associated with the lack of independence on the part of directors and hence their inability to stop management from engaging in such criminal activities (Monks and Minow, 2002). This has had the consequence of increasing emphasis on the importance of independent directors. The OECD and CACG principles of effective corporate governance address the issue of independence of directors (Chapter 3). These principles require boards of directors to include independent directors. Recent reforms in the US, to improve the effectiveness of boards of directors, have also tended to view the independence of the directors as determining the effectiveness of the board of directors in its controlling role (Chapter 3).

Director's independence is conceptually challenging. Independence refers to the "ability" of the board members to make their own judgements about critical issues rather than relying on the managers and other board members. Baysinger and Butler

(1985) point out that director independence involves both economic and psychological aspects. Socioeconomic independence refers to the absence of significant entanglements of board members - economically and socially - that might bias their opinion on the board and thus affect their capacity to competently assess and control management performance.

Director independence is also influenced by the way in which directors are elected or appointed. John and Senbet (1998), referring to the Anglo-Saxon situation where ownership is fragmented, contend that the chief executive officer (CEO) proposes names to be voted on directorships, a practice that leads to the ineffectiveness of boards and hence poor corporate governance. This is because, by owing appointment or nomination to the CEO, psychological, social or economic relationships may be established between the CEO and a director. This relationship can impair the ability of directors to critically review management performance.

A number of factors are considered when assessing director socioeconomic independence. One view suggests that director independence should be limited to considering the relationship with the CEO and the company. Eisenberg (1976 cited by Baysinger and Butler, 1985) defined an independent director as one who is not currently employed by the firm and has no strong psychological (familial) or economic dependence on managers. Another view suggests that directors should not be influenced by major shareholders.

The Private Sector Corporate Governance Trust (PSCGT, 2003) of Kenya has identified a number of indicators of director independence: being a non-executive director; not representing a major shareowner or nominated by such a shareowner; not being an employee of the company or any group of which it currently forms a part in any executive capacity for the preceding three years; not being a professional advisor to the company other than in a director capacity; not being a significant supplier or customer to the company or group; having no significant contractual relationship with the company or group; and free from any business or other relationship which materially interferes with the individual's capacity to act in an independent manner.

For the purpose of this research, the independence of directors is indicated by: an absence of family ties with the CEO, the absence of business relationships with the firm other than the directorship, and not being a representative of, or elected/nominated by, a major shareholder. These are considered critical in ensuring the ability of a director to exercise independent judgement. Eseinberg (1976, by Baysinger and Butler, 1985; and Monk and Minow (2002) posit that if outside independent directors command a powerful majority in the boardroom they will be better able to check any tendency by the CEO to abuse corporate power. This leads to the conclusion that director independence is one of the determinants of the effectiveness of the board in terms of board control.

**iii) Board leadership structure**

Board leadership structure refers to the separation or non-separation of the two highest level positions in a company: those of the chairman of the board of directors and of the CEO. The argument for separating the two posts is based on agency theory and reflects the need to avoid concentrating power in the hands of a single individual to such an extent that the board fails to exercise control (Daily and Dalton, 1997; Monks and Minow, 2002). The role of the chairman includes leading and uniting the board, initiating development and change, and acting as the company's prime spokesman with shareholders and other outside entities. The chief executive officer is responsible for the day-to-day running of the company.

If the chairman of the board is also the chief executive officer, it makes the management accountable to a board that is led by one of its own members which may also mean that the chief executive officer evaluates his own performance (Tricker, 1994; Monks and Minow, 2002). Demb and Neubeauer (1992) posit that combining the two positions will create a powerful individual, which may make the board less effective in exercising decision control.

An important issue that emerges from combining the two roles is the setting of the agenda and the control of information. As long as the CEO controls the quality, quantity, and timing of information that is presented to the directors, the directors can never be sure of getting what they need for true independent oversight. In Germany, the Netherlands, Switzerland and the Scandinavian countries, the posts of chairman of the board and the CEO are separated by law (Chapter 3). In the Anglo-Saxon model of corporate governance, there is currently a discussion on the separation of the two posts (Demb and Neubeauer, 1992; Maassen, 1999).

There are views predicated on the assumptions of stewardship theory that oppose the separation of the two positions. Supporters of a combined post point out the need for clarity of purpose and action, which is not found when the two positions are separated (Anderson and Antony, 1986; Lipton and Lorch, 1993 and Finkelstein and D'Aveni, 1994 all cited by Daily and Dalton, 1997). It is argued that a joint CEO-chairman is the key link between executives and directors. Also the better levels of knowledge and information possessed by a CEO/chairman may enable him to better direct the board's agenda and discussions (Lorch and MacIver, 1989). Other benefits of joint leadership include enhanced relations with external constituencies and improved efficiency in decision-making (Salancik and Meindl, 1984 cited by Daily and Dalton, 1997).

Despite these benefits, a separation of the roles is increasingly advocated. Cadbury (1992); OECD (1999); CACG (1999); OECD (2004), among others, have continued to advocate separation of the two positions in corporations. The argument for the independence of directors also applies to the separation of these roles. It is difficult for an individual responsible for overseeing both strategic (chairman) and operational

(CEO) matters to effectively separate these functions for the exclusive benefit of shareholders (Daily and Dalton, 1997 citing Dayton, 1984; Geneen, 1984; Rechner and Dalton, 1989). This leads to the conclusion that the separation of the positions is one of the determinants of the effectiveness of the board of directors with respect to board control.

**iv) Board meetings**

Board meetings refer to those board sessions in which deliberations are made concerning the discharge of the decision rights delegated by shareholders. They constitute events for exercising decision control rights. The way in which these meetings are structured is the key to the board's effective functioning; and discussions of what Moldoveanu and Martin (2001) have termed "uncomfortable issues". Demb and Neubaeuer (1992) posit that when meetings are not thorough, and directors do not participate in discussing various issues concerning the running of the company, the effectiveness of the board cannot be expected to be high. In such a case, agency problems at the board level are likely to occur.

The ineffectiveness of board meetings can also be caused by abdication of decision rights. This usually arises from the failure of deliberation – a failure to air ideas and views, failure of specification- failure to articulate ones own position clearly, and failure of commitment- unwillingness to address board issues. Critical aspects that affect the effectiveness of board meetings include their timeliness and the adequacy of information passed to the outside directors as well as the number of board meetings (Demb and Neubeauer, 1992). The OECD and CACG principles of effective corporate governance have stressed the importance of information passing to directors. This implies that one of the indicators of effective board meetings is their timeliness and the adequacy of information (board papers). The frequency of board meetings is likewise one of the indicators of board effectiveness with respect to control (Vafeas, 1995).

**(v) Board audit committee**

In agency theory, effective monitoring of agents requires the co-location of decision rights and requisite expertise/knowledge (Moldoveanu and Martin, 2001). This co-location is attained through the establishment of board committees. Committees are thus related to addressing the issue of information asymmetry between managers and directors. These committees usually include a remuneration committee, a succession committee and an audit committee. Audit committees are related to the control function of the board (Maassen, 1999). Auerbach (1973) points out that the New York Stock Exchange (NYSE) and the Securities and Exchange Commission (SEC) first proposed audit committees in 1939 and 1940, although they were not widely used for a long period. They started to be used in the US around 1967, and are increasingly recommended (Cadbury, 1992; Maassen, 1999; OECD, 1999, 2004).

Board audit committees mainly focus on the annual financial audit and the evaluation of staff in the accounting and finance sections of organisations (Auerbach, 1973). This committee is viewed as providing prospects to improve a board's ability to gain deeper insights into the company's financial performance. This is consistent with the claim that complex organisations require committees that can focus on different aspects of the firm's operation since no single director can have expertise in all areas of a firm's operation (Tricker, 1994). Audit committees are also viewed as a means of enhancing communications between the board and the external auditor, and through that benefit from the insights that an external auditor provides about the organization.

The recommendations in the various codes of corporate governance reflect the importance of audit committees is addressing the information asymmetry between directors and management, and thus improving board control. In the US, for example, the Security and Exchange Commission (SEC) proclaimed 1999 as "the year of the accountant" following audit scandals in several companies (Monks and Minow, 2002). This has led to recommendations to reform the audit committees by setting new standards including a duty of care for audit committees. Audit committees have been widely used in the US and increasingly in the UK and Australia (Demb and Neubeauer, 1992) and in other countries in Europe (Hopt and Leyens, 2004).

The OECD (1999); CACG (1999), OCED (2004) principles for effective corporate governance strongly recommend the establishment of an audit committee. As audit committees are increasingly promoted by multilateral organizations such as the OECD and CACG, they are likely to become a worldwide phenomenon. Other countries have recommended audit committees: the Peters Committee on corporate governance in the Netherlands has recommended the establishment of various board committees, particularly audit, remuneration and selection committees. The issue of the independence of audit committees is also currently being discussed. The Sarbanes-Oxley Act, discussed in Chapter 3, requires companies to form audit committees which are independent of management. An audit committee, with independent directors in the majority, is one of the determinants of the effectiveness of the board of directors with respect to board control.

***Board control***

Control by the board centres on its powers to determine its own direction and the policies of the organisation. When board control exists, the extent to which managers can pursue their own interests is significantly reduced. The current attempts to improve board control, expressed through national and international codes of corporate governance, reflect this vision (Chapter 3). Control, in this sense, refers to "the power to decide upon the corporate strategy of the enterprise". Corporate strategy involves the determination of the basic long-term goals and objectives of the enterprise, and the adoption of courses of actions and the allocation of resources necessary for carrying out

those goals. The board having to approve company strategy is one of the indicators of board control (Styles and Taylor, 2002).

In the Anglo-Saxon model, the board's legal obligation to shareholders includes a fiduciary duty to supervise management to ensure that they act in the best interest of shareholders. This is also the case in Tanzania as the model of corporate governance is based on the Anglo-Saxon model (Chapter 2). The oversight function implies a degree of confrontation between executive and non-executive directors (Maassen, 1999; Stiles and Taylor, 2002). Two organisations in the US, The Business Roundtable and the American Law Institute (ALI), have recommended key activities for the board related to control. The Business Roundtable asserts that activities related to control by the board include selecting, regularly evaluating, and if necessary replacing the CEO, determining management compensation and reviewing succession planning.

The American Law Institute has produced a similar list of functions: electing, reviewing and where appropriate dismissing the senior executives, overseeing the conduct of the corporation's business with a view to evaluating, on an on-going basis, whether the assets of the corporation are being used in a way consistent with shareholder wealth maximization (Monks and Minow, 2002). Thus, in addition to approving strategy, board control consists of employing top management, firing them when need be, rewarding them and in general acting as a source of discipline (Mace 1971; Fama and Jensen, 1980; Baysinger and Butler, 1985). CACG (1999) asserts that a fundamental responsibility of the board is to assess the performance of the chief executive officer (CEO). Thus, a common set of indicators of board control can be derived consisting of: approval of company strategy; selection of, and the ability to fire, the CEO; setting the CEO's remuneration and evaluation of the CEO. The issue of self-monitoring by directors is also discussed in the agency framework. Demb and Neubaeuer (1992) raise the issue of individual director evaluation by other directors as well as the evaluation of the overall board work as important control activities.

*Research Propositions*

To link the identified research model in Figure 4.2 with research sub-question 2, which states "what is the current situation with respect to the effectiveness of corporate governance in Tanzania and what are the factors determining this effectiveness", the following propositions are made.

***Proposition 1***

Shareholders that hold the majority of shares in a corporation exercise shareholder control.

This proposition links the ownership structure, which is a determinant of effective

corporate governance, to shareholder control, an indicator of effective corporate governance in Figure 4.2. It addresses research sub-question 2 by showing that ownership structure is a factor that determines effective corporate governance in Tanzania.

Propositions 2 (a)- (d) link the effectiveness of the board of directors, as a determinant of effective corporate governance, to board control an indicator of effective corporate governance in Figure 4.2. Extensive board control reflects that board control is present and that it encourages managers to pursue the goal of increasing shareholder wealth. It is observed from the performance of the control-related activities discussed previously.

*Proposition 2(a)*

The greater the number of independent non-executive directors relative to that of executive directors on the board of a corporation the more extensive the board control.

This proposition address research sub-question 2 by showing that independent non-executive directors are a determinant of board control.

*Proposition 2(b)*

The separation of the positions of board chairman and CEO, with an independent chairman of the board, leads to extensive board control.

This proposition addresses research sub-question 2 by showing that the separation of the posts of CEO and board chairman is a factor in determining board control.

*Proposition 2(c)*

Effective board meetings lead to extensive board control.

This proposition addresses research sub-question 2 by showing that effective board meetings are a factor in determining board control.

*Proposition 2(d)*

The establishment of a board audit committee, comprising of independent directors, results in extensive board control.

This proposition addresses research sub-question 2 by showing that the existence of a board audit committee is a factor in determining board control.

All these propositions address the current situation in Tanzania with respect to effective corporate governance and the factors determining it. The empirical investigation will

examine these propositions. It will be determined whether the factors covered by the propositions will be confirmed as the current determinants of effective corporate governance in Tanzania.

## 4.4 Operationalisation of the variables in the research model

Operationalisation refers to the process of specifying how, in practice, the elements specified in the model are to be observed (Verschuren and Doreeward, 1999). The measures applied to operationalise the variables in the model are provided in Table 4. These indicators were developed based on the literature on corporate governance (Chapter 3).

**Table 4**
**Operationalisation of variables**

| Variable | Operational definition | Indicators | Representative studies |
|---|---|---|---|
| Shareholder control | The power of shareholders to exercise control of the company | - Exercising veto power over decisions<br>- Influence on selection of, and access to, key people in the organization: chairman of the board and the CEO<br>- Influence on key decisions of the board/ management<br>- Direct involvement in management of the company | Scott (1997), Baums (1993) |
| Board control | The execution of activities related to control | - Approval of company strategy<br>- Hire and fire management (CEO)<br>- Setting the CEO's compensation<br>- Evaluating the CEO, board activities and individual directors | Baysinger and Butler, 1985 Jensen and Meckling, (1976); OECD (1999); CACG (1999) |
| | | | |
| Ownership structure | Identity and percentage of equity shareholding | - Percentage of equity shares held<br>- Identity, e.g. corporation, individual etc. | Vishny and Sheifer, (1986) Baum (1993), Clarke and Clegg (1998) |
| Board constitution | The proportion of executive and non-executive directors on the board | - Number of directors who are not full-time employees of the company<br>- Those who are full-time employees | Jensen (1993); Denis (2001), OECD (1999) |

| Variable | Operational definition | Indicators | Representative studies |
|---|---|---|---|
| Director independence | - Absence of business or social relations between the director and the company or company management | - Absence of consultancy assignments or trading relationships with the company<br>- Absence of social relations between directors and the CEO<br>- Not being appointed by, or working, for a large shareholder | Tricker, 1994; Demb and Neubauer (1992), PSCGT (2003), Scott (1997); John and Senbet (1998) |
| | - The process by which individuals are selected to become directors | - Procedures for appointing board members<br>- Procedure for selecting board chairman | |
| Board leadership structure | Separation or non-separation of the positions of chairman of the board and CEO | - CEO and board chairman posts held by different persons | Cadbury (1992); Lorch and McIver, (1989); Monks Minnow, (2002) |
| Board meetings | Board sessions in which decision control rights are exercised by directors | - Procedures for running meetings<br>- Information passed to directors before meetings<br>- Formal evaluation of directors and board activities | Stiles and Taylor, (2002); Demb and Naubeaur (1992) |
| Board audit Committee | Board working team selected to provide in-depth knowledge of financial matters concerning the company and report to the board | - Existence of a functioning audit committee<br>- The type of directors sitting on the committee | Demb and Neubauer (1992); Auerbach, (1973) |

# CHAPTER 5 CASE DESCRIPTIONS AND ANALYSES

## 5.1 Tanzania Breweries Ltd (TBL)

### *5.1.1 Background and profile of the company*

The history of TBL reflects the economic developments in Tanzania since the colonial days up to the present time. This history goes back over seventy years to when the Wright brothers established a brewery near Kariakoo at Dar es Salaam. Due to fierce competition from cheaper imported beer at that time, this initiative turned out to be unsuccessful. The existence of competition from outside the country reflected the liberal economic policies that the British colonial government pursued (Chapter 2). Although this early initiative to establish a brewery was not successful, it still encouraged the owner of a brewery in Kenya to establish a brewery in Tanzania (in Dar es Salaam). The brewery in Tanzania was commissioned in 1933 to produce beer under the brand name Tusker. This brewery also produced traditional beer from maize. In 1936, Kenya Breweries and Tanganyika Breweries were amalgamated to form the East African Brewery Ltd. In 1960, East African Breweries in Tanganyika became an incorporated company according to a Tanganyika Law (company ordinance Cap. 212) which currently still applies (Chapter 2).

In 1964, East African Breweries changed its name to Tanzania Breweries Limited. In 1967, the Government of Tanzania acquired 45% of its equity capital in line with the policy of the Arusha Declaration, while the remaining 55% continued to be held by East African Breweries of Kenya. It was agreed that the compensation in respect of these shares amounting to TAS 19.6 million, would be settled in January 1980 in accord with the FIPA Act of 1963 (Chapter 2).

In 1978, the Government of Tanzania declared its intention to assume control over the remaining shares in Tanzania Breweries. The government's stakes in the company were transferred to the treasury registrar in 1979, who then signed a memorandum of understanding with East African Breweries of Kenya so that the remaining shares (55 % of equity capital) would be sold to the Government of Tanzania. The cost of these, which accumulated to TAS 25.8 million, was settled in 1992, six years after the country had embarked on an economic reform programme. As part of this initiative, the privatisation of TBL began in 1993. The privatisation of TBL has attracted the attention of the donors and is widely regarded as a success story in Tanzania:

> … the privatisation of the Tanzania breweries was one of the first major privatisations to be undertaken by the Tanzania Parastatal Sector Reform Commission created to oversee the transition of some 250 state-owned enterprises to private ownership. The programme to remove Tanzania Breweries from government ownership and management involved privatisation, rehabilitation, and modernisation of the existing breweries and expansion

> through the construction of a Greenfield brewery at a total cost of US$ 87.2 million. South Africa Breweries became the majority shareholder after international bidding. The IFC helped cement the relationship between the government and a new foreign investor and to structure the financing necessary to carry out the project. This represents the most successful privatisation effort to date, with the company's production levels, product quality, market share, and financial performance all showing significant improvement…. (World Bank, 2002)

*Activities and company performance*

Tanzania Breweries' current activities consist of the production, the marketing, the distribution and the sale of malt beer. It operates in Dar es Salaam, Arusha and Mwanza, and currently distributes its products through ten depots situated throughout the country. The company produces malted barley at a plant in Moshi and has acquired shares in traditional beer and liquor manufacturing companies in Tanzania. In 1998, TBL acquired a 100% shareholding in Tanzania Distilleries Limited (TDL) and 60% in Dar Brew. In 1999, TBL sold 35% of its ownership in TDL to the Distillers' Corporation of South Africa. Prior to its privatisation, TDL was fully owned by the Government of Tanzania while the Dar es Salaam municipality fully controlled Dar Brew. TDL produces spirit drinks while Dar Brew produces two main brands of traditional brew called *Kibuku* and *Mwamba*. Both companies are located in Dar es Salaam.

The control of TDL and Dar Brew by TBL makes the TBL group the single largest producer and supplier of alcoholic beverages in Tanzania with a market share of about 98% of the total beer market. The issuance of a 20% equity shareholding to East African Breweries (EABL) of Kenya, which led to the closure of the EABL beer producing plant at Moshi in Tanzania, has further consolidated TBL's market dominance in the production and distribution of beer in the country.

TBL is one of the most important companies to the Tanzanian economy. It is currently one of the largest corporate taxpayers in the country (URT, 2003). It contributed over TAS 60 billion (approximately 60 million US$) in 2001/2002 in direct tax, excise duty and Value Added Tax. It currently employs over 1000 people around the country and has a network of SMEs involved in the beer business as part of its distribution channels. Also, TBL's operations have significant multiplier effects in the economy through linkages with farmers who grow barley.

TBL was granted a five-year tax holiday under the National Investment Promotion and Protection Act (NIPPA) of 1990. This Act was enacted as part of the government's efforts to attract investors into the country. This tax holiday expired in June 2002. The company has been performing well for a number of years. Profits after tax (PAT) have increased between 1998 and 2004. Table 5.1 shows profits after tax have been increasingly annually; except for 2001 and 2002 where profits were lower than in 1999/2000.Dividends paid have fluctuated slightly over this period. In 1998, 72.54% of the total profits were paid out as dividends while 69.33% was paid out in

1999/2000. Since then, the percentage payout has been in the mid-nineties. Despite fluctuations in the share price at the Dar es Salaam stock exchange (DSE), the TBL shares have generally been performing well compared to the Initial Public Offer price of TAS 500 and a face value of TAS 100. They were selling at TAS 1,550 in October 2002 but fell to TAS 1,400 by December 2004.

**Table 5.1**
**Performance of TBL from 1998-2004**
*Sources: Annual reports from 1998-2004, DSE records*

| Performance indicator | Year | | | | | |
|---|---|---|---|---|---|---|
| | **1998** | **1999/2000** | **2001** | **2002** | **2003** | **2004** |
| Revenues in TAS (billions) | 123.54 | 144.79 | 125.08 | 135.06 | 174.05 | 197.98 |
| Profits (PAT) in TAS (billions) | 23.99 | 30.88 | 28.79 | 26.87 | 32.298 | 39.24 |
| Dividends in TAS (billions) | 17.40 | 21.41 | 25.25 | 25.84 | 30.79 | 36.87 |
| Dividends as % of PAT | 72.54% | 69.33% | 87.69% | 96.14% | 95% | 94% |
| Total assets in TAS (billions) | 91.93 | 98.57 | 103.97 | 109.61 | 151.63 | 151.45 |
| Market capitalization in TAS (billion) | 156 | 129.7 | 235.9 | 377.5 | 442.3 | 411.9 |

TBL's market capitalisation has also fluctuated over time. In 1998, it stood at TAS 156 billion. In 1999/2000, the market capitalisation fell to TAS 129.7 billion, but showed a growth in 2001 and a significant one in 2002 and 2003 reflecting fluctuations in the share price in the market. By December 2004, the market capitalization stood at TAS 411.9 billion. The company assets at book value have also been increasing and other performance indicators liquidity and solvency show a positive trend.

### *5.1.2 Corporate governance arrangements*

Corporate governance arrangements have to fit within the framework of company ordinance Cap. 212. The framework recognises shareholders as members of the company and their right to participate in the affairs of the company. TBL has a unitary board arrangement referred to as the supervisory board. The supervisory board is the senior decision-making organ in the company and has decision control rights.

The company senior management constitutes an operating board that is responsible for operating the company on a day-to-day basis. The chief executive director (CED) who is in effect the chief executive officer (CEO) heads the operating

board. The members of this board are referred to as directors; e.g. the director of human resources and the director of finance. The CED links the supervisory board to the operating board. All senior managers are answerable to the CED who chairs all meetings of the operating board and reports to the supervisory board. In addition, the CED reports to the management of SABMiller in South Africa where their head office is located.

### *5.1.3 Ownership structure and control*

**Ownership Structure**

The ownership structure of TBL has changed over time (see Table 5.2). The change in the identity and degree of ownership reflects changes in the economy with respect to government ownership of corporations and the gradual evolution of private ownership of corporations. Prior to 1967, the company was fully privately owned. As part of the implementation of the Arusha Declaration of 1967, changes in ownership structure began to take place with the government acquiring increasing ownership of the company: 45% in 1967 and the other 55% in 1980.

The change in the economic policy formally introduced in 1986 led to a reversal of the government's ownership policy, and a move towards more private ownership of TBL began in 1993. The partial privatisation of TBL was effected in 1993 when SABMiller (then called Indol International B.V.) entered into a joint-venture agreement with the Government of Tanzania. The terms provided for SABMiller to assume control of 40.3% of the issued equity capital of TBL. The government of Tanzania retained 45.9%, with institutional investors purchasing the remaining shares. A further change occurred in 1998 leading to a higher concentration of TBL ownership by SABMiller. The terms of the joint-venture agreement included the undertaking of a rehabilitation and expansion programme by SABMiller.

SABMiller delivered equipment and project management services with a value of USD 19 million and a cash injection of USD 3.5 million . The cost of rehabilitation, as provided for in the joint-venture agreement, exceeded USD 22.5 million, and for that reason further financing was required. The government of Tanzania, SABMiller and other investors provided the additional financing. The contributions in terms of equity capital resulted in a change in the ownership structure.

**Table 5.2**
**The Ownership structure of the TBL**
*Source: Prospectus 1998, Annual reports from 1998 to 2004*

| Identify of shareholder | Percentage of total equity held | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Before Privatisation | | After privatisation | | | | | |
| | 1967-1979 | 1980-1992 | 1993-1997 | April, 1998 | 1998-2000 | 2001 | Oct, 2002 | Nov, 2002 to 2004 |
| NDC/Treasury Registrar | 45% | 100% | 40.3% | 36.9% | 29.7% | 16.36% | 5% | 4% |
| EABL | 55% | - | - | - | - | - | - | 20% |
| SABMiller | - | - | 45.9% | 50.5% | 50.40% | 66% | 66% | 52.8% |
| Public (traded at DSE) | - | - | - | - | 7.3% | 8.85% | 10.17% | 8.2% |
| IFC | - | - | 9.6% | 8.8% | 8.8% | 8.79% | 8.83 | 7% |
| Unit Trust of Tanzania | - | - | - | - | - | - | 10% | 8% |
| PROPARCO | - | - | 1.8% | 1.6% | 1.6% | - | - | - |
| Dresner Bank | - | - | 1.6% | 1.5% | 1.5% | - | - | - |
| FMO | - | - | 0.8% | 0.7% | 0.7% | - | - | - |

Currently, TBL is a subsidiary of SABMiller which holds 52.8% of the voting shares in TBL. This ownership reflects increasing control of important Tanzanian corporations by multinational corporations. East African Breweries Limited (EABL) is the other major shareholder of TBL: it acquired 20% of the shares in the company in exchange for KIBO – a former subsidiary of EABL. As part of this transaction, TBL also obtained the license to produce and distribute the full range of EABL beers as well as Guinness United Distiller and Vintners Limited (GuinnessUDV) brands. EABL is a subsidiary of Guinness based in the UK. KIBO beer brands formerly competed with TBL's brands, with KIBO having 14% of the beer market in Tanzania. The acquisition was aimed at eliminating this competition.

Other current minority shareholders are: the government of Tanzania (4%), the International Finance Corporation (7%), the Unit Trust of Tanzania (UTT)[45] (8%), and the general public - consisting of about 20,000 individuals who own small numbers of shares (8.2%). The general public acquired shares when TBL was listed on the Dar es Salaam stock exchange in 1998. The listing of the company was to an extent aimed at broadening the ownership base in line with the objectives of the government's privatisation programme. There is a standing agreement between SABMiller and the

[45] UTT (the Unit Trust of Tanzania) was established in June 2003 to take over the responsibilities of the Tanzania Privatisation Trust. This Trust was formed to hold some of Government shares in privatised companies with a view to selling them to the local people through the stock market in future.

Government of Tanzania by which SABMiller is required to inform the latter (with pre-emptive rights) about its intentions to sell its shares to another investor.

***Shareholder control***

Two important structures and processes through which shareholder control is exercised at TBL are the shareholders annual general meeting and their continuous direct influence on decision-making processes of the company by SABMiller. The use of the two structures/processes for exercising control reflects the degree of ownership of the company.

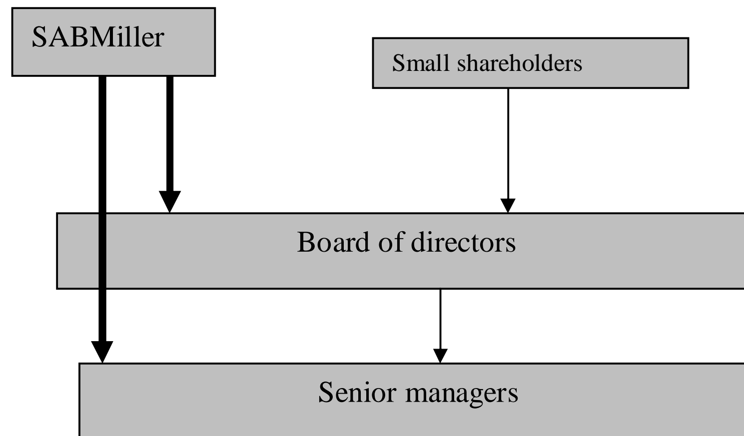
*SABMiller*

SABMiller was formerly called South African Breweries International (Africa) B.V (SABI) which in turn became Indol International B.V, a company incorporated in the Netherlands and a wholly-owned subsidiary of South African Breweries Limited (SAB) which was incorporated in the Republic of South Africa (RSA) in 1896. In 2002, SABI acquired 100% of Miller plc in the US. This created the second largest brewery in the world: SABMiller plc. Its control of TBL is revealed through its appointment of the key people in the company. It also has direct access to these people - the chief executive ‘officer’ (CED) and the board chairman.

Access to information, influence over decision-making processes, including veto power, and direct involvement in the management of the company are important means of control available to SABMiller. SABMiller does not depend on the annual general meeting or the minimum disclosures required by law to exercise control of the company. It can count on a continuous flow of information through a process of reporting by the TBL management to the SABMiller headquarters in South Africa. These arrangements ensure that SABMiller has access to significant information and decisions made at TBL.

The reports to SABMiller include important operational matters: product quality, sales targets and cash position. These reports are sent daily, weekly, monthly, quarterly and yearly in a prescribed form. Specific reports are also provided by TBL to SABMiller on demand. This implies that annual general meetings are mere legal formalities and perhaps serve more as a forum for the minority shareholders to be informed of developments within the company. Figure 5.1 indicates the direct and indirect control exercised by SABMiller, with the heavy lines indicating a strong control relationship, and the light ones representing a relatively weak one.

**Figure 5.1**
**The control of TBL by SABMiller**
*Adapted from Roe, 2003*




*Minority shareholders*
Two categories of minority shareholders exist at TBL: those who hold sufficient shares to entitle them to appoint a director, and those whose ownership is not sufficient for this. Minority shareholders who qualify to appoint directors do so. They thus have access to board decisions and can exert limited influence on the board decision-making process.

Minority shareholders who do not qualify to appoint directors have no access to the key decision-making processes. These are usually individuals plus some institutions including: the Public Sector Pension Funds (PSPF), the Parastatal Pension Fund (PPF), and the National Social Security Fund (NSSF). A significant number of the individual minority shareholders are members of SACCOS[46]. The influence of this group on decision-making is low since they have limited access to information and have no power to influence decisions.

This group of minority shareholders relies on the annual general meeting to air their views and attempt to exert influence on the decision-making processes. These are reflected in the questions about decisions that have been implemented by management, or which are proposed at the annual general meeting. Their actions are taken on the basis of the minimum statutory disclosures required by company law and the DSE listing regulations which all shareholders have access to: the annual audited reports and the half-yearly reports. The audited annual reports are sent to every shareholder. The

[46] SACCOS stands for Savings and Credit Cooperative Societies. These are organisations usually formed by employees at places of work for the purpose of mobilising savings from the members (employees) as well as providing credit to them. Some SACCOS are able to mobilise large amounts of funds some of which they have invested in the shares of the listed companies.

half-yearly reports are made public through the DSE notice boards. Other sources of information for minority shareholders include newspapers, radio and television.

The statutory reports which are sent to shareholders include a notice of the annual general meeting and an invitation to attend. The agenda for the annual general meeting includes: confirmation of the minutes of the previous annual general meeting, matters arising, consideration of the directors report, the auditors report, and the audited financial statements for the year under review, consideration of the declaration of dividends, appointment of auditors for the next financial year, approval of directors remuneration and any other business. This agenda is typical of annual general meetings, and is prepared by management and approved by the board of directors.

Shareholders are allowed to vote during the annual general meeting in line with the requirement of the law (Cap. 212), and as recommended in the OECD principles of corporate governance (Chapter 3). They are also allowed to appoint a proxy to attend the annual general meeting and vote on their behalf. Although decisions are made through a voting process, because of the majority holding of SABMiller, annual general meetings are largely a formality. The one-share-one-vote basis enables SABMiller to have its choice endorsed.

The view that the TBL annual general meeting is a legal formality is reinforced by the fact that, in practice, individual minority shareholders do ask discerning questions at these meetings but, if they are not satisfied with the answers/explanations they are provided with, they cannot alter the state of affairs. They have no power to discipline management or directors. Interviewed minority shareholders also pointed out that, the way in which the annual general meetings are handled limits their ability to exert control. For example, they are only allowed to pose a limited number of questions.

In most cases when the minority shareholders do not agree with issues that management/directors raise, they place then hope on the government protecting them from potential abuse by management which they view as being helped by the controlling shareholder. However, they also believe that the government officers and the directors of the company may conspire against SABMiller EABL them. This makes them feel helpless. For example, when a share swap between SABMiller and EABL was announced in July 2002, the minority shareholders expressed a fear with respect to their position once TBL had acquired KIBO. In this transaction, SABMiller received a 20% stake in EABL while minority shareholders had their effective ownership diluted from 10.2% to 8.2% as a result of a new issue of shares. Initially some minority shareholders objected to this transaction with one of them threatening to go to court. The issue was postponed, but was raised again and approved at an extraordinary meeting in November 2002, with minority shareholders expressing hope that the government would protect them. The government, however, supported this development even though minority shareholders complained about it and expressed their dissatisfaction.

There are also indications that SABMiller and TBL management work in co-

operation with the Government of Tanzania. In most annual general meetings, the treasury registrar has been called upon by the chairman of the board, who also chairs the annual general meetings, to make closing remarks. The treasury registrar, in turn, has tended to speak positively about the way in which the board of directors and management are handling the affairs of the company even in the midst of complaints by minority shareholders. Three incidents were provided as evidence of this assertion:

(1) In one of the annual general meetings, a minority shareholder made a suggestion to issue shares to directors of TBL as a way of aligning the interests of the directors with those of shareholders. The directors answered that that was not possible. The treasury registrar sided with the TBL directors in arguing against this proposal on the grounds that there were no shares available as all shares had already been issued.

(2) In an annual general meeting, minority shareholders demanded that they be allowed to elect a representative to the board. During this annual general meeting, the directors, supported by the treasury registrar, promised to consider the proposal. In the annual general meeting that followed, the minority shareholders were told that they needed to form a trust or association to which they could entrust their shares. The position of the treasury registrar on the representation of the public was that the minority shareholders should constitute themselves into a trust to hold their shareholding and, through that, representation to the board would be feasible.

(3) When the decision to swap shares between SABMiller and EABL was reached, there were no shares to give to EABL. There was therefore a need to increase the authorised share capital to meet this objective. The issue first arose during an annual general meeting but was contested by the minority shareholders. Management and directors postponed the issue. On 8th November 2002, an extraordinary meeting was held, this issue was again presented and approved. The authorised share capital was increased. The treasury registrar spoke positively of the issue and thanked fellow shareholders for approving it. Despite scepticism in the regulatory machinery of the government, mainly on the grounds that the acquisition had negative impacts on competition, as per the Fair Trade Practices Act of 1994, the transaction was finally approved[47].

An assessment of the above incidents points to a close working relationship between the treasury registrar and the TBL management. With respect to the first incident; while it is true that all shares had been issued and that there was none to be given to directors, the authorised share capital could have been increased to obtain the shares needed for the purpose. The company ordinances (Cap. 212) enable the authorised share capital of a company to be increased through a resolution passed by shareholders at an extraordinary meeting. This provision was used in connection with the EABL share

[47] It was not expected that this would fail. The government through its senior officers (as board members) participated in approving these strategies.

exchange (incident 3). The TBL directors made a proposal, approved during the extraordinary meeting, in which shares were swapped between SABMiller and EABL Ltd. SABMiller exchanged 20% of TBL shares for 20% of EABL shares.

With respect to the second incident, the position taken by the treasury registrar on the issue discouraged any further attempt to obtain minority representation. Although collectively the minority shareholders satisfy the criterion for appointing a director, their inability to organise themselves into an institution to hold their shares has had the consequence that they have not been able to appoint a representative to the board. The government did not provide assistance in guiding minority shareholders.

With respect to shareholder control, through influence on the appointment and access to key people, influence on key decisions of management/directors, and influence on decisions and the level of vote, the minority shareholders collectively score low on all these indicators. Table 5.3 provides responses to statements on shareholder control.

**Table 5.3**
**Shareholder control at TBL**

| | Not at all | Sometimes | Always |
|---|---|---|---|
| Directors fulfil their duty of reporting to the shareholders at the annual shareholder meeting | | | √ |
| Annual audited reports are sent to all shareholders before the annual general meeting | | | √ |
| Half-yearly reports are produced and made public | | | √ |
| Invitations to the annual general meeting are sent to shareholders in time | | | √ |
| Shareholders attending the annual general meeting exercise their right to vote on directors' proposals | | √ | |
| Large shareholders exercise considerable influence at the annual general meeting | | | √ |
| All decisions at annual general meetings made by voting | | | √ |
| The influence of large shareholders on director selection/appointment results in their control of the enterprise | | | √ |
| The controlling shareholders have access to key people in the organization | | | √ |
| Shareholders have the power to challenge or change the decisions of management and/or director | | | √ |

SABMiller appoints the majority of directors. All directors have an opportunity to visit SABMiller headquarters in South African once a year; and they do take advantage of this opportunity. SABMiller appoints the key officers of the company: the chief executive officer (CED) and the board chairman. All other senior managers: executive

directors for internal audits, finance, human resources, sales, marketing, planning, and distribution, and the company secretary, once appointed, are sent for training at a SABMiller-owned institute in South Africa.

In practice, the board of directors is not influenced by concerns of minority shareholders. A long-serving director in the company made this observation: “when our people complain at the annual general meetings, we just listen and keep quite because we know they make no difference”.

The extensive and continuous communication between TBL and SABMille, coupled with the involvement of SABMiller’s management in the decision-making processes of TBL, encourage management to continuously exert efforts towards meeting the interests of SABMiller. The conclusion is that their percentage ownership of TBL permits and encourages SABMiller to exercise control and hence reduce incentive problems.

### *5.1.4 Effectiveness of the board of directors*

Factors that usually determine the effectiveness of a board of directors with respect to control were explored.

***Board constitution***

The company has thirteen directors. With the exception of the executive managing director (EMD), who is a quasi-executive director, all the other directors are non-executive. The board of directors has seven Tanzanians and six from other countries. The Tanzanian directors include current and retired senior government officers. The EMD was a chief executive officer of TBL before it was privatised. Other members are a former government minister and career diplomat, a principal secretary from the Ministry of Finance, and another from the Ministry of Industry and Trade, and one career diplomat. The current permanent secretary in the vice president’s office, and a representative of the UTT are also members of the board. The non-Tanzanian directors are current employees of SABMiller or its subsidiaries.

The involvement of government officers in the company boards provides evidence of the close relationship between corporate entities and the government. It provides an explanation for the belief by minority shareholders that the government does not protect their interests in the event of the controlling shareholder, SABMiller, making decisions that they perceive not to be in their interest.

The inclusion of former and current senior civil servants on the board of directors is based on their influence/power with which they can influence government decisions/policies. It is considered their principal asset, which the company seeks to use. Such individuals are also helpful when issues arise over which the government and the company hold conflicting positions.

***Director independence***

To determine the independence of directors, the mode of appointment and possible relationship between the CEO and the major shareholders were assessed. In terms of appointment, directors are appointed through a procedure agreed upon by the Government of Tanzania and SABMiller in 1993 and amended in 2002. SABMiller and the government established the arrangement at a time when their shareholdings were in a ratio 45.5: 54.5. This procedure is enshrined in the company MEMARTS:

> "A shareholder with 8% of the company's ordinary share capital is entitled to nominate one director to the board and for each additional 8% an extra director". "....the government as long as it holds not less than 5% of the shares of the company, it shall be entitled to nominate not less than two directors…"

As a result of the dilution of shareholding arising from the SABMiller-EABL deal, the cut-off point for the government was revised down from 5% to 4%. This continues to provide the government with an opportunity to appoint two directors. The 8% criterion continues to apply to other shareholders. This shows that the controlling shareholder, SABMiller, wishes to continue to closely involve government officers in business decision-making processes. It also implies the exclusion of a large number of shareholders from the decision-making processes of the company and hence from the allocation of resources in the company.

Before the acquisition of KIBO in 2002, there were ten directors on the TBL board: eight appointed by SABMiller and two appointed by the Government of Tanzania. Currently, all shareholders who meet the 8% criterion are represented on the board. SABMiller have eight; IFC one[48]; EABL one; the Government of Tanzania two and the Unit Trust of Tanzania, one. SABMiller has appointed the Permanent Secretary from the Vice-President's office and a former ambassador as two of its directors.

The process of identifying potential directors to represent SABMiller on the board as well as senior management is performed by a SABMiller subsidiary, Bevman Services A.G. incorporated in Switzerland. This company has a contract for providing management services to TBL; and the recruitment exercise forms part of the arrangement. In terms of the process to recruit directors, Bevman Services A.G approaches individuals and asks them if they would like to be directors of TBL. The individuals approached are asked to submit a Curriculum Vitae which is scrutinised by SABMiller management before an appointment. The way in which SABMiller, through its subsidiary, carries out the appointment of directors is designed to ensure that they are economically and psychologically independent of the CED.

***Board leadership structure***

[48] IFC currently holds 7.03% but they have a representative in the board of directors

The positions of board chairman and chief executive officer have been separated. The company has established the position of executive managing director (EMD) alongside the position of chief executive director (CED). The EMD is not involved in the day-to-day activities of the company. He is also not part of management but is provided with information when he requires it. The EMD is also a member of the supervisory board of directors with voting powers. His well-informed position has been demonstrated at the annual general meetings where he has been asked a number of times by the board chairman to address questions/issues raised by shareholders - particularly the minority shareholders.

The CED performs the functions of a CEO. He manages the company on a day-to-day basis, chairs meetings of the operating board and reports to the supervisory board. The working relationship between the EMD and the CED is consultative. The CED consults the EMD, particularly when decisions have local implications. A large number of interviewees expressed the view that the EMD position was created to facilitate a smooth transition from state control of the corporation to private control[49]. This suggests that this position may not necessary exist in the future.

Prior to 2000, the Government of Tanzania appointed the board chairman. This was because the government held an ownership stake in the company which entitled it to appoint more than two directors; one being the board chairman. However, the government ownership has fallen below a level where it could continue to appoint more than two directors. This has led to the transfer of the right to appoint the board chairman to SABMiller. SABMiller, however, has appointed the same person that was appointed by the government. The power to appoint both the EMD and CED is enshrined in the company's MEMARTS.

***Board meetings***

Board meetings are held four times a year, but this can be increased depending on need. Preparations for these meetings include sending board papers (reports) to directors before the meeting. Some of the information is provided by email. Management prepares the agenda for these meetings in consultation with the chairman of the board. Board meetings are guided by the agenda, which generally contains: review of previous minutes, matters arising, business report for the quarter, profit forecast and any other business. The close involvement of SABMiller in management suggests that board meetings are, in practice, "counselling/advisory sessions".

***Board audit committee***

The Board has established an audit committee consisting of two non-executive directors and two members of the operating board (the CED and the director of internal audit).

[49] The person who was holding this position since TBL was privatised reigned at the end of 2004. This position has not yet been filled.

The responsibility of this committee is to advise the board on matters of internal control raised by the external auditors. It also serves as a link between the board and the external auditor. The committee meets once a year to discuss the financial statements of the company and the management report provided by the external auditor. It reviews the audited financial statements and the management report, and addresses issues raised by the external auditor. This is in line with the findings of Auerbach with respect to the functions of an audit committee (Auerbach, 1973).

This committee assists the board in being efficient and effective in its deliberations. The operations of the committee are influenced by the involvement of SABMiller's management in the affairs of the company. When auditors raise issues, this is communicated to SABMiller's management which, in conjunction with TBL management, addresses the auditors concerns. Table 5.4 provides the responses to statements which relate to the determinants of the effectiveness of the board with respect to the control function.

**Table 5.4**
**Effectiveness of the board of directors at TBL**

| | Not at all | Sometimes | Always |
|---|---|---|---|
| Non-executive directors constitute the majority on the board of directors | | | √ |
| Economic and social affiliations exist between directors and the company or company top management or large shareholder | √ | | |
| The positions of board chairman and CEO are separated | | | √ |
| Directors have established an audit committee | | | √ |
| The majority of members of the audit committee are non-executive directors | | | √ |
| The process of selecting/appointing directors is known to all shareholders | | | √ |
| Explicit criteria for selecting directors exist | √ | | |
| Directors have a clear and approved procedure for running meetings | | | √ |
| Information (board papers) reach directors on time before the date of meetings | | | √ |
| The agenda for the board meeting is set by the CEO (CED) | √ | | |

### *5.1.5 Board control*

The board of directors does not make decisions about hiring or replacing the chief executive director (CED). It can only advise SABMiller management if the directors hold the opinion that the CED is not performing as required. Also, the board does not

decide/determine the remuneration of the CED and nor do the directors conduct any formal evaluation of the CED, of individual directors or of board activities. An implicit evaluation of management performance takes place on an ongoing basis. It can be argued that further evaluation is not necessary because SABMiller conducts an evaluation based on the regular reports sent by TBL management. Thus, SABMiller performs all the control activities, which are usually the domain of directors, with the consequence that the board performs an advisory role to management rather than exercising control over it. The results of the interviews, provided in Table 5.5, show that board control is low in the case of TBL.

**Table 5.5**
**Board control at TBL**

| | Not at all | Sometimes | Always |
|---|---|---|---|
| Directors make the decision to hire a CEO | √ | | |
| Directors can discipline/fire the CEO | √ | | |
| Directors discuss and approve the strategy of the company | | | √ |
| Directors make decisions about the CEO's (CED's) remuneration | √ | | |
| Directors formally evaluate their activities, the CED and the individual directors | √ | | |

**Analysis and verification of propositions**

The analysis of the ownership structure and shareholders control indicates that SABMiller exercises control of management. This implies that the agency problem is addressed by SABMiller through its constant monitoring of management performance. SABMiller appoints all the senior management and the majority of directors, implying that if corrective action is required, such as replacing senior management, this decision can easily be instituted by them. SABMiller is an insider in the sense that it takes part in the decision-making processes of the company. This is a confirmation of Proposition 1 that: *shareholders that hold the majority of shares in a corporation exercise control.*

The constitution of the TBL board provides for a large number non-executive directors. Although it was found that a large number of directors are independent from the chief executive officer (CED), the fact that they are not involved in effectively controlling management means that Proposition 2 (a): The greater the number of independent non-executive directors relative to that of executive directors on the board of a corporation the more extensive the board control, is not confirmed in the case of TBL.

With respect to board leadership structure, the separation of the positions of chairman and chief executive officer is in line with agency theory in terms of strengthening board control. However, at TBL, the chairman of the board is not

independent with respect to the controlling shareholder and plays no significant role in enhancing board control. Since both the chairman and the CED are appointees of SABMiller, and hence not independent, proposition 2(b) that: *the separation of the positions of board chairman and CEO, with an independent chairman of the board, leads to extensive board control* is not confirmed in the case of TBL.

In terms of board meetings, the findings show that they are conducted effectively in terms of availability of information and the possibility for directors to challenge management. Although the necessary indicators of effective board meetings do exist, the non-involvement of the board in the control function implies that board meetings do not have any bearing on board control. This conclusion means that Proposition 2(c) that: *effective board meetings result in extensive board control* is not confirmed in the case of TBL.

Findings with respect to the board audit committee show that such a committee has been formed and is currently made up of both non-executive and executive directors. However, the role of committee with respect to board control is negligible. A board audit committee is not necessary in the current set-up of TBL where SABMiller exercises director control. This conclusion implies that Proposition 2(d) that: *the establishment of board audit committee comprising of independent directors, results in extensive board control* cannot be verified in the case of TBL.

## 5.2 Tanzania Oxygen Company Ltd (TOL)

### *5.2.1 Background and profile of the company*

TOL's history also mirrors the history of Tanzania and its economic developments since the colonial time. It began its operations in Tanzania in 1950, as a branch of the African Oxygen and Acetylene Company (AFROX) of South Africa. In 1968, East African Oxygen Limited from Kenya, a subsidiary of British Oxygen Company (BOC), bought all the shares in TOL from AFROX. In 1979, BOC sold the Government of Tanzania 60% of the equity in the company. The government ownership was vested in the National Development Corporation (NDC). However, the management of the company remained with BOC under a management agreement between the Government and BOC.

In 1988, BOC sold the remaining 40% of the company equity to the government of Tanzania. Buying this BOC equity capital at a time when it had signed an agreement with the IMF and the World Bank to abandon its centrally coordinated system of economic coordination in favour of a market-based system (Chapter 2) raises questions about the appropriateness of this decision. TOL was a fully state-owned corporation until 1997 when some of the shares were sold to private investors through the Dar es Salaam Stock Exchange.

*Activities and company performance*

Tanzania Oxygen limited is the leading producer and distributor of industrial and medical gases in Tanzania. The main lines of business are industrial gases, medical gases and health care products, as well as welding, metal fabrication and transport. The performance of the company between 1997 and 2003 is given in Table 5.6. It shows that the company has been performing poorly throughout this period. This performance is attributed to the ambitious expansionist strategy that management attempted to pursue immediately after the company was listed. The strategy involved the installation of a new plant with increased capacity for producing gas.

The plant, which is an Air Separating Unit (ASU), was installed and started operation in 1998. The cost of installing this plant was met through borrowed funds provided by two regional banks: the East African Development Bank (EADB) and the Preferential Trade Area Bank (PTA). The newly installed capacity is still not fully utilised because the initially targeted markets, that motivated the acquisition of the plant, have not been realised. Because of the fixed costs of under-utilised capacity and the associated costs of under-utilised capacity and the fixed financing costs, the company is currently facing a financial crisis. This crisis led to a situation of near bankruptcy when the financing banks threatened to liquidate the company in 2001. This was averted by a government intervention, committing itself to repay the bank loans owed by the company.

**Table 5.6**
**Performance of TOL from 1997-2003**
*Source: Annual Reports from 1998-2003, Company files, DSE files*

| Performance Indicator | Year | | | | | | |
|---|---|---|---|---|---|---|---|
| | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 |
| Revenues in TAS (billion)” | 2.46 | 2.13 | 2.02 | 2.18 | 2.13 | 2.38 | 2.92 |
| Profits (PAT) in TAS (billion) | -.56 | -.40 | -.18 | -.44 | -1.35 | -.71 | -1.23 |
| Dividends in TASs(billion) | - | - | - | - | - | - | - |
| Dividends as % of PAT | - | - | - | - | - | - | - |
| Book value of assets in TAS (billion) | 5.96 | 5.54 | 8.33 | 6.69 | 6.75 | 5.66 | 5.59 |
| Market capitalization in. TAS (billion) | 0.63 | 5.30 | 3.18 | 2.49 | 4.85 | 8.3 | 10.56 |

TOL has been operating at a loss since 1997. As a result, the company has not been able to pay dividends to its shareholders. The market price per share fluctuated considerably over time. The initial public offer price was TAS 500/= in 1997. It fell to TAS 260/= by December 2003 but rose to TAS 330 by December, 2004. The market capitalisation fell to TAS 3.18 billion and TAS 2.49 in 1999 and 2000 respectively, but rose to TAS 4.85

billion in 2001. In December 2003, the market capitalisation stood at TAS 10.56 billion. The increased market capitalization in 2001 reflects a rights issue effected in that year, which resulted in an increase in the number of shares. The government action to save the company from being liquidated in that year boosted the share price. The effect of government intervention to avert liquidation was also reflected in the share price in 2002 and 2003.

### *5.2.2 Corporate governance arrangement*

TOL was incorporated as a limited liability public company under the company ordinance (Cap. 212) in 1966. Corporate governance operates within the framework of this ordinances, which recognises shareholders as members of the company and subsequently the only constituency that is represented on its unitary board of directors and permitted to vote at the company annual general meetings. This orientation is captured by a comment made by a shareholder during one of the annual general meetings:

> "…We, as shareholders have our interests in the company as providers of finance. Management also has its own interests in the company. These interests are not the same and as shareholders we must find ways of making sure that the people we employ work for our interest and not theirs. We must figure out the most efficient mechanisms. Perhaps we should have a team of four people from ourselves who will look at the quarterly reports and ask questions to management. They can do a better job than the board…" (Translated from Kiswahili).

### *5.2.3 Ownership structure and control*

***Ownership structure***

In 1997, individual and institutional investors purchased some of the shares held by the government in TOL. This was in line with the current policy of privatisation discussed in Chapter 2. The government, which still holds 74.14% of the total equity capital, remains the controlling shareholder. The general public holds 20.16% while institutional investors hold the remaining 5.7%. The current number of individual shareholders is over 10,500. These shareholders include TOL's employees who acquired shares through the company's employee share ownership scheme. As in the case of TBL, a significant number of individual shareholders are members of SACCOS.

**Table 5.7**
**The ownership structure of TOL**
*Source: Company prospectus and annual reports from 1997-2003*

| Identify of shareholder | Percentage of total equity held | | | |
|---|---|---|---|---|
| | Before privatisation | | | After privatisation |
| | 1967-1978 | 1979-1987 | 1988-1996 | 1997-2003 |
| AFROX/BOC | 100% | 40% | - | - |
| Government- treasury registrar | - | 60% | 100% | 74.14% |
| Institutional investors: NSSF, PPF, IFC, and Banks | - | - | - | 5.70% |
| Public (individual shareholders) | - | - | - | 20.16 |

Currently, there are plans to reduce the government's shareholdings through a sale of its shares to a strategic investor. The government privatisation agency (PSRC) has identified a strategic investor and a memorandum of understanding has been signed. This investor is the former owner - British Oxygen Company (BOC) of Kenya - who has agreed to acquire about 60% of the shares. However, recently, some Tanzanian investors, led by a former board chairman of TOL who is the current executive managing director of TBL, have been soliciting other potential investors to form a consortium to buy the government's stake in the company[50]. These attempts are in their early stages and the outcome of these efforts is currently (ultimo 2004) uncertain.

***Shareholders control***

Shareholder control at TOL reflects the ownership structure shown in Table 5.7. The treasury registrar, who holds the majority of the equity capital, exercises greater control than the other shareholders. This control is revealed during the annual general meetings and by the continuous influence on the management decision-making processes that the treasury registrar exerts.

*The treasury registrar*

The treasury registrar has greater access to information than other shareholders. The TOL management is required to submit quarterly management reports including plans and budgets to the treasury registrar[51]. Specific information may also be produced on demand. The approval of the treasury registrar is critical in the implementation of major decisions. The treasury registrar also has access to key people in the company. These include the chairman of the board of directors and the chief executive officer (the managing director). The treasury registrar has the possibility, and has used it, to call

[50] Guardian, 23rd April, 2004
[51] The Public Corporations Act, 1992

senior management together with the chairman to discuss matters pertaining to the performance of the company and the way forward. The treasury registrar also influences the appointment of key people in the organisation. For example, during the board meeting in which the former board chairman was elected, the treasury registrar identified him as the person best suited to become board chairman.

While avenues for the treasury registrar's control exist and are used, there are inefficiencies in the way this control is exercised. For example, decisions tend to take a long time to make. An example is that when discussions with the potential strategic investor were in process, a number of decisions required the approval of the treasury registrar. The length of time it was taking to get the treasury registrar's decisions was excessive. Despite this weakness, the influence of the treasury registrar is significant and is taken seriously by management. Management expressed the view that the treasury registrar is the most important shareholder, whose interests must always be upheld. This view indicates that the treasury registrar is a credible threat and encourages managers to act and pursue strategies to maximise shareholder interests.

*Minority shareholders*

The annual general meeting has the character of a forum for minority shareholders to be informed about management decisions that have been made during the past year and for considering management proposals. This is because this is unnecessary for the treasurer registrar, as he is continually informed. The participation of the minority shareholders in the affairs of the company is facilitated by the minimum disclosures required by company law and the DSE listing regulations. Such disclosures include annual audited reports, and half-yearly non-audited financial reports posted on the DSE notice boards. In reality, the influence of minority shareholders at the annual general meetings is insignificant. Although minority shareholders do exercise their right to vote on proposals, the outcome of the vote depends on how the treasury registrar votes because he holds more than 50% of the voting rights.

There are other factors which reduce the potential influence of minority shareholders including the way in which annual general meetings are conducted and the way the agendas are set. The conduct of the 1998 annual general meeting illustrates how these factors can reduce the influence of minority shareholders in the governance of the company. This meeting is particularly stressed because it was during that year that the poor performance of the company was reported[52]. The company made huge losses and diminished the prospect of shareholders receiving dividends.

During this meeting, the inability of minority shareholders to discipline management and directors was demonstrated. The chairman of the meeting (who was

[52] TOL's financial year ends in December, and that annual results are presented in the following year. i.e 1997 results were tabled and discussed in 1998.

also chairman of the board of directors)[53] came under criticism from minority shareholders for running the annual general meeting in a way that denied shareholders the opportunity to ask questions and discuss issues adequately. Shareholders were not satisfied with a large number of the answers and explanations provided by directors; and they criticised management and directors for not being transparent[54]. The chairman (who was at that time also a Member of Parliament) responded by stressing that he held a number of shares (those held by the government) that formed the majority and, if there was a need to vote, he would emerge victorious. This communicated to the minority shareholders the message that they did not have the ability to discipline him. Change can only be instituted if the treasury registrar requires it.

The agenda for the annual general meeting, which provides the framework for permitting full disclosure of information and encourage accountability, also came under considerable shareholder criticism. A minority shareholder expressed concern that:

> "The way the agenda has been prepared is such that certain usual elements have been omitted in order not to give us shareholders the opportunity to discuss important issues. In this agenda, the item 'matters arising' has been omitted. This is to give management the opportunity to conceal information".

This comment implies that the minority shareholders can only obtain information to the extent that the management and directors allow. This is in contrast to the treasury registrar who has unlimited access to information.

At the 1998 annual general meeting all the directors resigned[55]. This resignation did not stem from the criticisms by the minority shareholders but from the treasury registrar's intervention. This is another reflection on the treasury registrar's decisive control. The decision to resign was communicated to the company secretary before the annual general meeting. However, there were attempts to handle this matter tactfully. For example, this resignation was recorded in the company minutes of that annual general meeting as: "that directors did not offer themselves for re-election should not to be viewed as reflecting the fear of being held accountable, rather it was just the right time to bring about change".

The way in which this resignation was recorded has to be placed within a broader context of events that took place before and after the board's resignation and the the company's current situation. The suspension of the then managing director by the board (before it resigned) and the fact that the company is still immersed in deep financial

---

[53] According to Cap. 212, Table C, the chairman of board is also the chairman of the annual general meeting.

[54] i.e. informing shareholders what actually caused the losses to the company.

[55] Yet, during an interview with one of the directors, the director stated that this was not a mass resignation.

problems, which in some ways seem to be a result of the poor decisions (with board approval) made by the suspended managing director[56], indicate that the board resigned due to pressure from the treasury registrar. During the course of this meeting, the board chairman said: " I and my board offer to resign our positions and allow the company to start afresh, for we feel that we should be responsible for some of the problems facing the company". Table 5.8 provides responses to statements on aspects of shareholder control.

**Table 5.8**
**Shareholder control at TOL**

| | Not at all | Sometimes | Always |
|---|---|---|---|
| Directors fulfil their duty of reporting to the shareholders at the annual shareholder meeting | | | √ |
| Annual audited reports sent to shareholders before the annual general meeting | | √ | |
| Half-yearly reports produced and made public | | | √ |
| Invitations to the annual general meeting are sent to shareholders in time | | | √ |
| Shareholders attending the annual general meeting exercise their right to vote on directors' proposals | | | √ |
| Large shareholders have great influence at the annual general meetings | | | √ |
| All decisions made at the AGM are effected by voting | | | √ |
| The influence of the controlling shareholder on director appointment/selection results in control of the company | | | √ |
| The controlling shareholder has access to key people in the organization | | | √ |
| Shareholders have the power to challenge or change the decisions of management and/or the directors[57] or reject them | | | √ |

### *5.2.4 Effectiveness of the board of directors*

The factors that determine the effectiveness of the board with respect to control that were investigated are: the board constitution, director independence, board leadership structure, board meetings and board audit committee. Emphasis was placed on understanding the impact of these factors on board control.

***Board constitution***

[56]The suspended managing director later sued the company (board) claiming that he unfairly dismissed. He demanded TAS 2.4 billion (about US$ 2.4 million). After a number of years of court hearings and concerned about the time the process was taking, the board agreed to settle the case out of court.
[57] Only the treasury registrar can have a veto power over decisions.

Currently TOL has fourteen, all non-executive, directors. The company is allowed by its MEMARTS to increase this number to twenty. The directors in this company are either heads, of or occupy key positions in, other organisations or in government departments, especially the treasury registrar's office. For example, the Chief Executive Officer of the Social Action Trust Fund (SATF) represents his institution. Other institutional shareholders have appointed their own members of staff to represent them on the board. For example, senior members of the management of pension funds such as PPF and NSSF represent these institutions. A Member of Parliament has also been appointed as a director of this company.

The current board has two directors who represent the general public (i.e. the minority shareholders). These directors were appointed following shareholders complaints that they were not represented in the company's decision-making organs. Following a long debate at the 1998 annual general meeting two directors, who are themselves shareholders, were appointed to the board. The various shareholders appoint individuals based on non-explicit criteria. However, it was mentioned that knowledge of the industry in which the company operates, and the trends in that industry, as well as an ability to understand financial issues are key factors in determining the board's ability to contribute usefully in deliberations. It was observed during the interviews that some directors lacked an understanding of some of the important issues in the operation of a board such as whether the board had formed an audit committee. This implies that they may not be participating in board deliberations effectively.

***Director independence***

According to the company's MEMARTS, directors should be elected through a voting process at the annual general meeting. A shareholder who intends to nominate a director is required to provide notice of that intention to the company secretary fourteen days ahead of the annual general meeting during which the election will take place. The names of the individuals provided by shareholders are read out at the annual general meeting followed by a vote. This is also the process for those appointed by minority shareholders save for the brief self-introduction made by the contestants. For any individual nominee, the support of the treasury registrar is required because, if he opposes it, it will not be accepted.

The appointment procedure ensures that candidates for the directorships are independent of the managing director. However, independence from the appointing shareholder remains problematic, particularly for those appointed by the controlling shareholder. During board deliberations/meetings the relative power of individual directors is reflected. The power being linked to the relative power of the appointing shareholder. Directors who represent the treasury registrar are considered more influential, and their opinions are interpreted as reflecting the position of the government. This has the effect of discouraging contrary opinion from other directors.

A director commented that:

> "…it is after all the government which suffers the most when things go wrong, so although we discuss issues and offer our suggestions, if they are not acceptable to the government's representatives we give up because even if it is voted on at the annual general meeting, the government's position will prevail..."

This comment suggests that some directors may not make much effort to provide arguments and present their views because they believe that directors representing the treasury registrar will not accept such views. This can be classified as an agency problem at the board level.

***Board leadership structure***

The positions of chairman and chief executive officer of the company have been separated. This separation establishes checks and balances in the decision-making processes of the company. As noted, the treasury registrar influences the appointment of both the board chairman and the chief executive officer (managing director). In this respect, the chairman is not independent from the treasury registrar.

The CEO works closely with the board chairman in running the company and in the preparation for board meetings. This provides the chairman with additional access to information about the company. During the annual general meetings, the CEO relies on the chairman for support. When the CEO wishes to obtain the board's approval over an issue, he first discusses it with the chairman who will then support the CEO's position during board deliberations. The fact that the CEO has to first persuade the chairman in order to gain his support shows that directors can reject management proposals.

***Board meetings***

Board meetings are held four times a year and can be scheduled as circumstances demand. The preparations for the board meetings include sending information (board papers) to directors. These reports are sent two weeks ahead of the meeting to provide sufficient time for directors to prepare. Other ways in which directors access information about the company include visiting the company to meet the CEO. The agenda for the board meetings is set by management and approved by the board. The agenda is the first item to be discussed and agreed upon. Additional issues that directors propose are included in the agenda which, in general, contains: approval of the minutes of the previous board meeting, matters arising, quarterly performance report and any other business. This approach provides continuity in the management of the affairs of the company and serves as a form of progress evaluation as well as serving as a basis for future actions.

***Board audit committee***

The company has not established a formal audit committee. However, there is an informal arrangement whereby directors delegate matters to the board chairman and his deputy, which they then report back to the board about. Through this arrangement, issues usually reserved for an audit committee are addressed: audit issues and clearing queries raised by the external auditors. Also, the chairman's deputy discusses the financial statements with the external auditor before such statements are laid before the board for further deliberation and approval. Through this arrangement, the board's awareness of management decisions and the board's ability to exert control over management decisions are enhanced. The results of the interviews on determinants of effectiveness of the board of directors with respect to the control function are summarised in Table 5.9.

**Table 5.9**
**Effectiveness of the board of directors at TOL**

| | Not at all | Sometimes | Always |
|---|---|---|---|
| Non-executive directors constitute the majority on the board of directors | | | √ |
| Economic and social affiliations between directors and the company or the company's top management or large shareholders exist | | √ | |
| The positions of chairman and CEO are separated and held by different individuals | | | √ |
| The board of directors has established an audit committee | √ | | |
| The majority of members of the audit committee are non-executive directors | No audit committee exists | | |
| The process of appointing directors is usually communicated to all shareholders | | | √ |
| Explicit criteria for selecting/appointing directors exist | √ | | |
| Directors have a clear and approved procedure for running board meetings | | | √ |
| Information (board papers) are sent and reach directors ahead of board meetings | | | √ |

### *5.2.5 Board control*

Directors do undertake the control related activities as part of control over management decisions (see Table 5.10). The company's MEMARTS shows that the chief executive officer is also a director, and is appointed by fellow directors to assume the executive function:

" the directors may from time to time appoint one of their body to be managing director

or hold any other executive office by whatever name called on such terms and (subject herein mentioned) for such period they think fit" sec. 83 (a)

As directors appoint the managing director, they can replace him. However, they cannot remove him from the directorship because the appointment of director is performed through a procedure beyond the control of the board of directors. By virtue of his position as a director, the managing director participates in decisions that are aimed at controlling his decisions. This reduces the extent to which other directors can be critical of his decisions. Despite this, the board of directors has the final say on important decisions. The board of directors discusses and approves the company strategy. The current chief executive officer of the company observed that; "I am guided and monitored at the same time… this board is too cautious".

It is also the responsibility of the directors to determine the remuneration of the chief executive officer. The company's MEMARTS state explicitly that the directors have the powers to decide how the managing director is to be compensated. This is also the case in practice. There are no formal evaluations of the managing director or of other directors, neither do directors evaluate their own work. An implicit evaluation of the CEO's performance does take place through the discussion on the strategy and general performance of the company.

**Table 5.10**
**Board control at TOL**

| | Not at all | Sometimes | Always |
|---|---|---|---|
| Directors make decisions about hiring (appointing) the managing director | | | √ |
| Directors can discipline/fire the managing director | | | √ |
| Directors discuss company and approve the company's strategy | | | √ |
| Directors decide on the managing director's remuneration | | | √ |
| The board of directors formally evaluates its activities, the managing director or individual directors | √ | | |

**Analysis and verification of propositions**

The extent of the control that the treasury registrar exercises in the case of TOL is significant. The access to information and the power to influence the appointment or firing of key people imply that senior management will make decisions with the interests of the treasury registrar well in mind. This indicates that the treasury registrar is a credible threat and hence plays an important role in addressing agency problems. The influence that the treasury registrar exerted following the revelation of poor performance in 1998 testifies that he exercises this control. This confirms Proposition 1

that *shareholders that hold the majority of shares in a corporation exercise control.* Although the proposition is confirmed, there are indications that this control is not always applied effectively. The slow pace with which decisions are made by the treasury registrar implies that a certain degree of inefficiency exists with respect to the use of the power held and information accessed by the treasury registrar.

Discussions about board control indicate that the board of directors exercises significant control over management through the execution of control-related activities. This means that the direct control exercised by the treasury registrar goes hand in hand with that exercised by the board of directors. The previous discussions of the board constitution and director independence have indicated that the constitution of a board of non-executive directors, who are independent from management, enables it to effectively execute control-related activities. Thus, for this case Proposition 2 (a), that the greater the number of independent non-executive directors relative to that of executive directors on the board of a corporation the more extensive the board control, is confirmed.

The separation of the posts of chief executive officer and of chairman of the board has been found to have a positive effect on the accountability of the chief executive officer to the board of directors, and enhance the board's ability to exercise control over him. The requirement at TOL that the CEO answers to the chairman of the board indicates that the chairman plays an important role in encouraging the CEO to make shareholder wealth-maximising decisions. This means that Proposition 2 (b), that *the separation of the positions of the board chairman and CEO, with an independent chairman of the board leads to extensive board control,* is confirmed in this company.

The board meetings are organised and held in ways that enhance the board's understanding of the company's situation and ability to raise important issues, and that management is called upon to answer. This implies that these sessions play a significant role in encouraging management to pursue shareholder interest and hence Proposition 2 (c), that *effective board meetings result in extensive board control*, is confirmed. Although the proposition is confirmed, there are indications that not all directors make the expected contribution. The presence of some directors on the board who appear to have no knowledge about some of the basic issues of the company indicates that their contribution during these meetings is inadequate.

The findings with respect to a formal audit committee indicate that a formal audit committee has not been formed at TOL. For that reason, Proposition 2 (d), that *the establishment of a board committee comprising of independent non-executive directors results in extensive board control,* is not confirmed. Despite non-confirmation of the proposition, there are indications that such a committee is required for enhanced efficiency of the board in its control function. The existence of an informal arrangement in which the board relies on the deputy chairman to perform the work of reviewing the financial statements of the company and assist the board in understanding the reports

points to the need to establish such a committee.

## 5.3 Tanzania Tea Packers group Ltd (TATEPA)

### *5.3.1 Background and profile of the company*

Unlike the previous two companies which were established during pre-independent Tanzania, TATEPA was established in 1994 and commenced operations in 1995. The company started as a private entrepreneurial initiative involving packaging and distributing tea in Tanzania. Its history reflects the recent socioeconomic developments in Tanzania in which the private sector is increasingly being encouraged to take the leading role in the economy (Chapter 2). TATEPA's operations were initially located in Dar es Salaam. The raw tea was sourced in and transported from the upcountry tea growing/producing areas of Mufindi, Tukuyu, and East Usambara. In 1998, the production facility was moved to Mafinga in Iringa, which is the main tea producing area in the country. Its administration and distribution functions have continued to be based in Dar es Salaam.

*Activities and company performance*

The company's main line of business is the packaging and distribution of tea under the C*hai Bora* brand name. Recently instant coffee, under the *Kahawa Bora* brand name, has been introduced. Despite the growing competition in the tea industry, particularly from illegal imports reflecting the effects of trade liberalization and the poor enforcement of laws governing the importation of goods[58], TATEPA has retained a large share of the tea market in the country. It managed to maintain about 70% of the tea market in 2001, 2002 and 2003. It has also been the market leader in 2004.The company is currently pursuing an expansionist strategy through organic growth as well as through acquisitions. The acquisitions include Wakulima Tea Company and Kibena Tea Limited, in May 2001 and February 2002 respectively.

TATEPA has generally been a profitable company since it began operation (see Table 5.11). Only in 2001, was a loss registered, which has been attributed to the acquisitions made in 2001 and 2002. The company has also been regularly paying dividends to its shareholders. Its share price on the Dar es Salaam stock exchange stood at TAS 600 in December 2002 compared to the Initial Public Offer (IPO) price per share of TAS 330 in 1999. In December 2004 the share price stood at TAS 405.75. The company's market capitalization has been growing and reached TAS 8.22 billion by December 2003 and TAS 6.72 billion by December 2004. In 2004, the market capitalisation fell while profits increased. However, no dividends were declared in that year which could explain why the share price fell pulling down the overall market

[58] Enforcement of laws is a pervasive problem in Tanzania. Chapters 2 and 4; URT, 1996

capitalisation[59]. The sudden upsurge in the market capitalisation in 2000 was caused by the fact that TATEPA went public which made it possible to determine a realistic company share price.

**Table 5.11**
**Performance indicators for TATEPA from 1997-2004**
*Sources: company prospectus, annual reports from 1997-2004 and DSE files*

| Performance indicator | Year | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 |
| Revenues in TAS (billion) | 2.48 | 3.20 | 3.54 | 4.06 | 4.64 | 9.81 | 12.54 | 14.87 |
| Profits (PAT) in TAS (billion) | .45 | .51 | .74 | .55 | -.08 | .45 | .27 | 1.33 |
| Dividends in TAS (billion) | .12 | .137 | .42 | .42 | .42 | .58 | .61 | - |
| Dividends as % of PAT | 27% | 27% | 57% | 77% | -530% | 129% | 234% | - |
| Total Assets in TAS (billion) | 9.64 | 1.76 | 2.12 | 2.94 | 5.07 | 14.48 | 18.96 | 19.52 |
| Market capitalization in TAS (billion) | 0.2 | 0.21 | 0.39 | 4.03 | 6.81 | 8.64 | 8.22 | 6.72 |

### *5.3.2 Corporate governance arrangement*

The structure of corporate governance is in line with the shareholder-oriented model implied in company ordinance (Cap. 212) in which directors are appointment by the shareholders who are the only organisational constituency that executes corporate governance-related activities including voting at the annual general meeting. The company has a one-tier board structure.

### *5.3.3 Ownership Structure and Control*

***Ownership Structure***

The initial capital for starting up TATEPA was provided by the two founding entrepreneurs and an institutional investor. The founding entrepreneurs, who still hold significant stakes, are a Tanzanian Member of Parliament and a UK businessman. The institutional investor was Tanzania Venture Capital Fund (TVCF), a subsidiary of Commonwealth Development Cooperation (CDC) also from the UK. In 1998, the

[59] The exists a debate on whether payment of dividends afters shareholder wealth (via share price) and some authors argue that payment of some dividends is better than none suggesting that this issue is important in the determination of share price.

company had issued 21,120 ordinary shares of TAS 10,000 each. These shares were split, in that year, into 8,448,000 shares of TAS 25.00 each to facilitate listing on the Dar es Salaam stock exchange[60]. East Usamabara Tea Company and Taganyika Wattle Company also acquired shares in TATEPA in that year. The ownership structure before and after listing on the Dar es Salaam stock exchange in 1999 is shown in Table 5.12. The years covered in this table represent a period during which important changes took place with respect to the ownership structure of the company; particularly the spread of the ownership base of the company with other shareholders acquiring major stakes.

FreshFields Investments Limited, a wholly owned subsidiary of the Commonwealth Development Cooperation, is currently the controlling shareholder of TATEPA. It holds 53.01% of the ordinary share capital. FreshFields Investments is a locally-registered company established to enable CDC invest in TATEPA. It took over the shares that were previously held by EUTCO and TANWAT. This was necessary because foreigners (including foreign corporations) were once not permitted to deal in shares of a listed company, although this has now changed (Chapter 3). Although FreshFields holds the majority of the equity capital, it does not treat TATEPA as a subsidiary. This is because it does not have control of the board of directors due to limitations provided in the company's MEMARTS. According to UK company law, control of the board of directors is an essential condition for a company to treat another company as a subsidiary.

**Table 5.12**
**The ownership structure of TATEPA**
*Source: Prospectus, 1999; annual reports 2000-2004*

| **Identity of shareholder** | **Percentage of total equity held** | | | | | | |
|---|---|---|---|---|---|---|---|
| | **1998** | **1999** | **2000** | **2001** | **2002** | **2003** | **2004** |
| Tanzania Venture Capital Fund | 47.30% | 37.74% | 32.04% | 31.98% | - | - | - |
| EUTCO/TANWAT | 26.30% | 26.28% | 26.28% | - | - | - | - |
| FreshFields Investments Ltd | - | - | - | 26.28% | 52.71% | 53.01% | 53.37% |
| Small shareholders- Public | - | 14.96% | 14.96% | 18.24% | 12.09% | 12% | 7.5% |
| Social Action Trust Fund | - | - | 5% | 5% | 5.31% | 5.32% | 5.34% |
| J.J. Mungai | 10% | 7.97% | 9.53% | 9.53% | 6.46% | 6.92% | 6.28% |
| G. Theobald | 10% | 7.97% | 9.19% | 7.97% | 6.25% | 6.26% | 6.97% |
| National Social Security Fund | - | - | - | - | 5.41% | 5.43% | 5.44% |
| Parastatal Pension Fund | - | - | - | | 11.03% | 11.06% | 11.09% |
| Thompson Lloyds and Ewart | 4% | 3.19% | 1.11% | - | - | - | 2.51% |
| G.P. Theobald | 2.40% | 1.89% | 1.89% | 1% | 0.74% | - | 1.49% |

[60] CMSA encourages companies to have small values per share to encourage wider share ownership

***Shareholder control***

Unlike the previous cases, where shareholders with over 50% of the shares are able to exercise control of the company, TATEPA's MEMARTS has set a limit to the degree of control exercisable by a single shareholder through the board of directors. The maximum number of directors a single shareholder can appoint is set at two. There is, however, a pervasive influence which the controlling shareholder exerts on management decision-making processes. The managing director consults the representative of the controlling shareholder (FreshFields Investments) before making any major decision. Before TATEPA acquired the Kibena company (formerly also controlled by CDC), the country manager of CDC, who is also a director on the TATEPA board, held extensive discussions with the TATEPA managing director.

The founders of TATEPA insisted that shareholders should be directors so that they could directly participate in the decision-making processes of the company. Alternatively, they can directly appoint people to represent them on the board. In this construction, each shareholder has direct access to the person or people he/she has appointed to the board of directors.

The directors do report to shareholders during annual general meetings. Given that shareholders with at least 5% of share capital can either be directors or appoint them, such shareholders have access to significant information about the operations of the company. The annual general meetings are relevant to the minority shareholders who have no direct access to information through directors. In terms of influencing decisions, this reporting is only procedural since the minority shareholders have not sufficiently power to change a decision. If issues are voted on at shareholder meetings, the vote of the minority shareholders cannot overturn any decision that CDC supports. When asked if the minority shareholders, who are over 2000 in number, can influence any decisions made at annual general meetings, one of the non-executive directors interviewed ruled out any such influence: “they have no influence; but their questions are answered politely during the annual general meeting”.

Access to information about the company's activities and performance reflects the ownership structure. However, all shareholders have access to reports prepared by the company as required by company ordinances and listing regulations: namely, the annual audited reports and the un-audited financial reports the company releases on half-yearly basis. The half-yearly un-audited financial statements are published in the popular newspapers and on the DSE notice boards while the annual audited reports are sent to each shareholder at least twenty-one days before the date of the annual general meeting. The report also contains an invitation to the annual general meeting and the agenda for the meeting which includes: confirmation of minutes of the previous annual general meeting, adoption of the annual report for the year, adoption of annual accounts for the year, appointment of external auditors, consideration and declaration of dividends,

confirmation of the non-voting directors and any other business. Shareholders are also allowed to send in issues to be included in the agenda. However, no experience with this aspect was cited. Table 5.13 provides responses to aspects of shareholders control.

**Table 5.13**
**Shareholder control at TATEPA**

| | Not at all | Sometimes | Always |
|---|---|---|---|
| Directors do fulfil their duty of reporting to the shareholders at the annual shareholder meeting | | | √ |
| Annual audited reports are sent to shareholders before the annual general meeting | | | √ |
| The half-yearly reports are produced and made public | | | √ |
| Invitations to the annual general meeting are sent to shareholders in time | | | √ |
| Shareholders attending the annual general meeting exercise their right to vote at the annual general meeting | | | √ |
| Large shareholders have great influence at the annual general meeting | | | √ |
| All decisions at the annual general meeting are made by voting | | | √ |
| The influence of large shareholders on director selection and at the annual general meeting results to their control of the enterprise | | √ | |
| The controlling shareholder has access to key people in the organization | | | √ |
| Shareholders have the power to challenge or change the decisions of management and/or the director (approve or reject)[61] | | | √ |

### *5.3.4 Effectiveness of the board of directors*

The factors that determine the effectiveness of the board of directors in exercising control were investigated.

***Board constitution***

Currently, TATEPA has eleven directors of whom seven are non-executive and four are executive directors. The executive directors include the managing director and his assistant. The company also has two non-voting directors. These are experts in the tea industry. There are also directors who are founders of the company. Although they do not qualify by the shareholding criterion, as founders they have the opportunity to

[61] Since controlling shareholders are constantly involved in the management decision-making processes, decisions at the annual general meeting are approved without difficulty.

continue being directors. The constitution of the board of directors reflects the ownership structure. Of the current directors of TATEPA, seven are of British nationality (including the MD) and four are Tanzanians including the chairman of the board.

Some of the Tanzanian directors appeared to lack knowledge about key issues of the company. For example, they did not know of some of the basic aspects of its governance, as described in the company's MEMARTS, including the criterion for a shareholder to appoint directors. One director particularly mentioned that he did not know his rights (including of compensation) as a director. This casts doubts on their effective role during board deliberations, which is essential for board control. The institutional representatives on the board tend to change. The general practice is for heads of institutions to become directors or to appoint specific individuals from their institutions to represent their institution on the board. However, in cases where these heads of institutions or specific individuals are not able to attend board meetings, they appoint other representatives to attend some of the board meetings. It was found that this practice leads to loss of information and continuity and weakens the role of institutional shareholders in terms of contributing to board deliberations.

***Director independence***

According to the company's MEMARTS, each shareholder who holds at least a 5% equity stake in the company qualifies to appoint a representative to the board. Shareholders directly appoint directors, and most of such appointees are employed by the shareholder entitled to appoint a director. This is particularly the case with the institutional investors. Except for the non-voting directors, the appointment of directors is made without prior knowledge of the managing director. Except for the board chairman, none of the directors has a business relationship with the company, other than as directors representing significant shareholders. Thus, psychological or economic relationships between the managing director and other directors, which could compromise independence with respect to management, do not exist. However, directors are not independent with respect to the shareholders entitled to appoint them.

The practice in this company is that, as soon as a shareholder has acquired sufficient holdings to qualify to appoint a director, the company secretary communicates information about this right to the shareholder. As shareholders appoint directors of their own choice, at the time of their choosing, there are no direct connections between these appointments and any specific criterion since there are no explicit criteria to guide the appointment of directors. However, the company secretary provides an informal general guide to a shareholder who qualifies to appoint a director. Financial skills were cited as key skills in debating and influencing decisions at the board.

In line with the practice in this company which requires shareholders to become

directors, or make direct appointments, the policy of the company with respect to remuneration of the directors is to provide an allowance to the shareholders (instead of to the director directly) who in turn can make their own decisions whether to pay the directors who represent them or not. These remunerations are proposed by management and approved by shareholders at the annual general meeting.

***Board leadership structure***

The two top-level leadership positions of the company have been separated. Both the chairman of the board and the managing director were founding shareholders. The separation of the positions is viewed in this company as the sharing of power in the organisation between the founders, as opposed to viewing it as an attempt to introduce checks and balances to encourage accountability. In addition, this separation allows the managing director to concentrate on internal day-today issues while the chairman links the company to the outside world, particularly in managing relations with the government.

The chairman of the board is also a Member of Parliament (MP) and holds a ministerial position in the current government. In his position as a senior government officer, the chairman is valuable for the company by providing useful information with regard to government policies that affect the company[62]. He also lobbies the government. Thus, the separation of the positions is not linked to the views in agency theory; instead it is a strategic decision to have an individual who can help the company in managing its external environment in a key position.

***Board meetings***

The board meetings are held quarterly, as provided for in the company's MEMARTS, but can also be held as required. The procedure for running meetings is well known to all directors. The company secretary prepares the agenda for board meetings and discusses it with the managing director. Directors are also able to propose topics for discussion at the start of the meeting or under the heading of any other business. The agenda is sent to all directors along with management reports to prepare for the meetings. The reports are sent twenty-one days ahead of the meeting. In some cases, notice of the meeting is sent to directors, followed by board papers some days later. These reports are detailed and provide the necessary information.

The monthly management reports provided by the managing director provide a basis for directors to exercise control over management decisions by enabling directors to ask discerning questions. An experienced director, who also served as a board member in a state-owned corporation, pointed out that the reports he receives are more

[62] One interviewee suggested that even without holding the current position as minister, the current chairman is well known and influential. He would still be valuable for the company.

detailed and informative than what he used to receive from state-owned corporations[63]. During board deliberations, senior members of management also attend; usually the financial controller, the marketing manager, and the production manager. As heads of departments, they are a source of information for directors as they can be called upon to provide expert and detailed explanations on matters falling under their departments.

***Board audit committee***

A board audit committee has not been established at TETEPA. This is attributed to the size of the company which makes the interpretation and assessment of the financial statements straightforward. However, as TATEPA continues to grow there is increasing recognition of the need for an audit committee. Currently, deliberations are underway about forming an audit committee. The reason given for not establishing board committees, indicate that the function of this committee would be to help the board better understand the financial information. This is consistent with the claims that board committees are useful in helping the board to gain a deeper understanding of aspects of the company's operation including its financial aspects (Tricker, 1994). Table 5.14 provides the results of the interviews held with respect to the determinants of the effectiveness of the board with respect to the control function.

**Table 5.14**
**Effectiveness of the board of directors at TATEPA**

| | Not at all | Sometimes | Always |
|---|---|---|---|
| Non-executive directors constitute the majority on the board of directors | | | √ |
| Economic and social affiliations between directors and the company or the company's top management or large shareholders exist | √ | | |
| The posts of chairman and CEO are separated and held by different individuals | | | √ |
| Directors have established an audit committee | √ | | |
| The majority of members of the audit committee are non-executive directors | No audit committee exists | | |
| The process of selecting/appointing directors is known to all shareholders | | | √ |
| Explicit criteria for selecting/appointing directors exist | √ | | |
| The directors have a clear and approved procedure for running board meetings | | | √ |
| Information (board papers) is sent to all directors in time for the meetings | | | √ |

[63] This confirms the conclusion made in Chapter 2 that the corporate governance system of state-owned corporations was informationally deficient.

### *5.3.5 Board control*

The directors execute all activities related to the control function of the board (see Table 5.15). They make the decision over who to hire as the managing director. The managing director is employed on a contract basis, which is renewable every five years by the board of directors. The directors have the ability to replace the managing director before his contract expires or to refuse to renew it. The directors approve the remuneration of the managing director and always hold detailed discussions on the company's strategy before they approve it.

There is no formal evaluation of the function of the managing director, the board's activities or individual directors. However, indirect evaluation takes place through the discussions on the company's strategy and the realisation of targets. In the event that directors do not agree with management proposals, they usually do not approve the implementation strategy. The rejection/acceptance of management proposals is viewed as evaluation and feedback to the managing director.

**Table 5.15**
**Board control at TATEPA**

| | Not at all | Sometimes | Always |
|---|---|---|---|
| Directors can discipline/replace the Managing Director | | | √ |
| Directors discuss and approve the company strategy | | | √ |
| Directors decide on the Managing Director's remuneration | | | √ |
| The board of directors formally evaluates its activities, the managing director or individual directors | √ | | |

***Analysis and verification of propositions***

With respect to ownership at TATEPA, the forgoing discussions have indicated that the Commonwealth Development Cooperation, which holds the majority of shares through its subsidiary FreshField Investments, exerts significant influence on the decision-making process of the company, and that major decisions cannot be made without its prior approval. This means that CDC exercises significant control over the management. Although CDC's influence over the company, through the board of directors, is limited due to the limitation on the number of directors it can appoint, it has still significant influence on the management through the direct contacts between the CDC representative and the managing director of TATEPA. In terms of agency theory, it can be concluded that CDC acts to limit agency problems which supports Proposition 1 that, *shareholders that hold the majority of shares in a corporation exercise control.*

The findings with respect to board control indicate that the board also exercises significant control. The majority of directors are representatives of different shareholders. These representatives are independent with respect to management, and

hence can hold views independent of management without being psychologically compromised. This means that Proposition 2 (a), that *the greater the number of independent non-executive directors relative to that of executive directors on the board of a corporation the more extensive the board control,* is confirmed for TATEPA.
The positions of CEO and chairman of the board are separated in the case of TATEPA. However, this does not encourage accountability as it is viewed as a sharing of the corporation's power between the company's founders. This implies that the separation of the positions in the current arrangement does not serve the role advocated in agency theory which is to enhance board control over management. Proposition 2 (b), that *the separation of the positions of board chairman and CEO with an independent chairman of the board, leads to extensive board control,* is therefore not confirmed in this company.

In terms of board meetings, key aspects of effective board meetings are observed and this implies that the sessions contribute to enhancing board control. This implies that Proposition 2 (c), that *effective board meetings result in extensive board control*, is confirmed at TATEPA.

TATEPA has not established an audit committee. This means that Proposition 2 (d), that *the establishment of board audit committee comprising of independent directors results in extensive board control,* cannot be verified for this company.

## 5.4 Tanzania Cigarette Company (TCC)

### *5.4.1 Background and profile of the company*

The history of the Tanzania Cigarette Company (TCC) reflects the socioeconomic development of post-independence Tanzania. It was established in 1961 when British American Tobacco, through the East African Tobacco Company, built a cigarette manufacturing plant in Dar es Salaam. The company was incorporated under the company ordinances (Cap.212) of the laws of the United Republic of Tanzania, under the name BAT Tanzania Ltd, in 1965. As part of the socialist policies of the Arusha Declaration, the Government acquired a 60% interest in the company in 1967 which was vested in the National Development Corporation (NDC). In 1975, the Government bought the remaining interests in the company (40%). During the Government's control of the company, the name was changed to Tanzania Cigarette Company Limited, also known as "Sigara". The subsequent change in Government policy with respect to ownership of corporations led to the privatisation of TCC.

*Activities and company performance*

The manufacturing and distribution of cigarettes constitutes TCC's main line of business. Currently, TCC has more than 95% of the cigarette market in Tanzania. The company's management is pursuing a two-pronged strategy for growth: organic and

acquisition strategies. The organic growth strategy includes improving the distribution network and the development of export markets, and improving cost management. The export markets include Mozambique and the Democratic Republic of Congo (DRC). TCC has also established a branch office in Uganda. With respect to acquisitions, TCC acquired RJR Kenya Limited and renamed it TCC (Kenya) Limited in January 2000.

TCC is one of the most important corporations in Tanzania. It is an important source of Government revenue in the form of tax. In the 2003 economic survey, TCC was included in the list of leading corporate taxpayers in the country (URT, 2003). TCC is linked to the major agricultural sector of the Tanzanian economy since it is a major buyer of Tanzanian tobacco. This tobacco accounts for about 90% of the blend in the cigarette products both sold locally and exported in the region. Similar to TBL, TCC is one of the local value-adding agro-based manufacturers in the country. Investments totalling over US$ 60 million were made in the company between 1996 and 2000. TCC was granted a five-year income tax holiday under the 1990 National Investments Promotion and Protection Act (NIPPA). This tax holiday ended in July 2003.

**Table 5.16**
**Performance of TCC from 1997-2004**
*Source: Annual reports (2000-2004), Prospectus (2000), and DSE files*

| Performance indicator | Year | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **1997** | **1998** | **1999** | **2000** | **2001** | **2002** | **2003** | **2004** |
| Revenues in TAS (billion) | 71.18 | 72.71 | 77.59 | 86.25 | 88.45 | 96.87 | 109.23 | 120.52 |
| Profit (PAT) in TAS (billion) | 6.05 | 8.93 | 15.28 | 16.39 | 22.21 | 21.07 | 23.56 | 17.84 |
| Dividends in TAS (billion) | 3.00 | 6.00 | 9.00 | 11.70 | 22.70 | 30.70 | 21.90 | 15.60 |
| Dividends as % of PAT | 49.6% | 67.1% | 58.9% | 71.4% | 102% | 146% | 92.9% | 87.4% |
| Total assets in TAS (billion) | 44.46 | 46.84 | 58.14 | 59.88 | 60.31 | 59.87 | 62.41 | 58.78 |
| Market capitalisation in TAS (billion) | 2 | 2 | 2 | 50 | 162 | 170 | 172 | 176 |

TCC has made profits in each of the last seven years and dividends have been paid out annually. This reflects the success of the strategy adopted by management. The extent of dividends to shareholders has fluctuated over the seven-year period. In 1997 about 50% of the profits were paid out in dividends, and 67.1% in 1998; 58.9% in 1999; 71.4% in 2000; 102% in 2001 and 146% and 93.1% in 2002 and 2003 respectively. The dividends paid out in 2001 and 2002 that exceeded the profits made in those years imply that previous reserves were paid out as dividends. The market performance indicators also show that TCC has been performing well. By December 2004, its market price per share was TAS 1,760 compared to its face value of TAS 20 and its IPO price of TAS

410. The market capitalisation stood at TAS176 billion by December, 2004. The liquidity and solvency positions of the company are also sound as indicated in its annual reports for various years.

### *5.4.2 Governance arrangement*

Tanzania Cigarette Company has a one-tier board structure. Company ordinance (Cap. 212) provides the framework for its governance. Shareholders appoint directors to run the company on their behalf. Directors thus are expected to account to shareholders for the authority delegated to them.

### *5.4.3 Ownership structure and control*

***Ownership Structure***

The market reforms that started in the late 1980s resulted in TCC being privatised in 1995. The government sold 51% of its holding in TCC to RJ Reynolds Tobacco Company, a subsidiary of RJR Nabisco Inc. from the US at a price of US $55 million. In May 1999, Japan Tobacco International (JTI) acquired all the non-US tobacco operations of RJR Nabisco including the 51% stake in TCC. The transaction whereby ownership of TCC was transferred from RJR to JTI was part of a global deal with JTI purchasing RJR's global interests in tobacco for US$ 7.8 billion. TCC then became a subsidiary of the third largest cigarette manufacturer in the world by volume (excluding the China National Tobacco company). It is regarded as one of the top fifteen markets.

In August 2000, TCC was listed on the Dar es Salaam Stock exchange in accordance with a special resolution by shareholders in July 2000. Listing facilitated the disposal of part of the Government's shares to local private shareholders. Further ownership concentration by JTI occurred in September 2000 when it purchased 24 million ordinary shares from the Government, representing 24% of the equity holding. This resulted in the current 75% ownership of the company by JTI (see Table 5.17). The current other shareholders of the company are the Government of Tanzania (2.5%), the Unit Trust of Tanzania (3%) and the general public (19.5%). The company has established an employee share-ownership scheme. These shares are included under the general public shares shown in Table 5.17. The general public shares also include holdings by institutions such as PPF, NSSF and SACCOS, with the largest holding being held by PPF. As in the previous cases studies, a significant number of individual shareholders are members of SACCOS.

**Table 5.17**
**Ownership structure of TCC**
*Sources: Prospectus (2000), Annual reports (2000-2003)*

| Shareholder identity | Percentage of total equity held | | | | |
|---|---|---|---|---|---|
| | 1961-1966 | 1967-1975 | 1976-1995 | 1995-2000 | 2000-2003 |
| BAT | 100% | 40% | - | - | - |
| Government of Tanzania | - | 60% | 100% | 49% | 2.50% |
| Unit Trust of Tanzania | - | - | - | - | 3% |
| The General Public | - | - | - | - | 19.5 |
| RJN Nabisco; Japan Tobacco Int. | - | - | - | 51% | 75% |

JTI, the controlling shareholder of TCC, was founded in 1898 and was a Japanese government monopoly until 1985. The JTI group is currently a diversified global company with interests in pharmaceuticals and food industries. It is one of the dominant players in the international tobacco industry, listed on the Tokyo Stock Exchange and Japan's five other stock exchanges.

***Shareholder control***

*Japan Tobacco International- JTI*

The controlling shareholder is closely involved in the management of the company. JTI management in Geneva approves the goals and strategies that the TCC management implements. Two reporting approaches have been instituted to aid control: management reporting and internal audits conducted by JTI management. TCC's heads of departments send management reports to regional heads of departments in Geneva on a monthly basis. In this respect, TCC has a matrix structure in which heads of departments report to both the CEO/chairman in Tanzania and the regional heads of departments in Geneva. The CEO/chairman also sends reports to the JTI office in Geneva on a monthly basis. Specific information is also provided to JTI management as required.

JTI management in Geneva also sends an audit team to review TCC operations on a regular basis. The audit team reviews a number of aspects relating to the management of the company including the financial resources, plans and the progress towards attainment of goals. It holds regular meetings with management and raises key issues to obtain clarifications. Through the regular reporting and internal audits, JTI management is able to have at its disposal the high level of information required for directing and controlling TCC.

All key appointments are made by JTI. It appoints the CEO/chairman who, in turn, recommends the appointment of all other senior members of management (heads of departments) to the heads of directorates in Geneva whose approval is required

before the CEO/chairman proceeds to employ these officers. The compensation for these managers (including the CEO/chairman) is set by JTI.

*Minority shareholders*

Minority shareholders largely rely on the annual general meeting which are held as required by law. A typical agenda for the annual general meeting contains confirmation of the minutes of the previous annual general meeting, matters arising, adoption of accounts, and adoption of the declaration of dividend. Additional items can be the appointment of the auditor, resignation and appointment of directors, remuneration of directors and any other business.

The annual audited reports and the half-yearly reports are provided to all shareholders as required by the law and the DSE listing regulations. The annual audited reports are always sent to all shareholders, while the half-yearly reports are posted on the DSE notice boards and in the popular newspapers.

Minority shareholders cannot exert significant influence over decision-making processes. This is because they do not have sufficient voting power, and have no effective representation on the board of directors. Despite this poor influence on decision-making processes, the minority shareholders interviewed appear to be satisfied with the situation at TCC. They attribute this to the fact that TCC has been paying the highest level of dividends when compared to other listed companies. Table 5.18 shows responses to aspects of shareholder control.

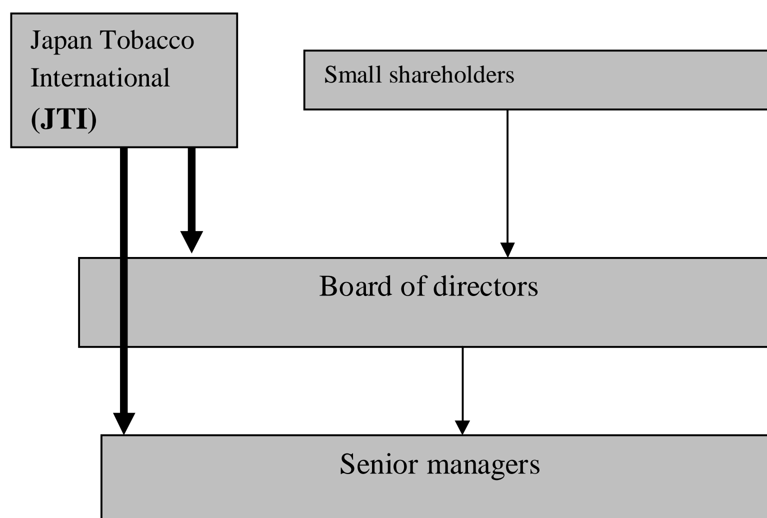
**Table 5.18**
**Shareholder control at TCC**

| | Not at all | Sometime | Always |
|---|---|---|---|
| Directors fulfil their duty of reporting to the shareholders at the annual shareholder meeting | | | √ |
| Annual audited reports are sent to shareholders before the annual general meeting | | | √ |
| Half-yearly reports are produced and made public | | | √ |
| Invitations to the annual general meeting are sent to shareholders in time | | | √ |
| Shareholders attending the annual general meeting exercise their right to vote on director's proposals | | | √ |
| Large shareholders have great influence at the annual general meeting | | | √ |
| All decisions at the annual general meeting are made by voting | | | √ |
| The influence of large shareholders on director selection and at annual general meeting results in their control of the enterprise | | | √ |

| | Not at all | Sometime | Always |
|---|---|---|---|
| Controlling shareholders have access to key people in the company | | | √ |
| Shareholders have the power to challenge or change the decisions of management and/or the director (approve or reject) | | | √ |

Control over TCC is firmly exercised by JTI in ways similar to those with which SABMiller exercises control over TBL. Figure 5.2, where the heavy arrows indicate strong control while the light arrows show weaker control, shows that JTI controls the board of directors as well as management. In addition to appointing the CEO/chairman and senior members of management, it also appoints the majority of directors. It can be concluded that incentive problems are minimised by JTI through its continuous monitoring of management.

**Figure 5.2**
**The control of TCC by JTI**
*Adapted from Roe, 2003*




### *5.4.4 Effectiveness of the board of directors*

The determinants of board effectiveness with respect to control were further investigated.

**Board constitution**

Currently, the TCC board of directors has seven directors and its constitution reflects the ownership structure of the company. Four of the directors are non-executives and the remaining are executive directors. According to the current company constitution, the number of directors must not fall below five or exceed seven, the majority of whom

should be non-executive directors. The current situation means that this condition is being fulfilled in practice.

**Director independence**

Director independence was assessed by considering the way in which appointments as director are made, and any close relationships with the management or the company. The appointment of board members is conducted according to the standing agreement between the Government of Tanzania and JTI through which the relevant shareholding rights are applied in appointing directors.

> As long as either JTI or the Government holds more than 50% of TCC issued and fully paid up share capital, the relevant party shall be entitled to nominate four directors. Should the shareholding fall to 49%, the relevant party shall be entitled to appoint three directors. Should the shareholding fall to below 49% but above 25%, the relevant party shall be entitled to appoint two directors. Should the shareholding be between 10% and 25%, the relevant party shall be entitled to appoint one director to the board: The Government, as long as is a TCC shareholder, is entitled to nominate a director to the board.

The board members representing JTI who are based in Tanzania are appointed by the CEO/chairman in consultation with the JTI Geneva office. Those based outside Tanzania are appointed at the JTI head office in Geneva. The CEO/chairman has been delegated powers by JTI to appoint local directors. The current Government director is the Principal Secretary in the Ministry of Finance. There is also a director that represents the public and who was appointed through a process in which institutional shareholders were asked to nominate a representative. This nominated director had to be approved by the existing directors. This director effectively owes his appointment to the CEO-chairman since he must be supported by the majority of directors who are themselves appointees of the CEO-chairman. Given this approach, the majority of directors are not independent of the management.

**Board leadership structure**

The two top positions in the company the board chairmanship and chief executive officer, have been deliberately combined. The combination of these positions reflects the history of the company since it was privatised. The first company to acquire TCC, RJR Nabisco, had a unitary board leadership structure. This model was kept at TCC when JTI became the controlling shareholder and the legacy continues.

Three reasons were given for the continued non-separation of the positions. Firstly, combining of the positions helps to avoid conflicts that could arise if the two positions were separated. The combination avoids any disjointed messages being sent to stakeholders, which could arise if the two positions were separated. Secondly, speed in

decision-making is achieved because the need to contact a board chairman is eliminated. Thirdly, splitting the two positions is desirable only when a strong board to control/discipline management is desired, and this is not the case with TCC.

**Board meetings**

Board meetings are held four times a year, and can also be convened as required to deliberate on issues that are considered urgent and cannot wait for a regular meeting. For the ordinary meetings, a notice of the meeting is sent to the directors twenty-one days ahead. The preparation for board meetings includes dispatching information to members so that they can prepare for the meetings. These reports, along with the agenda, are sent to directors at least one week before the meeting. The members of the executive committee, whose issues are to be included in the agenda, prepare reports which are reviewed by a committee consisting of the CEO chairman, the company secretary and the financial controller to ensure the quality of content and presentation. Thus, items for the agenda are obtained from members of the executive committee (heads of departments) and from directors, and are put together by the legal affairs department and discussed with the CEO.

**Board audit committee**

The board has not established a board audit committee. The explanation provided for this situation is that the company is treated as a division of JTI, and is integrated into the management of JTI. Also the directors are not, in practice, independent. This means that if a board audit committee was formed, the CEO-chairman would have a great influence over it, which negates the point of a board audit committee. The audit team sent in by JTI is considered sufficient to address all control-related issues. This team reports to the JTI management in Geneva, which in turn reports to JTI Tokyo. The results of the questions relating to effectiveness of the board are shown in Table 5.19.

**Table 5.19**
**Effectiveness of the board of directors at TCC**

| | Not at all | Sometimes | Always |
|---|---|---|---|
| Non-executive directors constitute the majority on the board of directors | | | √ |
| Economic and social affiliations between directors and the company, or the company's top management, or large shareholders exist | | | √ |
| The positions of chairman and CEO are separated | √ | | |
| Directors have established an audit committee | √ | | |
| The majority of members of the audit committee are independent directors | No audit committee exists | | |
| The process of selecting/appointing directors is known to all shareholders | | | √ |
| Explicit criteria for selecting directors exist | √ | | |
| Directors have established a clear and approved procedure for running board meetings | | | √ |
| Information (board papers) is sent to all directors in time for meetings | | | √ |

### *5.4.5 Board control*

The board of directors does not perform a number of the key activities that would constitute board control (see Table 5.20). The board does not make decisions relating to employment of management – neither the CEO nor other senior managers of the company. The board cannot discipline the CEO-chairman or replace him if it wants to. Although management claims that the board deliberates on, and approves, the company strategy and define policies of the company, in practice this appears to be a procedural issue.

The board does not set the compensation of the CEO-/chairman and no formal evaluation of the CEO-chairman or other directors is conducted. Referring to the controlling role of the TCC board, the CEO-chairman made the following remark:

> "I do not require a strong board in terms of being able to control me: I need a board that is more able to advise me with regard to local conditions; for example, how we should comply with tax issues and expand our local markets. The board needs to be strategic and add value in terms of the local dimension"

The TCC board is considered to be more of an executive committee (part of management) and less a board in terms of exercising control. This is because the large shareholder already controls the management.

**Table 5.20**
**Board control at TCC**

| | Not at all | Sometimes | Always |
|---|---|---|---|
| Directors make decisions about hiring the CEO/chairman | √ | | |
| The board of directors can discipline/fire the CEO/chairman | √ | | |
| Directors discuss and approve the company strategy | | | √ |
| Directors decide on the CEO/Chairman's remuneration | √ | | |
| Directors formally evaluate their activities, the CEO-chairman, and individual directors | √ | | |

**Analysis and verification of the propositions**

The findings in this case show that the controlling shareholder, JTI, exercises significant control over management. Access to information is obtained through an internal system of continuous communication with TCC management; all managers are required to report to JTI Geneva. JTI management has significant access to the information necessary to monitor management performance and take corrective action if it determines a need to act. JTI also approves all senior management appointments at TCC after a thorough selection process. Thus, through continuous review of performance, JTI management is able to exercise effective control of management and address agency problems that might exist between management and shareholders. Thus, Proposition 1, that: *shareholders that hold the majority of shares in a corporation exercise control,* is confirmed at this company.

With respect to the board constitution, the non-executive directors form the majority on the board. However, because the board does not perform key control-related activities it means that Proposition 2 (a), that *the greater the number of independent non-executive directors relative to that of executive directors on the board of a corporation, the more extensive the board control,* is not confirmed at TCC.

With respect to the separation of the positions of CEO and chairman of the board, it was found that the two positions are combined. This means that Proposition 2 (b), that *the separation of the positions of board chairman and CEO, with an independent chairman of the board, leads to extensive board control,* is not confirmed at this company.

In terms of board meetings, the findings with respect to the conduct of board meetings indicate that the necessary attributes for effective meetings exist. However, the non-involvement of the board in control-related activities imply that these meetings are only counselling or advisory sessions. This means that Proposition 2 (c), that *effective board meetings result in extensive board control,* is not confirmed in the case of TCC.

The directors of TCC have not established a board audit committee. The need

for such a committee does not appear to exist in the current arrangements in which JTI controls management. Proposition 2(d) that: *the establishment of a board audit committee in comprising of independent directors results in extensive board control* could therefore not be verified at TCC.

# CHAPTER 6 CROSS CASE ANALYSES AND GUIDELINES FOR CORPORATE GOVERNANCE IN TANZANIA

## 6.1 Ownership structure and shareholder control

**Ownership structure**

There is a concentration of ownership by a single shareholder at each of the four companies studied. Table 6.1 shows the controlling shareholders and the extent of their holding in the companies. The controlling shareholders all hold more than 50% of the voting share capital in the companies. Except in the case of TOL, the controlling shareholders are foreign organisations. The extensive communication between the companies based in Tanzania and the headquarters of the shareholders based abroad (Chapter 5) implies that important decisions that have consequences on the performance of these companies, and hence the Tanzanian economy, are being made outside of Tanzania.

**Table 6.1**
**The ownership structure of the companies**

| | TBL | TOL | TATEPA | TCC |
|---|---|---|---|---|
| Controlling shareholder | SABMiller | Government of Tanzania | CDC-FreshFields Investments | JTI |
| Holding by the Controlling shareholder in % | 52.8% | 74.14% | 52.26% | 75% |
| Holding in % by other shareholders combined | 47.2% | 25.86% | 47.74% | 25% |
| Ownership by foreign shareholders | 79.86% | 0% | 59.27% | 75% |
| Ownership by local shareholders | 20.14% | 100% | 40.73% | 25% |
| Number of individual shareholders | About 20,000 | About 10,500 | About 1680 | About 10,000 |

The ownership structures in the cases of TBL, TOL and TCC reflect historical developments in Tanzania that continue to shape corporate governance. In the cases of TBL and TCC, ownership concentration reflects the privatisation strategy employed in divesting control of state-owned companies that is selling a large number of shares to strategic investors. In the case of TOL, ownership reflects the legacy of the earlier

socialist policies pursued by the government including the nationalisation of private property. Efforts are currently being made to further privatise this company.

TATEPA was established after economic reforms were introduced in 1986; its ownership reflects the sources of the funds used to set it up which came mainly from CDC through its subsidiary company Tanzania Venture Capital Fund. The phenomenon of concentrated ownership is not unique to these companies. A number of other firms in Tanzania have been, and continue to be, privatised through strategic investors leading to a concentration of ownership of corporations[64].

**Shareholder control**

In all the four companies, controlling shareholders do exercise control over the organisations. This control is exercised through participation in the decision-making process of these corporations and facilitated by access to information. For example, while minority shareholders have to rely mainly on annual audited reports and the half-yearly un-audited ones for information, controlling shareholders have access to information on demand.

In all the four companies, management consults the controlling shareholders before making major decisions. The goals that management strives to achieve are also agreed with the controlling shareholders. In addition, the controlling shareholders have instituted internal procedures and mechanisms which further ensure that management provides relevant information.

Controlling shareholders in all the companies researched also have access to key people in the companies. These include the board chairman and the chief executive officer whom such shareholders either appoint or have an influence in their appointment. The controlling shareholders (except with TATEPA) also appoint the majority of directors on the board.

The influence of controlling shareholders is reflected in the annual general meetings of the companies. When major decisions which require the shareholders' approval at these meetings have to be made the vote of the controlling shareholders determines the outcome. This extensive control by controlling shareholders is recognised and viewed favourably by the regulatory authorities in Tanzania. An officer from the Capital Markets and Security Authorities (CMSA) observed that:

> "The difference between companies in developed countries and companies in our country [Tanzania] is that companies in the West are better supervised while ours are poorly supervised. In that sense the companies which have controlling shareholders, which are now being better supervised, are doing well. One does not have to discourage the phenomenon of

[64] For example, the Government is currently looking for strategic investors for Tanzania Railways Corporation, Tanzania Electrical Company Ltd, and Tanzania Harbours Authority (Daily News of August 5th, 2003). Air Tanzania Corporation (ATC) has been privatized through a strategic investor- South African Airways.

controlling shareholding".

The findings in the four case studies apply to a large majority of large companies in Tanzania both listed and non-listed. The phenomenon of shareholder control, connected to concentrated ownership, applies to a significant number of corporations in Tanzania (Chapter 2). This implies that the separation of ownership from control has not really taken place in the Tanzanian context. This conclusion challenges the Berle and Means hypothesis that the ownership and control of corporations have become separate. This further 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 (Clarke and Clegg, 1998; Berglof and Claessens, 2004). Table 6.2 shows responses to aspects of shareholder control in the researched companies obtained through interviews and document accessed.

**Table 6.2**
**Shareholder control in Tanzanian companies**

| | **TBL** | | | **TOL** | | | **TATEPA** | | | **TCC** | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | N | S | A | N | S | A | N | S | A | N | S | A |
| Directors do fulfil their duty of reporting to the shareholders at the annual shareholder meeting. | | | √ | | | √ | | | √ | | | √ |
| Annual audited reports are sent to all shareholders before the annual general meeting. | | | √ | | √ | | | | √ | | | √ |
| Half-yearly reports are produced and made public. | | | √ | | | √ | | | √ | | | √ |
| Invitations to the annual general meeting are sent to shareholders in time. | | | √ | | | √ | | | √ | | | √ |
| Shareholders attending the annual general meeting exercise their right to vote on directors' proposals. | | | √ | | | √ | | | √ | | | √ |
| Large shareholders have greatest influence at the annual general meeting. | | | √ | | | √ | | | √ | | | √ |
| All decisions at the annual general meeting are made by voting. | | | √ | | | √ | | | √ | | √ | |
| Shareholders elect/appoint directors. | | | √ | | | √ | | | √ | | | √ |
| Large shareholders have | | | √ | | | √ | | | √ | | | √ |

| | TBL | | | TOL | | | TATEPA | | | TCC | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | N | S | A | N | S | A | N | S | A | N | S | A |
| access to key people in the organization. | | | | | | | | | | | | |
| Shareholders have the power to challenge or change the decisions of management and/or the director | | | √ | | | √ | | | √ | | | √ |

*Key: N= Not at all; S = Sometimes; A = Always*

## 6.2 Effectiveness of the board of directors

**Board constitution**

All the companies researched have boards of directors that are characterised by having more non-executive directors than executive directors. In all the companies, the company MEMARTS show that non-executive directors should be in the majority on the board. An important element of the constitution in the four companies is the inclusion one the boards of directors of individuals who hold senior government positions or who have been senior civil servants in the past. All the companies researched include on their board individuals who can link the company to the external environment, particularly to influence government decisions and policies.

One interviewee observed that "people are not appointed directors because of their skills, but because of their ability to assist the company in the case of trouble… and some companies try to make sure they have such individuals from important government ministries". This supports the observation that corporate governance in developing countries is intertwined with political governance (Oman et al., 2003; Berglof and Claessens, 2004).

**Director independence**

In three of the four cases, the appointment of directors is directly linked to shareholding. The appointment procedures are documented in the companies' MEMARTS. At TBL, TATEPA and TCC, a shareholder with a specified level of equity ownership qualifies to appoint a director. In the case of TBL, each block of shares constituting 8% of the total voting shares entitles a shareholder to appoint a director. In the case of TCC, a minimum of 10% shareholding is required to appoint one director and shareholdings between of 25% and 48% entitles a shareholder to two directors, three directors if the shareholding reaches 49% and four directors for shareholdings of 50% or more. In the case of TATEPA, a minimum shareholding of 5% is required to appoint a director with a limit set at two directors for a shareholder with a holding of at least 20% of voting capital. For TOL, any shareholder can nominate a director but they have to be elected at the annual general meeting.

Except for TCC, the CEO has no influence over the director-appointing process. There are also no significant business relationships between the companies and their directors. This ensures that directors are independent from the CEOs or managing directors. Except for representatives of minority shareholders, directors usually know the shareholder that appointed them and to whom they owe allegiance in all the four companies. This implies that directors are not independent with respect to the shareholders who appointed them.

In all four companies, there are no explicit criteria for appointing directors. Shareholders use their own judgement to select an individual they consider suitable for the job of directorship. However, in two of the four companies, it was found that particular types of skills and knowledge are viewed as being helpful for board deliberations. These include knowledge of the industry in which the company operates and the ability to understand financial aspects of the company.

**Board leadership structure**

The positions of board chairman and CEO have been separated in three of the four companies researched. The two positions are combined in the case of TCC. In the companies where the posts are separated, the reasons for such a separation differ. In the case of TOL, separation is viewed as a means of introducing checks and balances to prevent a situation where a powerful individual is created who may be difficult to control. For that reason, it is used to exercise control and is thus in line with the agency theory. In the case of TATEPA, the separation is viewed as a means of sharing corporate power between the founders of the company rather than as a checks and balances mechanism. It is therefore not meant to enhance board control.

The separation of the posts in the case of TBL is related to the King's code of corporate governance which requires South African companies and their subsidiaries to separate the two positions. However, the chairman of the board is seen as an individual who is helpful in networking and influencing the external environment. This implies that, in the case of TBL, the separation of the positions does not impact on board control.

Three reasons were provided for combining the two positions at TCC. Firstly, TCC does not require an effective board to exert control. This is because the control exercised by JTI international is adequate. The combination of the two positions also makes decision-making faster. Finally, a strong CEO is desired in order to avoid potential conflicts of interest between the two positions. This reason is consistent with what has been found in the literature: the unification of these two corporate positions provides a clarity of purpose and action not found with their separation (Andersen and Anthony, 1986; Lipton and Lorsh, 1993 and Finkelstein and D'Aveni, 1994 all cited by Daily and Dalton, 1997). Despite criticisms of such joint structures, a joint leadership

structure is found in the vast majority of companies (Lorsh and McIver, 1989; Daily and Dalton, 1997).

**Board meetings**

The four companies all have established procedures for running board meetings. These procedures are stated in the respective company's MEMARTS. This includes preparation for the meetings sending board papers to the directors as well as the agenda for the meetings in advance of the meeting to enable them to prepare. Directors in all of the companies follow a standardised procedure for conducting the meetings.

The board meetings generally follow an agenda that includes approval of the minutes and matters arising, a quarterly business report, and any other business. In all the case companies the management prepares the agenda but does consult the board chairman in the process. However, directors are permitted to introduce new topics or subjects into the agenda for discussion. This way of setting the agenda and conducting board meetings is effective in ensuring that directors give attention to all the key issues, which is seen as essential for the effective execution of control activities. It was found in two of the companies that some directors lack knowledge of basic issues concerning the company in which they are directors. This suggests that their contribution in board deliberations may not be significant.

**Board audit committee**

Only one company, TBL, has established a formal board audit committee. The non-executive directors constitute one half of the members of this committee, which is chaired by a non-executive director. In the case of TOL, there is an informal arrangement through which a non-executive director performs the role of an audit committee. In both companies, corporate governance reforms in the US were cited as major motivating factors for establishing these arrangements.

In addition, in the case of TBL, the board committee was established to meet the requirements of the King's Committee of Corporate Governance in South Africa where SABMiller is based. The functions of the board audit committee at TBL include reviewing financial statements and addressing queries raised by the auditors. The committee also has a duty to assist other directors in understanding the financial statements.

At TOL an informal arrangement exists whereby the board chairman and his deputy are asked to review the financial statements and assist the board in understanding them. TATEPA is viewed as a small company and its financial statements are "fairly easy to understand". However, the directors of TATEPA are contemplating establishing an audit committee in the future, taking into account the increasing complexity of the financial statements as the company grows. In the case of TCC, an audit committee has not been established because it is not required. This is

because the current level of control exercised by JTI is seen as being sufficient and hence no need for additional control mechanisms.

**Table 6.3**
**Effectiveness of the boards of directors in Tanzanian companies**

| **Statement** | **TBL** | | | **TOL** | | | **TATEPA** | | | **TCC** | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | N | S | A | N | S | A | N | S | A | N | S | A |
| The board of directors is dominated by non-executive directors | | | √ | | | √ | | | √ | | | √ |
| There are economic and social affiliations between directors and the company or with company senior management | √ | | | | √ | | √ | | | | | √ |
| The posts of chairman CEO have been separated | | | √ | | | √ | | | √ | √ | | |
| The board of directors has established a board audit committee | | | √ | √ | | | √ | | | √ | | |
| The majority of the audit committee are non-executive directors | | | √ | No audit committee | | | No audit committee | | | No audit committee | | |
| The process for selecting/appointing directors is communicated to shareholders | | | √ | | | √ | | | √ | | | √ |
| There are explicit criteria for selecting directors | √ | | | √ | | | √ | | | √ | | |
| Directors have established a clear and approved procedure for running meetings | | | √ | | | √ | | | √ | | | √ |
| Information (board papers) is sent to directors in time to prepare for the board management meetings | | | √ | | | √ | | | √ | | | √ |

Key: N= Not at all; S= Sometimes; A= Always. The audit committee has not been formed at TOL, TATEPA and TCC

## 6.3 Board control

In the two cases of TOL and TATEPA, directors perform all the activities usually related to the control function of the board: making decisions about hiring the chief executive officer (CEO) of the company; having the ability to discipline (dismiss) the CEO; making decisions about the CEO's directors' compensation; and discuss and approve the company’s strategy. In the other two cases of TBL and TCC, the directors

do not perform the majority of these key activities. The only activity that the directors perform in these two companies is to discuss and approve the company's strategy. However, the discussion over the strategy is not for the purpose of exercising control over management decisions. It serves the purpose of providing directors with an opportunity to provide advice to management on how the agreed goals can be achieved. The granting of approval is also a matter of procedure.

With regard to a formal evaluation of the chief executive Officer, the board’s activities and individual board members: it was found that such an evaluation does not take place at any of the four companies. However, an implicit evaluation of the CEO does take place through the discussion and approval of the company's strategy. The disparities in the extent to which the boards of directors are engaged in activities related to the control function are explained by the extent to which the controlling shareholders themselves exert influence over management decisions. Table 6.4 shows responses to aspects of board control.

**Table 6.4**
**Board control in Tanzanian companies**

| **Statement** | **Responses** | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | **TBL** | | | **TOL** | | | **TATEPA** | | | **TCC** | | |
| | N | S | A | N | S | A | N | S | A | N | S | A |
| Directors make decisions about hiring/appointing the CEO/managing director | √ | | | | | √ | | | √ | √ | | |
| Directors can discipline/fire the CEO/managing director | √ | | | | | √ | | | √ | √ | | |
| Directors make decisions about the CEO/managing directors’ remuneration | √ | | | | | √ | | | √ | √ | | |
| Directors discuss and approve company strategy | | | √ | | | √ | | | √ | | | √ |
| The board formally evaluates its activities, the CEO and individual directors | √ | | | √ | | | √ | | | √ | | |

*Key: N= Not at all; S= Sometimes; A= Always*

The control by SABMiller over TBL and by JTI over TCC has replaced control by directors. This is consistent with the assertion by Roe (2003) who posits that when a controlling shareholder exercises control, the board of directors tends to be less involved in control. The controlling shareholders in TOL and TATEPA do exert a level of control over management decisions but leave space for directors to exercise a significant level of control as evidenced by their involvement in control activities.

**Analysis and verification of the propositions**

The discussions show that the four companies researched have large controlling shareholders who are the key determinant of effective corporate governance in these companies. Proposition 1, that *shareholders that hold the majority of shares in a corporation exercise control,* is confirmed in the four companies.

With respect to board constitution and director independence, the directors in three of the four companies are independent of management but not of controlling shareholders. The boards of directors in two of the companies do not exercise control of management, as they do not execute key functions related to board control. In the other two cases, the board does exercise control of management. This implies that Proposition 2 (a), that *the greater the number of independent non-executive directors relative to of executive directors on a board of a corporation, the more extensive the board control,* is confirmed in two companies but not confirmed in the other two.

In terms of leadership structure, the findings show that the separation of the position of chairman from that of chief executive officer has been implemented in three cases but that they are combined in one case. The separation of the positions is only useful in terms of control in one company. This means that Proposition 2 (b), that *the separation of the positions of board chairman and CEO with an independent chairman of the board leads to extensive board control,* was confirmed in one company and not confirmed in three companies.

The findings with respect to board meetings indicate that elements of effective boards meetings do exist in all the four cases. However, the relationship between board meetings and board control was only found in two companies. This means that Proposition 2 (c), that *effective board meetings result in extensive board control*, was confirmed in two companies and not confirmed in the other two.

With respect to board audit committees, it was found that only one company had established a formal audit committee. However, even in this company, the establishment of the board audit committee was not related to board control. Proposition 2 (d), that *the establishment of a board audit committee comprising of independent directors results in extensive board control*, could not be verified because such a committee had not been established in three of the companies and not useful for purposes of board control in one company. Further discussions of these findings are provided in Section 7.6.

## 6.4 Comparison of recommended guidelines with empirical findings

Two sets of guidelines for corporate governance have recently been developed and recommended for adoption by companies in Tanzania. The first set of guidelines was developed with the financial assistance of the International Finance Corporation (IFC) and was viewed as part of private-sector capacity building in Africa. A number of

companies were involved in developing the guidelines: the Nordic Consulting Group (NCG), the African Management Services Company (AMSCO) - an Amsterdam-based affiliate of the World Bank, Resource Development and Management Associates (REDMA) - a local consulting firm and the Dar es Salaam Stock Exchange.

The guidelines were reviewed at a seminar held in 2000 and formally introduced in November, 2002. The review seminar drew participants from a broad section of Tanzanian society including Chief Executive Officers of private companies, university lecturers, regulatory authorities (e.g. CMSA and BRELA) and private-sector supporting institutions - such as the Confederation of Tanzania Industries. The attendance at this review seminar of representatives of important institutions in Tanzania appears to give the guidelines legitimacy.

The second set of guidelines was prepared and recommended by the Capital Markets Authorities (CMSA). Both sets of recommended guidelines are seen in this research as reflecting and constituting acceptable and desired practices. They constitute benchmarks for developing effective corporate governance in Tanzania. These guidelines are therefore analysed and compared with the empirical findings from the case studies. This comparison will reveal the extent to which firms already embed the recommendations in current practices, and the extent to which further reforms are required. The discussion of the guidelines also sheds light on their relevance in addressing corporate governance issues in the Tanzanian context.

### *6.4.1 The Steering Committee's recommended guidelines*

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

The instrumental view of stakeholding (Chapter 3) appears to underpin these guidelines. These guidelines reflect 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 the 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 line with the shareholder instrumental view of the firm and therefore remain within the legal framework which recognises shareholders as the only organisational constituency represented in a company's decision- making boards.

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. 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.

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.

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.

**The general function of the board of directors**

Company law in Tanzania, as in many other countries, states that directors will manage corporations. However, it does not specify what activities constitute “managing a corporation”. The guidelines recommended by the Steering Committee on Corporate Governance provide, in broad terms, a definition of the function of the board of directors: determination of the purpose and values of the corporation and defining the strategy through which the purpose of the corporation will be achieved. In executing this function, directors are called upon to exercise leadership, enterprise and integrity in directing the affairs of a corporation; and should demonstrate transparency, accountability and responsibility. These aspects were debated in the principles of effective corporate governance developed by the OECD and CACG (Chapter 3). The Steering Committee on Corporate Governance has also made reference to these principles.

***Guidelines for privately-owned corporations***

In addition to the guidelines that apply to the corporations in general, the guidelines address issues specific to privately-owned corporations which are the focus of this research. This is because of the increasing importance of privately owned corporations to the economy of Tanzania. Issues of shareholder rights and control, board control activities and determinants of board effectiveness with respect to control are addressed. Table 6.5 details the aspects of shareholder control which have been compared with the empirical findings from the case studies.

**Table 6.5**
**Shareholder control**

| Guideline description | Empirical findings |
|---|---|
| Shareholders of the company have to jointly and severally protect, preserve and actively exercise the supreme authority of the company through general meetings. | Controlling shareholders dominate and exert significant influence on decision-making processes in the four companies. |
| Shareholders' rights should be protected in the corporate governance framework and the means to effect such rights secured. | The company ordinance (Cap. 212) provides for shareholders to participate in the affairs of companies. This requirement is reproduced in the companies' MEMARTS. |
| Shareholders have the right to be informed about major decisions in the company such as a change in the MEMARTS. | Such information is usually provided. However, approval by controlling shareholders is required to effect change. |
| Shareholders should have the opportunity to participate effectively including access to all information and voting procedures. | Majority shareholders have greater access to information through key people such as the CEO and the Chairmen of the Board. Minority shareholders rely mainly on statutory reports for information. |
| The corporate governance framework should ensure the equitable treatment of all shareholders. | The company ordinance (Cap. 212) details the ways in which shareholders should be treated. |

***Determinants of board effectiveness with respect to board control***

The recommendations in the guidelines issued by the Steering Committee on Corporate Governance, with respect to board control activities and their related determinants, are provided in Table 6.6 and compared with the empirical findings from the case studies.

**Table 6.6**
**Board control and its determinants**

<table>
<tr><th colspan="2">Board control</th><th>Empirical findings</th></tr>
<tr><td colspan="2">An effective board should head the company and provide strategic guidance and effective control of the company, and must be accountable to the company and the shareholders.</td><td>In the cases of TBL and TCC, the board does not exercise control. In the cases of TOL and TATEPA the boards do exercise significant control. Formal reporting at annual general meetings takes place and annual reports are issued.</td></tr>
<tr><td colspan="3">Determinant of board effectiveness</td></tr>
<tr><td></td><td>Description</td><td>Empirical findings</td></tr>
<tr><td>Constitution</td><td>Independent non-executive directors should be independent of management and free from any business or other relationship which would interfere with the exercise of their ability to bring an independent judgment to bear on issues of strategy, performance, resources, key appointments and standards of conduct.</td><td>Non-executive directors dominate the boards of directors in all companies researched: TBL, TOL TATEPA and TCC. Except for TCC directors are independent from management but not from the appointing shareholders. In the case of TCC the majority of directors are not independent from the management.</td></tr>
<tr><td>Board leadership structure</td><td>The board should be chaired by an independent director who is not managing the company.</td><td>The positions of chairman of the board and CEO are separated in three of the companies: TBL, TOL and TATEPA. However, the chairmen are not independent individuals. In the case of TCC, the positions are combined.</td></tr>
<tr><td>Appointment and independence</td><td>There should be formal and transparent procedures for the nomination and appointment of new directors to the board.</td><td>In the cases of TBL, TATEPA and TCC, shareholders who satisfy a specified criterion appoint directors. In the case of TOL, any shareholder can nominate a shareholder who is then elected or not at the annual general meeting. These procedures are outlined in the companies' MEMARTS.<br>No explicit criteria exist to guide shareholders in effecting the appointments.</td></tr>
<tr><td>Board committee</td><td>In order to avoid potential conflicts of interest, the board of directors should set up independent remuneration committees: to determine on their own behalf and on the shareholder's behalf the remuneration of respective individual executive directors.</td><td>Only TBL has an established audit committee but no other committees. The other three companies have not formed any formal committee.</td></tr>
<tr><td>Board succession plans</td><td>The weighty responsibilities placed upon directors, the level of commitment called for, and the fast changing corporate environment dictate that companies prepare those expected to assume these roles.</td><td>Boards of directors do not have any succession plans. This is a result of direct shareholder appointments.</td></tr>
</table>

### *6.4.2 CMSA's recommended guidelines*

The Capital Markets and Securities Authority (CMSA) has developed and recommends

its own set of guidelines on corporate governance for adoption by publically listed companies in Tanzania. 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. CMSA acknowledges the influence of the principles for effective corporate governance developed by the OECD as well as by CACG (Chapter 3). The CMSA recommended guidelines take a shareholder-instrumental view of organisations:

> "The 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".

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 other aspects. However, no clear strategy has been put in place to encourage companies to implement these guidelines. 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.

***Shareholder control***

The guidelines provide a list of items relating to the rights of shareholders in the governance of corporations. These rights are viewed in this research as aspects of shareholder control and are compared with empirical findings from the case studies in Table 6.7.

**Table 6.7**
**The shareholders control - CMSA**

<table>
<tr><th>Description</th><th>Empirical findings</th></tr>
<tr><td>Every publically listed company's board should ensure equitable treatment of shareholders including minority ones.</td><td rowspan="2">Shareholders in the four companies investigated receive annual reports, and half-yearly reports are made public by DSE. However, controlling shareholders have access to inside information not available to other shareholders. Information asymmetry thus exists between controlling and minority shareholders.</td></tr>
<tr><td>All shareholders should receive relevant information on the company's performance through the distribution of regular annual reports and accounts, half-yearly results and quarterly results as a matter of best practice.</td></tr>
<tr><td>The shareholders should receive a secure method of transfer and registration of ownership as well as a certificate or statement evidencing such ownership in the case of a central depository environment.</td><td>Methods of share transfer and registration exist. Ownership certificates are given. The Dar es Salaam stock exchange maintains a central depository system.</td></tr>
</table>

| Description | Empirical findings |
|---|---|
| Every shareholder shall have the right to participate and vote at the general shareholders meeting including the election of directors. All shareholders should be encouraged to participate in the annual general meetings and to exercise their votes. Shareholders, while exercising their right of participation and voting during annual general meetings of their company, should not act in a disrespective manner as such action may undermine the company's interest. | In all the four companies, shareholders have and exercise the right to vote on issues they are asked to vote on. |
| Every shareholder shall be entitled to ask questions, seek clarification on the company's performance as reflected in the annual reports and accounts or in any matter that may be relevant to the company's performance or promotion of shareholders' interests and to receive an explanation from the directors and/or management. | Minority shareholders do ask questions and seek clarifications at the annual general meetings. |
| Every shareholder shall be entitled to distributed profits in the form of dividends and other rights for bonuses, shares, script, dividend or rights issue, as applicable and in proportion to its shareholding in the company's share capital. | Shareholders in the cases of TBL, TCC and TATEPA have been receiving dividends. TOL has not been making a profit, and hence no dividend has been paid. |
| The board should maintain an effective communication policy that enables both management and the board to communicate effectively with its shareholders, stakeholders and the public in general. Every listed company should encourage the establishment and use of the company's website by shareholders to ease communication and interaction among shareholders and the company. | In the case of TBL, there are communication procedures between SABMiller and TBL's management. A similar arrangement exists in the case of TCC. The controlling shareholder in TATEPA also has access to information. In the case of TOL, the treasury registrar has access to regular information and more on demand. In all the four companies, minority shareholders rely mainly on statutory reports for information. |
| The annual report and accounts to the shareholders must include highlights of the operation of the company and its financial performance. Companies, as a matter of best practice, are encouraged to organize regular investor briefings when the half-yearly and annual results are declared or as may be necessary to explain their performance and promote interaction with investors. | The annual reports do include the highlights as specified by the listing regulations. |

| Description | Empirical findings |
|---|---|
| Institutional investors are particularly encouraged to make direct contact with the company's senior management and board members to discuss performance and corporate governance matters as well as vote during the annual general meetings of the company. | Except in TATEPA, where CDC through FreshFields Investments is the controlling shareholder, institutional shareholders hold minority stakes in the companies. Some have board representation in TOL and TATEPA. They vote during AGMs. Controlling shareholders do have contacts with management. |
| Every listed company should encourage and facilitate the establishment of a Shareholders' Association to promote dialogue between the company and the shareholders. The Association should play an important role in promoting good corporate governance and actively encourage all shareholders to participate in the annual general meeting of the company or assign necessary voting proxies. | None of the companies has established an association of shareholders. |
| Giving shareholders sufficient information on voting rules and procedures. | Voting rules are contained in the companies MEMARTS. |
| Giving shareholders the opportunity to place items on the agenda at annual general meetings. | Shareholders are allowed to suggest items to be included in the agenda at the annual general meetings. The agenda is the first item to be approved before the annual general meetings proceeds. |
| Giving shareholders the opportunity to vote in absentia. | Shareholders can appoint a proxy in the companies studied. |
| Giving shareholders the opportunity to consider the advantages and disadvantages of casting their votes | At annual general meetings shareholders are invited to vote. It can be assumed that they consider the cost and benefit of their votes. |

**The directors' control activities**

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. These activities are shown in Table 6.8 and compared with the empirical findings from the case studies.

**Table 6.8**
**Directors' control activities**

| Description | Empirical findings |
|---|---|
| Define the company's mission, its strategy, risk policy, plans and objectives including approval of its annual budgets. | The pervasive influence of controlling shareholders is key in the performance of these activities. In the cases of TBL and TCC, the board of directors performs these activities to fulfil the requirement that "the board has approved": SABMiller and JTI respectively have effective approval. In the cases of TOL and TATEPA, directors are involved more directly in these activities. |
| Oversee the corporate management and operations, management accounts, major capital expenditures, acquisitions and divestitures and review corporate performance and strategies at least on a quarterly basis. Identify the corporate business opportunities a well as principal risks in its operating environment, including the implementation of appropriate measures to manage such risks or anticipated changes impacting on corporate business. | The TBL and TCC boards undertake these activities as a formality. These are the duties of directors in TATEPA and TOL. |
| Development of appropriate staffing and remuneration policies including the appointment of the chief executive and senior staff, particularly the finance director, operations director and the company secretary as applicable. | In the case of TBL, SABMiller fills senior management positions. In the case of TCC, JTI appoints the CEO/chairman and senior members of management. The directors perform these tasks in the cases of TATEPA and TOL. |
| Review, on a regular basis, the adequacy and integrity of the company's internal control, accounting and financial compliance with applicable laws, regulations, rules and guidelines. | In all the four companies, the review of the internal control system is reported in the financial reports. |
| Monitor the effectiveness of the corporate governance practices under which it operates and propose revisions as may be required. | The boards of directors do not make formal evaluations of their activities and processes. |
| Taking into consideration the interests of the company's stakeholders in its decision-making process. | The interests of shareholders - maximisation of wealth constitutes the key criterion in decision-making. |

| Description | Empirical findings |
|---|---|
| The board should monitor and manage potential conflicts of interest at the management, board and shareholder levels. | The controlling shareholders dominate decision-making processes including annual general meetings. |
| The board of directors of every listed company should appoint a remuneration committee or mandate a nominating committee consisting mainly of independent and non-executive directors to recommend to the board the remuneration of the executive directors and the structure of their compensation package. The determination of the remuneration for the non-executive directors should be a matter for the whole board. The remuneration of the executive directors should include an element that is linked to corporate performance including a share-option scheme so as to ensure the maximization of the shareholders' value. | No remuneration committees have been set up. In the case of TBL, remunerations are decided by SABMiller and presented at the annual general meeting for approval. A similar approach is used in the case of TCC. In the cases of TOL and TATEPA, management proposes the remunerations to the board. The board presents such proposals to the annual general meeting for approval. |

## Determinants of board effectiveness

A number of the factors included in the conceptual model of this research have been reflected in the guidelines of corporate governance recommended by CMSA with respect to board constitution, board leadership structure, appointment and independence of directors, board meetings and the board audit committee.

### *Board constitution*

The guidelines recognise that the effectiveness of the board of directors is determined by its constitution. The guidelines address a number of aspects relating to the constitution of the board, which they encourage companies to take into account. These aspects are listed in Table 6.9 and compared with empirical findings in the four case studies.

**Table 6.9**
**Aspects of board constitution**

| Description | Empirical findings |
|---|---|
| A balance between independent, non-executive directors and executive directors should be reflected. The independent and non-executive directors should form at least one-third of the membership of the board. The board should disclose in its annual report whether independent and non-executive directors constitute a third of the board and if it satisfactorily represents the minority shareholders. | The majority of directors are non-executive directors. The directors are not independent from the appointing shareholders. In the case of TOL, the minority shareholders (individuals) are represented on the board; no such representation is provided at TBL, TATEPA or TCC. However, on the TCC board, the institutional shareholders have one representative.<br>TBL and TCC have started to indicate the categories of directors in their annual reports. |
| The board comprises a number of directors which fairly reflects the company's shareholding structure. The board composition should not be biased towards a substantial shareholder but should reflect the company's ownership structure. The board should also provide a mechanism for the representation of the minority shareholders without undermining the collective responsibility of the directors.<br><br>In circumstances where there is no majority shareholder but there is still a single substantive shareholder[65], the board should exercise judgment in determining the board representation of such a shareholder and those of the other shareholders which reflects the shareholding structure of the company. | In the case of TBL, the controlling shareholder has appointed 61% of the directors. Other major shareholders also appoint directors: the Government of Tanzania 2, IFC 1, EABL 1 and the Unit Trust of Tanzania 1. The individual minority shareholders who, hold 8.2%, are not represented on the board.<br><br>In the case of TOL, directors are nominated by various shareholders and elected at the annual general meeting. In the case of TATEPA, the controlling shareholder has appointed two directors while others have been appointed by other shareholders who hold at least 5% of the total holding. Small shareholders who collectively constitute 12% are not represented on the board. In all the companies, appointments are governed by the company's MEMARTS. At TCC, JTI has appointed 4 directors; Government of Tanzania 1; and minority shareholders (institutions) 2. |

[65] A substantial shareholder, for the purpose of the CMSA's guidelines, is a person who holds at least fifteen per cent of the voting shares of a listed company and has the ability to exercise majority voting in the election of a director.

| Description | Empirical findings |
|---|---|
| The size of the board should not be too large to undermine an inter-active discussion during board meetings or too small such that the inclusion of a wider expertise and skills to improve the effectiveness of the board is compromised. | TBL has 1, TOL has 14, TATEPA has 11 and TCC seven directors. |

***The board leadership structure***

It is recognised in the guidelines that the leadership structure of a board constitutes one of the key elements that determine its effectiveness. In this regard, the guidelines require companies' board of directors to reflect the aspects of leadership structure provided in Table 6.10 which are compared with evidence from the cases.

**Table 6.10**
**Aspects of board leadership structure**

<table>
<tr><th>Description</th><th>Empirical findings</th></tr>
<tr><td>Every public listed company should, as a matter of best practice, separate the roles of the chairman and chief executive in order to ensure a balance of power and authority and provide for checks and balances.</td><td rowspan="2">The positions of board chairman and CEO have been separated in three cases. Different reasons are provided for this separation: it severs the checks and balances requirement in the cases if TOL but not in the cases of TBL and TATEPA. The two positions are combined in the case of TCC.</td></tr>
<tr><td>Where the role of the chairman and the chief executive is combined, there should be a clear rationale and justification, and must be for a limited period and approved by the shareholders. There should be measures that have been implemented to ensure that no one individual has unfettered power over decisions in the company; and a plan for the separation of the roles where such a combined role is deemed necessary during a restructuring or change process.</td></tr>
<tr><td>The chairmanship of a public listed company should be held by an independent or non-executive director.</td><td>In the cases of TBL and TCC, the controlling shareholders appoint the chairmen. In the case of TOL, directors appoint the chairman, however the treasury registrar exerts some influence over the election of the chairman. In the case of TATEPA, the directors elect the board chairman. Thus, in the cases of TBL, TCC and TOL, the chairmen are not independent of appointing shareholders.</td></tr>
</table>

| Description | Empirical findings |
|---|---|
| No person should hold more than two chairmanships in public-listed companies at any one time in order to ensure effective participation in the company's affairs. | None of the board chairmen hold such a position in more than two listed companies. |
| Every listed company should also have a clear succession plan for its chairman and chief executive in order to overcome unplanned and sudden departures which could undermine the company's and shareholders' interests. | The boards of directors do not prepare succession plans for the chairman or CEO. The position of the chairman is filled as outlined earlier. The appointment of a CEO in the case of TBL is determined by SABMiller while in the case of TOL and TATEPA, it is the board's decision. |
| The chief executive should be responsible for implementing the board's corporate decisions and there should be a clear flow of information that facilitates both quantitative and qualitative evaluation and appraisal of the company's performance. | Chief executive officers or managing directors are responsible for implementing board decisions.<br>Quarterly board meetings are held during which performance is assessed. |
| The chief executive is obliged to provide necessary quality information to the board for the discharge of the board's business. | The boards of directors have access to information provided by the chief executive officers in the form of board papers. |

***Director independence***

The appointment of directors is connected to the extent of their independence. Recognising this connection and the influence it has on the performance of the board in control activities, the guidelines address various aspects relating to the appointment and hence independence. Table 6.11 provides the aspects considered, which are compared with the evidence from the cases.

**Table 6.11**
**Appointment and independence of directors**

| Description | Empirical findings |
|---|---|
| The board of every listed company should appoint a nominating committee composed of majority non-executive directors with the responsibility of proposing new nominees for the board and for assessing the performance and effectiveness of directors in performing their role in the company. | None of the boards have a nominating committee. Shareholders nominate/appoint in the cases of TBL, TATEPA and TCC. In the case of TOL, nominated individuals have to be elected at an annual general meeting. In all the four companies, the mechanisms for appointment are enshrined in the companies' MEMARTS. |

| Description | Empirical findings |
| --- | --- |
| The nominating committee should consider only persons of calibre, credibility and who have the necessary skills and expertise to exercise independent judgment on issues that are necessary to promote the company's objectives and performance in its area of business. | In all the four companies, there are no explicit criteria applied to guide the nomination or appointment of directors. |
| The nominating committee should also consider candidates for directorships proposed by the chief executive and shareholders. | The chief executive officers or managing directors do not propose candidates for directorships. |
| The board, through the nominating committee, should, on an annual basis, review its required mix, skills and expertise, which the executive directors as well as the independent or non-executive directors should bring to the board, and disclose the same in the annual report. | Directors do not carry out any assessment of skills, mix and expertise. Consequently, no such disclosure is made in the annual reports. |
| The board should implement a process of assessing the effectiveness of the board as a whole, committees of the board, as well as of each individual director and such a task should be assigned to the nominating committee. | The boards of directors do not carry out any formal self-assessment of either the board as a whole or individual directors. |
| Newly-appointed directors should be provided with necessary orientation in the area of the company's business in order to enhance their effectiveness on the board. | Orientation is provided in the case of TBL. Such orientation is not provided in the cases of TATEPA, TOL and TCC. |
| The nominating committee should recommend, to the board, candidates for directorships to be voted on by the shareholders since the responsibility of nominating rests on the full board, after considering the recommendations of the nominating committee. | Directors do not nominate candidates for directorships. It is the responsibility of shareholders to identify and nominate/appoint potential individuals. |
| The process of appointing directors should be sensitive to gender representation. | This depends on who shareholders decide to appoint as director. |
| No person should hold more that three directorships in public listed companies at any one time in order to ensure their effective participation on the board. | In the four companies researched, no director was found to sit on the board of more that three listed companies. |

***The board audit committee***

The guidelines recommended by CMSA state that shareholders' interests should be protected through the establishment of a board audit committee. The guidelines further specify the way in which such a committee should be constituted and led. The aspects

relating to the audit committee are listed in Table 6.12 and compared with the empirical findings from the four case studies.

**Table 6.12**
**Board audit committee**

| **Description** | **Empirical Findings** |
|---|---|
| The board shall establish an audit committee of at least three independent and non-executive directors who shall report to the board, with written terms of reference, which deal clearly with its authority and duties. | Only TBL has established a formal audit committee. The committee has an equal number of executive directors and members of management. No formal committee exists in the case of TOL, although an informal arrangement exists where some non-executive directors perform some of the functions of an audit committee. No audit committee has been established at TATEPA or at TCC. |
| The chairman of the audit committee should be an independent or non-executive director. | The chairman of the audit committee in the case of TBL is a non-executive director but not independent. |
| The board should disclose in its annual report whether it has an audit committee and the mandate of such committee. | TBL discloses in the annul reports that it has established an audit committee. |

## 6.5 Discussion of the comparison of guidelines with the empirical findings

The two sets of recommended guidelines reflect the Anglo-Saxon conceptualisation of the problems of corporate governance: i.e. the need to make boards of directors effective in controlling management and accountable to shareholders. The guidelines have addressed issues that influence the effectiveness of the board of directors by prescribing directors' responsibilities, their organisation and shareholder rights. An Anglo-Saxon conceptualisation appears to have obscured the relative power and information issues within shareholder groups in the Tanzanian companies. The guidelines do not address the issue of controlling shareholders, and the resultant power and information asymmetry with respect to minority shareholders.

A comparison of the guidelines and the empirical results shows that in each of the four companies, a number of practices recommended by both sets of guidelines do form part of the current corporate governance practices. The comparison also reveals a number of key aspects that are not addressed in practice, and which need to be introduced in order to be in compliance with the requirements of the guidelines.

In terms of the board constitution, which addresses the types of directors, the empirical findings show that the boards of directors are constituted of mainly non-executive directors. The CMSA recommends that at least one-third of directors be non-

executives. Although the guidelines recommend that boards of directors should include representatives of minority shareholders, this is only the case in one company. Three of the companies do not satisfy this requirement. The right to appoint directors is linked to the extent of shareholding in the three companies (Chapter 5).

With respect to board leadership structure, the two positions of board chairman and CEO have been separated in three of the four corporations. This is to an extent consistent with the recommended guidelines. However, they fall short of full compliance because the board chairmen are not independent. In the case of TCC, the two positions are combined. This clearly deviates from the demands of the two sets of recommended guidelines.

An audit committee has been formed in one company, which is to an extent consistent with the CMSA's guidelines. However, it falls short of full compliance with the recommended guidelines because the members of the committee are not independent of the controlling shareholder. The other three companies have not formed audit committees and hence do not meet the guidelines.

In terms of board meetings, the four companies display similarities in the ways in which board meetings are conducted: management provides information to the directors in time, directors are permitted to add items for discussion to the agenda, and directors hold detailed deliberations on issues. This is in line with the guidelines recommended by the CMSA.

The other aspect where companies should be in line with recommended guidelines is in director nomination, where the issues of criteria and appointment processes deviate from recommended guidelines. None of the companies explain the criteria for appointing directors as required by the guidelines. This includes defining the skills, calibre and integrity of potential individuals. The two sets of guidelines recommend that the board should nominate directors through a nomination committee. Currently, none of the companies have has established a nomination committee. The guidelines also recommend the establishment of a remuneration committee; a condition not currently fulfilled by the companies. Further, the establishment of shareholder associations, as recommend in the guidelines, has not been performed by any of the companies. This observation is further commented upon in Section 7.6.2.

# CHAPTER 7 CONCLUSIONS AND RECOMMENDATIONS FOR DEVELOPMENT OF CORPORATE GOVERNANCE IN TANZANIA

## 7.1 Current body of knowledge and concepts appropriate for assessing the effectiveness of corporate governance in Tanzania

Two broad perspectives of corporate governance are discussed in the corporate governance literature: the liberalist and the communitarian perspectives. Within these broad perspectives, four distinct models have been identified: the Anglo-Saxon model, the Germanic model, the Japanese model and the Latin model. The Anglo-Saxon model is market-based whereas the Germanic and Japanese models are bank- and group-based respectively. The Latin model exhibits characteristics of both the insider and market-based models and hence the term hybrid model. The four models have been reproduced in other parts of the world but conditioned by the specific contexts.

The four models evolved in different contexts in which social practices with respect to corporate governance differ. Current corporate governance practices reflect these variations (Tricker, 1994; 2000). There is an ongoing debate about the possible convergence of the models. Bradley et al. (1999), Denise and McConnell (2003), and Hopt and Leyens (2004) posit that recent research shows a trend towards convergence of the models. The Germanic and Japanese models are acquiring characteristics of the Anglo-Saxon model by encouraging markets for corporate control. Changes are also occurring in the Anglo-Saxon model. For example, ownership concentration has been increasing in UK companies (Chapter 3). Views have been expressed that convergence is not likely to occur due to the fundamental differences that exist among the models (Clarke and Clegg, 1998; Roe, 2003). Although it is unlikely that the models will become similar in all respects, these recent developments suggest that the traditional differences will narrow.

Various theoretical perspectives have been applied in frameworks for studying the phenomenon of corporate governance: transaction cost economics theory, agency theory, managerial-hegemony theory, class-hegemony theory, stewardship theory, stakeholder theory and resource dependence theory. For the purpose of this research, transaction cost and agency theories were used in this research. Self-interest and opportunism in economic relationships, which are the key assumptions of transaction cost economics and agency theories, also apply in the Tanzanian context (Bagachwa et al., 1992; Kihiyo, 2002). The essence of transaction cost and agency theories is that managers have an incentive to pursue their own personal goals such as empire building and consumption of perquisites rather than maximising shareholder wealth (Jensen and

Meckling, 1976). The cost of the non-wealth maximising actions is born by shareholders, and hence the need to control managers to minimise these costs and maximise shareholder wealth (Hart, 1995). The need to encourage managers to maximise shareholder wealth is essential in motivating shareholders to supply the finance required by organisations, which is the central issue in contemporary debates on corporate governance (Berglof and Claessens, 2004).

Transaction cost economics and agency theories propose general mechanisms that encourage managers to pursue shareholder interests. These fall into two categories: external and internal mechanisms. External mechanisms operate outside the firm and encourage managers (agents) to make decisions that lead to the attainment of shareholder interests. These mechanisms are the legal and regulatory framework, and the competitive markets for labour, capital and products. Organizations take external mechanisms as given (Dyck, 2001). Internal mechanisms of corporate governance: bonds, performance-based incentives and monitoring mechanisms, ownership structure, debt and the board of directors operate within the firm (Chapter 4). Shareholders can change internal mechanisms depending on the prevailing circumstances.

The conditions required for the effective functioning of the external mechanisms do not currently exist in the Tanzanian context (Chapter 4). This is the case for the developing world in general: capital markets, and competitive product and labour markets are not developed, and legal and regulatory frameworks are weak (Lin, 2000; Claessens, 2004; Berglof and Claessens, 2004). Internal mechanisms such as bonds, debt and performance-based incentives face limitations because they rely on external mechanisms for effective functioning (Berglof and Claessens, 2004). It was concluded from the literature review that, in general, performance-based compensations tend to be used in situations where the ownership of corporations is fragmented as in the case of the UK and US, and less so when it is concentrated as in the case of Germany and Japan (Chapter 3).

The prevailing situation in Tanzania is characterised by concentrated ownership, which implies that performance-based compensations may not be that common. This conclusion is in line with Berglof and Claessens' (2004) observation that, in the context of developing countries where ownership is concentrated, the use of performance-based incentives may be non-existent because large shareholders have the power and incentive to monitor management and can hire and fire management as they deem fit. For these reasons, this research focussed on the internal mechanisms of the ownership structure and the board of directors as they provided a good prospect of answering the main research question.

The literature reviewed also showed that the board of directors is the most promising mechanism for monitoring and disciplining management, and has great flexibility in terms of controlling managerial behaviour (Styles and Taylor, 2002). The ownership structure and the board of directors provided the conceptual base from which

to explore corporate governance practices in Tanzania and determine their effectiveness. Concepts connected to ownership structure and the board of directors have been introduced based on the literature review, and applied in the empirical investigation. These include shareholder control, board control, and the determinants of board control: constitution, director independence, leadership structure, board meetings and board audit committee.

## 7.2 Current situation with respect to effectiveness of corporate governance in Tanzania and the factors determining it

The purpose of corporate governance from a liberalist perspective is to protect and further the interests of shareholders by encouraging managers to make decisions that maximise shareholder wealth (Chapter 3). The model of corporate governance in Tanzania is modelled on the liberalist model (Chapters 2 and 3). Consequently, the effectiveness of corporate governance is judged in terms of the extent to which it effectively 'encourages' managers to make decisions that maximise shareholder wealth (Chapter 4). For the purpose of this research, effective corporate governance is considered to exist if the mechanisms investigated (ownership structure and board of directors) do encourage managers to pursue this wealth maximisation goal in the current Tanzanian situation.

**Ownership structure**

Controlling shareholders constitute effective monitors and hence do control managers in the companies researched. The controlling shareholders exercise control over management decisions through their access to and appointment (and the power to fire) of key people in the organisation, their access to information, and their active participation in decision-making processes. Through these avenues, they encourage managers to make decisions that maximise shareholder wealth. In all the companies researched, controlling shareholders have the final say on decisions reached at annual general meetings because of the control rights they hold. This creates a pervasive influence over the managers' decisions and the managers have to take into account the interests of such shareholders in their decision-making processes. The concentrated shareholding that has been found in the companies researched is a phenomenon that is widespread in Tanzania. All the companies listed on the Dar es Salaam stock exchange, and a number of other non-listed companies, have controlling shareholders (Chapter 2). The cases provide evidence that the ownership structure is an important determinant of effective corporate governance in Tanzania.

The findings from the cases with respect to the role of large shareholders are consistent with findings in the existing corporate governance literature. Denise and McConnell (2003), in their survey of the literature, point out that large shareholders

have the motivation to expend resources on monitoring management. Large shareholders are seen as the most important and effective corporate governance mechanism in the developing world (Claessens, 2004; Berglof and Claessens, 2004). In the context of developing countries, the effectiveness of large shareholders with respect to corporate governance is related to them generally being foreign corporations. Dyck (2001) posits that companies with foreign shareholders tend to have effective corporate governance because they adopt standards applicable in developed countries, and this leads to effective corporate governance in a corporation operating in a developing country. Berglof and Claessens (2004) assert that large shareholders from developed countries raise the level of corporate governance in a developing country because they introduce high standards of corporate governance usually more applicable in developed countries. The evidence from three of the companies researched supports this assertion from the emerging literature on corporate governance in developing countries in transition.

**Effectiveness of the board of directors**

With respect to the board of directors, the research focused on factors which are considered in agency theory to determine the effectiveness of boards of directors in exercising board control. The determinants investigated in this research were: board constitution, board leadership structure, directors' independence, board meetings and board audit committees (Chapter 4).

*Board constitution*

The empirical results in the cases show that, in all the four companies, the non-executive directors constitute the majority of board members. The extent to which the constitution of the board determines the effectiveness of the board in the control function is judged to be low for two cases. In these two cases, the boards of directors are not involved in key control activities because the controlling shareholders perform such activities. The finding from these two companies corroborates the observation in the literature that the presence of large shareholders tends to undermine the other corporate governance mechanisms (Berglof and Claessens, 2004). In the other two cases, the board constitution is judged to determine board control to a large extent. The non-executive directors do execute all the activities related to the control function of the board. This strengthens the argument in the literature that boards of directors can be an effective corporate governance mechanism (Styles and Taylor, 2002; Denise and McConnell, 2003). This research shows that this is the case only where large shareholders allow boards of directors to perform such control by not being too closely involved in control of the corporation.

With respect to the recommended guidelines discussed in Chapter 6, the findings show that the number of non-executive directors relative to the size of boards in all the

companies researched meets the requirements of the CMSA guidelines and those by the Steering committee on Corporate Governance in Tanzania, which require at least one-third of board members to be non-executive directors.

*Director independence*

The extent to which director independence determines the effectiveness of the board of directors in the control function is low for two of the companies and high for the other two. In the cases where directors are independent, such independence tends to translate into effective control of management. However, the findings indicate that even in the companies where directors are independent of management, the issue of director independence with respect to controlling shareholders remains challenging. The current system, where only shareholders who meet specified criteria are entitled to appoint directors, poses a serious challenge to the independence of directors. This finding is consistent with the literature in that large shareholders generally threaten the independence of directors because they tend to be appointed by the mandate of these large shareholders (Berglof and Claessens, 2004).

The area of director independence is one in which the recommended guidelines by both the CMSA and the Steering Committee on Corporate Governance in Tanzania have not been met by any of the four companies. It also constitutes one of the most challenging issues of corporate governance in Tanzania, and for developing countries in general. This is because large controlling shareholders might well resist attempts to improve director independence since this may not be in their interests. Berglof and Claessens (2004) argue that reforms to improve corporate governance in developing countries might be resisted by large shareholders who benefit from the existing arrangements in which they control corporations. Yet, director independence is seen as an important reform issue in the improvement of corporate governance practices, and one that countries must address (OECD, 1999; CACG, 1999, OECD, 2004).

*Board leadership structure*

The extent to which the separation of the positions of board chairman and chief executive officer determines board control in the companies researched is low for two companies, high for one and non-applicable to one company where the positions are combined. In the company where the separation of the two positions does determine board control, the separation is consistent with agency theory since it establishes a system of checks and balances in the decision-making processes of the company (Cadbury, 1992; OECD, 1999; CACG, 1999; OECD, 1999).

In the company where the roles of chairman and CEO have not been separated, the reason for non-separation is that the controlling shareholder controls the company effectively and hence sees no need to introduce additional controls including the separation of the two positions. This suggests that the separation of the posts needs to be

pursued where it introduces additional useful controls. With respect to the recommended guidelines, the separation of the positions in three of the cases meets a specific requirement of the two sets of guidelines in that the same individual does not hold both positions. However, the separation of the positions in these three companies falls short of full compliance with the guidelines because the board chairmen are not independent of the controlling shareholders.

*Board meetings*

The extent to which the board meetings determine the effectiveness of the board in terms of the control function is low for two companies and high for the other two. As with other determinants of board effectiveness, board meetings do not contribute in a significant way to the effectiveness of the board in the control function in two companies because the board does not exercise control. Board meetings in the remaining two companies do determine board control since they constitute forums that exercise control over management decisions.

In all the companies researched no formal evaluation of directors' activities or individual directors takes place as recommended in the general literature on corporate governance. In this respect, companies do not meet the requirements of the CMSA guidelines, which require company directors to formally evaluate individual members of the board, the chief executive officer and the board's own performance.

*Board audit committee*

The contribution of the audit committee in determining board control is low in the one company that has established such a committee, the explanation being the high control executed by the controlling shareholder. This is consistent with the previous conclusion that the internal mechanisms of corporate governance are influenced by the ownership structure (Berglof and Claessens, 2004). In the other companies, a board audit committee has not been established.

The establishment of an audit committee is one of the recommendations in the CMSA set of guidelines (Chapter 6). As a structure, the one audit committee in the companies researched is consistent with the guidelines. However, the membership of the audit committee does not meet the independence requirements set out in the guidelines. The fact that one company established an audit committee but that this committee is ineffective due to the existence of a large shareholder, renders the recommendation for establishing audit committees irrelevant. This is because if a board of directors is ineffective due to overarching control by large shareholders, it cannot be expected that any committees it establishes will be effective.

*Directors' knowledge and skills*

The directors' knowledge and skills were found, in two companies (TOL and TATEPA), to be a key determinant of their ability to understand and contribute to the discussions during board deliberations. A knowledge of the industry in which the company operates, and trends in that industry, knowledge of, and experience in, financial issues are valuable skills. This is consistent with the current developments elsewhere, where such attributes are a necessary qualification for directors, particularly for those that serve on a board audit committee. For example, in the US, members of audit committees must prove their qualifications and experience in accounting and finance (Hopt and Leyens, 2004).

## 7.3 Issues concerning the development of effective corporate governance in Tanzania

The findings in this research point to three major clusters of issues which need to be addressed to further develop corporate governance practices in Tanzania: developing a foundation for effective corporate governance, the need to address the potential problem of expropriation from minority shareholders in companies with controlling shareholders, and issues affecting the effectiveness of boards of directors.

### 7.3.1 The foundation for effective corporate governance

The discussions in Chapter 2 about the Tanzanian context, and the different mechanisms that encourage mangers to pursue shareholder goals (Chapters 3 and 4), have shown that a market-based economy is only beginning to take root in Tanzania with the consequence that a large number of elements that make up an efficient market economy are still in their early stages of evolution. For example, a capital market regulatory authority is still in its infancy stage. This market is not yet efficient in terms of encouraging managers to pursue shareholder interests: it does not yet function as a credible threat to managers who do not maximise shareholder wealth. Similarly, the enforcement of laws, which is an important factor for an efficient market economy is still weak; some laws are outdated to the extent they no longer fit the existing market economy. There is a general need to develop the basic foundations for effective corporate governance in Tanzania, which is not dissimilar to the needs elsewhere particularly in developing countries in transition. For example, Southeastern European countries (SEE) and the Commonwealth of Independent States face similar challenges (OECD, 2003; Berglof and Claessen, 2004)

### 7.3.2 The potential expropriation problem

Although large shareholders provide effective corporate governance in the current situation in Tanzania, they also pose a significant challenge. Denise and McConnell

(2003) and Berglof and Claessens (2004) point out that such extensive control provides controlling shareholders with the possibility of private benefits, i.e. benefits that are not available to other shareholders, and that this has the consequence of reducing firm value. In Czech Republic and Russia controlling shareholders have siphoned profits from corporations to the detriment of minority shareholders (World Bank, 2000; Dyck, 2001).

The evidence from the case studies in this research shows that there are 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 directors of companies. In annual general meetings, which they rely on for information on the performance of the corporations, they do not have an adequate voice (Chapter 6). This makes them as vulnerable as those in Czech Republic and Russia discussed previously.

The vulnerability of minority shareholders implies that the traditional agency problem facing Anglo-Saxon companies, which pits shareholders against powerful managers, is not so relevant in the Tanzanian context and, instead, the core problem involves a struggle between controlling shareholders and minority ones. This is again typical of developing countries in transition (Berglof and Claessens, 2004). This leads to a potential expropriation problem where dominant shareholders take advantage of their effective control over corporate resources to expropriate or divert resources from the corporation in ways that deprive minority shareholders of their fair share of income from those resources (Oman et al., 2003). Such a situation has been reported in the Southeastern European countries and Commonwealth of Independent States (OECD, 2003). 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. This suggests that initiatives to improve corporate governance in SEE and CIS will have more practical relevance to the Tanzanian context than those in developed economies, and moreover important lessons can be learnt.

The implication for the future development of corporate governance in Tanzania is that it points to the need to protect minority shareholders. La Porta et al. (2000) have identified six legal protection forms, referred to as anti-director rights and measured by the "anti-director rights index. 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; 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 percent, and the pre-emptive rights of shareholders only wavable by a shareholders' vote.

Some of the anti-director rights do exist in Tanzania. For example, the company ordinance (Cap. 212) provides for shareholders holding at least 10% of equity capital to call for an extraordinary shareholder meeting. Sec. 114 (1) states:

> "The 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 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".

Although this section is aimed at providing protection, the main problem in Tanzania with respect to laws relates to their poor enforcement. Laws may exist in statute books but their application in practice is poor (Chapters 2 and 4). A problem with law-oriented solutions to corporate governance identified by Black et al (1999) in the context of Russia also applies to Tanzania:

> [T]he principal problem is not that laws aren't strong enough, but that they aren't enforced… unhappy shareholders can rarely develop enough facts to prove the rampant self-dealing that occurs every day. The courts respect only documentary evidence, which is rarely available, given limited discovery and manager's skills in covering their tracks… [P]ursuing a case… will take years, and when you are done, enforcing a judgment is problematic, because enforcement is by the same biased or corrupt lower court that the shareholder began at (Black et al., 1999 cited by Dyck, 2001).

The problem of enforcing of laws and regulations is a fundamental problem with respect to corporate governance in developing countries such as Tanzania (Berglof and Claessens, 2004; Chapter 4 of this research). In general, the phenomenon of concentrated ownership is viewed as a response to this problem (Berglof and Claessens, 2004). Yet, as demonstrated previously, enforcement is a key requirement on which a large number of other mechanisms depend for their effectiveness (Chapter 4). This strengthens the previous argument that the basic foundations need developing.

### *7.3.3 Factors affecting the effectiveness of the board of directors*

A number of factors which determine board effectiveness with respect to the control function still need to be addressed. They include: director independence, director evaluation and the board leadership structure. The issues discussed in Chapter 2 with

respect to the scope of accountability of directors is also important for the evolvement of effective corporate governance.

**Director independence**

The evidence from the case studies shows that the level of shareholding that is required for shareholders to appoint representatives to the board is institutionalised as evidenced by their specification in company MEMARTS. This regulation generally favours the controlling shareholders since it allows them to appoint the majority of the directors, the chairman of the board and the CEO, while excluding a large number of shareholders from being represented in the important corporate decision-making processes. This has also the consequence of impairing director independence and thus is consistent with the finding of Berlof and Claessens (2004) that the independence of directors diminishes where there are large shareholders. This is an area that requires further efforts to improve the situation.

**Director evaluations**

The company boards investigated do not address the issue of formal evaluations. Directors do not currently carry out formal evaluation of themselves, of the chief executive officer of board activities. This means that an assessment of the board's needs for specific skills and knowledge is not undertaken. It also suggests that once individuals are appointed as directors, no further personal development is encouraged since there is no basis on which to recommend improvements. It was also found that the majority of the companies did not provide new directors with orientation on their roles.

**Board leadership structure**

Of the three companies that have separated the positions of board chairman and chief executive officer, only one of them has separated the positions in order to enhance board control. The overall evidence is that separation is only useful for control purposes when the board of directors is, in practice, involved in decision control. When the controlling shareholder directly monitors management, and the directors are not independent, then separation of the positions becomes irrelevant.

**Scope of directors' accountability**

The current form of corporate governance in Tanzania recognises shareholders as the only organizational constituency that should be represented on a corporation's decision-making board of directors. This system is brought about through the linked colonial past with the British (Chapter 2). The Company Ordinance is in the process of being replaced by a Company Act, 2002. This Act, which is awaiting operationalisation by the Minister, requires directors to consider the interests of other stakeholders, i.e. employees, at the same level as they consider the interests of shareholders.

> "The matters to which the directors of the company are to have regard in the performance of their functions include, in addition to the interests of the members, the interests of the company's employees" (Company Act, 2002 sec. 183 [1]);
>
> "The duty imposed by this section on the directors is owed is owed by them to the company (and the company alone) as is enforceable in the same way as any other fiduciary duty owed to a company by its directors" (sec. 183 [2]).

These statements indicate attempts to broaden the scope of accountability for directors and management, implying that directors can be held accountable for the interests of employees. The rationale behind stakeholder orientation in Tanzania goes back to the early days of independence. Economic systems that favour only a relatively small number of people in society were challenged after independence through the Arusha declaration in 1967 (Chapter 2).

In terms of the Company Act, 2002; requiring directors to have regard to the interests of employees might be different from them actually considering such interests in practice. The implementation of such a 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. This raises questions about the criteria for resolving these conflicting interests. In practice, the implementation of this section of the Act is problematic because directors are appointed or elected by shareholders. Directors owe their positions and hence allegiance to the shareholders and not to the employees. It cannot be expected that a representative of shareholders will protect the interest of employees if doing so would compromise shareholder interests.

## 7.4 Summary: determinants of effective corporate governance in Tanzania

In the current situation in Tanzania, the following determinants of effective corporate governance can be identified:

### *7.4.1 Ownership structure*

The ownership structure, which determines shareholder control, is an important determinant that was found in all cases. A concentrated ownership is a phenomenon that is widespread in Tanzania, and so there is a significant likelihood that large shareholders constitute an important determinant of effective corporate governance in a large number of companies in Tanzania.

### *7.4.2 Effectiveness of the board of directors*

Boards of directors also constitute an important mechanism in Tanzania. However their effectiveness in the control function varies from company to company as shown in the cases. 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 case-based evidence has shown that in companies where boards are important for control purposes (i.e. exercising decision-control), the effectiveness of the board of directors is to varying degrees determined by its constitution, director independence, the board leadership structure and board meetings.

*Board constitution and director independence*

The board constitution and director independence are two factors that determined effective corporate governance in two of the companies researched. They enhance effective corporate governance by increasing board control through independent judgement of the management's actions and proposals. In general, this occurs in situations where the board exercises control over management and is consistent with the agency literature reviewed in Chapter 3.

*Board leadership structure*

The separation of the positions of board chairman and CEO is an important factor in determining board control. It establishes a checking mechanism in the decision-making process of the company, which is required for effective board control. Although this factor was found in only one company, this finding implies that in companies in a similar situation the separation of the two positions is an important determinant of effective corporate governance.

*Board meetings*

Board meetings were key determinants of effective corporate governance in the two of the companies researched. This is because they constitute a forum for executing the decision-control component of the decision-making process. In general, board meetings are key determinants of effective corporate governance in situations where the board exercises control over management decisions.

*Director's knowledge and skills*

Although not included in the original research model, the directors' financial skills and experience, as well as their knowledge of the industry in which the company is operating, are key requirements for effective board deliberations and hence control. This finding extends the original model as developed in Chapter 4 (Figure 4.2) and implies

that, in situations where board control is required, the directors' knowledge of the industry in which the company operates, their experience and their financial skills are important elements that deserve attention.

## 7.5 Reflection on the research

The findings in this research, which has been conducted in the setting of a developing country in transition, strengthens the emerging literature on corporate governance in developing and transition economies as it confirms a number of features which are seen as typical of these contexts (Okeahalam and Akinboade, 2003; Melyoki, 2004; Berglof and Claessens, 2004). Based on the theoretical reasoning underpinning this research (Chapter 4), a number of corporate governance mechanisms have been identified which operate outside the firm itself: the legal and regulatory framework, and the competitive markets for capital, products, and managerial labour. Internal mechanisms discussed are bonds (i.e. management contracts), the ownership structure, performance-based compensation and the board of directors. A legal and regulatory framework does exist but further improvements are required in terms of corporate governance in Tanzania.

The existing framework is faced with the problem of poor enforcement of laws and regulations. This is seen as the most challenging issue in Tanzania (Chapter 4) and in developing countries in general (Berglof and Claessens, 2004). The enforcement of laws and regulations is a key element of the sound foundations upon which effective corporate governance can be developed (Vishny and Shleifer, 1997; Oman et al., 2003; Berglof and Claessens, 2004). The theoretical assertion that enforcing laws, particularly the protection of minority shareholders, will encourage investments and the spread of ownership cannot be shown with the existing situation in Tanzania which works to constrain the development of capital markets. 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. While a significant number of corporations have now been privatised, the government is still an important owner (Chapter 2). The government continues to keep shares in some corporations and although it has become a minority shareholder it remains an important one. Through this shareholding it continues to appoint senior civil servants to directorships in important corporations. This indicates that the decision-making processes of government and those of corporations are intertwined. This is consistent with the literature on corporate governance in developing countries: Oman et al. (2003) observe that the governance of corporations in developing countries is interlinked with that of the political system.

In addition to Government appointments, senior civil servants are also appointed to directorships in private companies by the owners and the management. For example, the Speaker of the National Assembly was appointed chairman of the board of directors of Vodacom, a private company, in January 2003. Vodacom is a subsidiary of a company based in South Africa. Criticisms were voiced regarding the conflict of interest inherent in the two positions: the Speaker responded that " …there was no conflict of interest…"[66]. The speaker continues to serve as board chairman of Vodacom. The involvement of key civil servants, and other people who wield significant influence in society in the decision-making processes of companies such as board meetings makes accountability by these companies towards the Government and society as a whole problematic.

Civil servants are required to develop and enforce laws and regulations which regulate the behaviour of business in the economy. By also being part of corporate decision-making processes, the possibility that senior civil servants will be used to protect corporation interests by influencing the content of laws and regulations, or by having laws that are not enforced, will be increased. Berglof and Claessens (2004) posit that large shareholders can influence the way laws and regulations are written and enforced. It is in this context that the protection of minority shareholders remains a critical problem. However, this is not peculiar to Tanzania as shown by the observation that:

> " in many developing, transition and emerging-market countries, the effects of the expropriation problem are severely exacerbated, moreover, by the destructive, often acutely negative-sum game, behaviour of powerful vested interest groups that are entrenched in highly concentrated oligopolistic structures of local political as well as economic power. Particularly damaging is often the considerable extent to which the behaviour of such powerful local groups (closely tied to foreign investors in some countries, less so in others) serves to weaken or undermine healthy price competition and the proper function of markets- which are indispensable for a country to achieve a reasonably sustained productivity growth- as well as to weaken or undermine the development and consolidation of democratic political institutions" (Oman et al., 2003).

The inclusion of senior civil servants in corporate decision-making processes could result in the domination of business interests over other important interests particularly where they conflict. In a society where a disjuncture between civil society and the state exists, such as in Tanzania (Chachage, 2003), business economic interests will likely dominate other considerations including political processes. Efforts need to be invested to address this issue.

[66] See the Guardian, 21st May, 2003.

The conclusion that significant control over Tanzanian corporations resides outside the country means that important decisions with implications for the Tanzanian economy are made abroad (Chapter 6). This poses a serious challenge to the long-term development of Tanzania, and the realisation of the 2025 development vision discussed in Chapter 2. The realisation of the goals contained in this vision depends on involving the 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 aspirations of this vision.

Important shareholders are not based in Tanzania but abroad which invokes the notion of an absentee landlord in the governance of corporations. Since important decisions are made outside Tanzania, there is a likelihood 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 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.

## 7.6 Conclusions and recommendations

### *7.6.1 Conclusions*

The proposition that large shareholders are the key determinant of effective corporate governance in Tanzania has been confirmed in this research. This finding corroborates the findings in the general literature that large shareholders are an effective mechanism for corporate governance (Shleifer and Vishny, 1986; Roe, 2003; Denise and McConnell, 2003). This finding strengthens the emerging literature on corporate governance in developing countries that large shareholders are the single most important mechanism in these contexts (Oman et al., 2003; Berglof and Claeesens, 2004).

However, large shareholders although effective in controlling incentive problems, also pose a challenge with respect to the interests of minority shareholders. One finding from this research has shown that a key corporate governance issue in Tanzania is the one of weak minority shareholders versus powerful controlling shareholders. This finding is consistent with the literature in that, in developing countries, the issue for corporate governance involves the expropriation of minority shareholders by large ones (Denise and McConnell, 2003; Oman et al., 2003).

The evidence from the case studies with respect to concentration of ownership and the relative power of large shareholders in corporate decision-making processes points to a practical challenge in the approach being pursued by CMSA in its

recommendations. These recommended guidelines do not sufficiently address this core issue of corporate governance in Tanzania. This reflects the fact that these guidelines were "borrowed" from developed countries (Chapter 6). This suggests that caution should be exercised in developing guidelines so that they fit the context rather than simply transplanting ones that will not work. Berglof and Claessens (2004) also warn against transplanting codes of corporate governance to contexts which do not have the necessary supporting environments.

Evidence was found that confirms the theory with respect to the role of the board in a control function. The findings show that an effective board of directors is an important determinant of effective corporate governance normally where large controlling shareholders do not address control aspects which are the domain of the board. It can be concluded that when large shareholders become fully involved in control, boards of directors became mere advisory committees to management. This is a confirmation of the literature in that large shareholders tend to render ineffective other corporate governance mechanisms (Berglof and Claessens, 2004). This is also the conclusion with regard to the separation of the chairman and CEO positions. Such separation does not necessarily lead to an effective board in the control role. This further implies that caution must be exercised to avoid transplanting codes of corporate governance from developed countries which do not fit the developing economy situation.

The findings show that, in some cases, 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. However, evidence shows that large numbers of non-executive directors on the board are useful in the control function in some of the cases. This leads to the conclusion that in the absence of shareholders who closely monitor management, a large number of independent non-executive directors are helpful in controlling management.

The findings with respect to director independence pose challenges to the guidelines recommended by both the Steering Committee on Corporate Governance and the Capital Markets and Securities Authority (CMSA) which recommend that non-executive directors should be independent. In a situation where the controlling shareholders appoint the majority of directors, independence remains a challenge and will require a considerable amount of effort to achieve, particularly because it can be resisted by the large shareholders (Berglof and Claessens, 2004). Direct appointment by shareholders, as currently practiced in Tanzania, also raises the issue of criteria. The findings from all the companies show that the process of appointing directors is not guided by explicit criteria. This suggests that such appointments may not be based on clearly defined needs. The companies are also not meeting the requirements of the recommended guidelines by failing to explicate the appointment criteria. This leads to

the conclusion that current practices need to be reformed to improve the effectiveness of corporate governance.

The evidence from the case studies challenges the current 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. This implies that, in the future, the post-privatisation corporate governance arrangements should be considered in advance.

### *7.6.2 Recommendations*

**Recommendations for government and regulatory institutions**

*Developing the foundations for effective corporate governance*
On the basis of the theoretical conclusions, it has been argued that the foundations for the development of effective corporate governance are currently weak in Tanzania, and require developing and strengthening. The key issue is the enforcement of laws and regulations with respect to corporate governance. As in other developing countries in transition, such a foundation is critical for the development of capital markets which are seen as essential for the sustainable development of countries (Shleifer and Vishny, 1986; Oman et al., 2003; Berglof and Claessens, 2004).

The recommended strategies for improving the enforcement of laws and regulations include the training, sensitisation and awareness raising of the lawmakers (Members of Parliament) and law enforcers (judges and managers of regulatory organs) with respect to issues of corporate governance. This will enable Members of Parliament to appreciate the issues involved in corporate governance and enhance the prospects of developing appropriate laws for Tanzania and as well as the prospect that these laws will be enforced in practice.

There is a need to raise the profile of corporate governance as an important issue in economic development. Currently, there is little debate in Tanzania on the issue of corporate governance, which is seen as reflecting a lack of awareness of its importance for economic development (Melyoki, 2004). The media should be encouraged to report corporate governance issues and become more analytical of such issues. This will contribute to raising the profile of corporate governance as an important development issue. This will require sensitisation and awareness raising for the media. These recommendations could be implemented by CMSA and BRELA in collaboration with the Ministry of Justice and Constitutional Affairs.

*Protection of minority shareholders*

A key issue emerging from the empirical investigation was the need to protect minority shareholders against possible abuse by large shareholders. This is also part of developing a sound foundation for effective corporate governance. The protection of minority shareholders is seen as a key policy issue in developing countries (Berglof and Claessens, 2004) and is relevant to Tanzania. The protection of minority shareholders primarily requires the enforcement of laws and regulations be improved. However, it also requires the 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.

Greater access to information will enable minority shareholders to challenge the decisions of management and large shareholders and so prevent the possibility of diverting resources from the firm. Strategies for increasing access to information include the development of reputable institutions such as a specialised investigative financial press, brokerage institutions, and financial analysts that could help to improve corporate governance practices. Strengthening the professional accounting and auditing organisations (NBAA) should also be part of the effort to improve corporate governance. This recommendation can be jointly implemented by CMSA and NBAA.

The protection of minority shareholders in Tanzania should also involve a review of the current laws to ensure they provide the required protection. The current requirement for at least a 10% holding of voting equity to convene an extraordinary general meeting should be reconsidered because it appears prohibitive in a country such as Tanzania where the large 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. This issue should be debated to arrive at a threshold appropriate for Tanzania. This debate can be stimulated and coordinated by CMSA in collaboration with BRELA.

Educating minority shareholders on their rights, and the protection of these rights, will further minimise the abuse from large shareholders. Educational campaigns can be helpful in bringing about an understanding. CMSA should encourage companies to organise educational seminars for their shareholders. CMSA should also enforce its recommendations for forming shareholder associations as these could also organise educational seminars as well as acting as a lobbying body for the rights of minority shareholders. Shareholder associations can be a powerful force to protect the interests of shareholders. For example, minority shareholder associations in France put pressure on the French market regulator to investigate Marionnaund, the French perfume manufacturer, for failing to release its half-yearly results before it revealed that accounting errors had led to a loss of €93 million, and a shortfall in earnings in three years. This company has a significant shareholder, with a 22% stake and 35% of voting

rights (http://www.iht.com, January, 2005). This shows that shareholder associations can be useful in protecting minority interests against large shareholders.

*Reforming annual general meetings*

The organisation of internal corporate decision-making processes plays an important role in helping to protect minority shareholders. For example, it was found in one of the case studies that annual general meetings were used to frustrate minority shareholders' attempts to enforce discipline on management and directors. The position of the chairman of the annual general meeting is crucial here. When the chairman of the meeting is also a director, he may have an interest in protecting the board from shareholder criticisms. It is recommended that the organisation of annual general meetings be reformed to allow shareholders the possibility of exercising their power. The chairman of the annual general meeting should not be the chairman of the board or a director but a person independent from management and the board of directors, and should be elected by shareholders for each annual general meeting. This will ensure that all directors, including the board chairman, are made accountable to shareholders. To give effect to this recommendation, regulatory institutions such as CMSA should include this recommendation in the DSE listing requirements.

*Representation of employees*

The requirement in the Company Act 2002, that directors consider the interests of employees equally with those of, shareholders can only be meaningful if employees are represented on the board of directors. BRELA, as a regulatory authority for enforcing company law, should involve itself in realising the "consideration of employee interests" in practice, and seek to include employee representation in law. Trade Unions should actively debate and seek actual representation in the boards of directors to effect this requirement of the law.

*The broader issue of business accountability*

The problem of the accountability of corporations to Tanzanian society has significant implications for the development of corporate governance in Tanzania. Corporate governance should be viewed as a public policy issue, and efforts made to decouple the business decision-making process from the government/political decision-making process. This issue needs to be addressed as part of the broader initiative to promote good governance in Tanzania (Melyoki, 2004).

*Reviewing guidelines for corporate governance*

The assessment of the current recommended guidelines has revealed that they do not address the 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 review of the guidelines should be carried out by CMSA in collaboration with the newly-established Institute of Corporate Governance (TICG). CMSA should also actively encourage companies to implement the recommended guidelines. In addition, CMSA should carry out periodic assessments to determine the extent of compliance by companies as well as periodically reviewing the guidelines. This will encourage self-monitoring and help achieve effective corporate governance as suggested in the corporate governance literature (Chapter 4).

*Future privatisations and corporate governance*
Issues of privatisation which lead to a weak position for a large majority of shareholders should be addressed. It is recommended that future privatisations should consider the position of minority shareholders after privatisation. The understanding reached should be enforced. This is an activity for the Parastatal Sector Reform Commission (PSRC).

*Initiative to develop corporate governance*
The guidelines recommended by the two distinct institutions have a large number of similarities (Chapter 6). This implies that there is duplication of effort by these institutions. The task of promoting and encouraging companies to adopt recommended guidelines, which is currently seen as the preserve of the organisations that have developed them, could be more efficient within a common framework. Institutions interested in corporate governance and accountability can join hands and leverage resources in the development of effective corporate governance. The efforts by CMSA, the National Board of Accountants and Auditors (NBAA) and other organisations to establish the Institute of Corporate Governance (TICG) should be supported to make the institute operational.

**Recommendations concerning boards of directors**
*Developing director independence*
The director independence issue has been identified as a major problem in Tanzania. To address it, the recommendations by CMSA and the Steering Committee on Corporate Governance are relevant and thus supported. 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. The practice as currently used in one of the case companies to limit the number of directors that a single shareholder can appoint (Section 5.3.4) should be encouraged.

*Director evaluations*

It is recommended that companies introduce board evaluations. This is in line with international efforts to improve the effectiveness of boards. Demb and Neubeauer (1992) recommend that boards should introduce director evaluations and feedback. Directors need to establish criteria for evaluating individual directors. The criteria should focus on important issues for the specific company and should be linked to the kinds of decisions and processes necessary for the effective performance of the company. Evaluations should be performed at two levels: the level of the board as a whole, and of individual directors and the CEO. Evaluation criteria need to reflect the actual performance of the people being evaluated, and need to be linked to the criteria for appointing directors. Boards of directors can implement this recommendation.

*Director orientation*

With respect to director orientation, the recommendation by CMSA and the Steering Committee on Corporate Governance on director-orientation is seen as relevant. The evidence from the case studies shows that companies often do not orient newly-appointed directors, or officially introduce them to their jobs. Orientation would provide directors with insights into their roles in the company and could be done by the chairman of the board.

*Board structure*

The findings have shown mixed results with regard to the leadership structure determining the effectiveness of corporate governance. It is recommended that the adoption of a split leadership structure should be evaluated, and its relevance determined, on a case-by-case basis. The CMSA guidelines and those of the Steering Committee on Corporate Governance, which require companies to separate the positions, are only useful in situations where true director independence exists. This is also the case with the constitution and establishment of board committees. A company's board of directors, in collaboration with its shareholders, can address this issue.

**Recommendations for educational institutions**

To recruit from the market requires the development of a market for directors. The cases have shown that companies currently recruit either retired civil servants or current government employees as directors, and these are usually not particularly skilled with regard to private sector issues. This implies that there is need to develop a pool of directors from which corporations can source skilled individuals. Thus there is a need to embark on developing corporate governance through training programmes. This could be addressed by institutions of higher learning, such as universities and colleges, introducing courses on corporate governance. This is consistent with efforts to develop effective corporate governance in other developing countries in transition (OECD, 2003).

## 7.7 Contribution of the research

The World Bank (2000) and Rwegasira (2000) point out that the burgeoning literature on corporate governance focuses mainly on developed countries. This research has contributed to the body of knowledge by providing insights into corporate governance practices in the specific situation of Tanzania, a developing country in transition.

In this research, mechanisms of corporate governance have been identified from the general literature and confronted with the specific Tanzanian situation to determine those that are actually effective in encouraging managers to maximise shareholder wealth. This research strengthens the theoretical base of the emerging literature on corporate governance practices in developing countries, which recognises that this phenomenon is different in these contexts than in developed countries (Lin, 2000; Claessens, 2004; Berglof and Claessens, 2004), by pointing out the limitations of a large number of mechanisms in the context of Tanzania.

The research has identified those mechanisms that currently determine effective corporate governance in Tanzania, and these were empirically investigated and described. It was found that ownership structure is an important determinant of corporate governance in Tanzania and this supports the view in the emerging literature on corporate governance in developing countries, in which it is posited that this is the most important mechanism (Berglof and Claessens, 2004). Specific suggestions are included for improving corporate governance practices in Tanzania (Section 7.6.2).

The intertwinement of corporate decision-making processes with those of government political processes has been highlighted in this research. This results from the inclusion of senior civil servants on the boards of directors of corporations. This reveals fundamental accountability problems between business and Tanzanian society and makes the improvement of corporate governance a difficult task. In this, this research establishes that corporate governance practices in Tanzania have similarities with those of other developing countries in transition noted by Oman et al. (2003) and OECD (2003).

An explication of an appropriate explanatory model for effective corporate governance in Tanzania, as a developing country, has been made. Since most developing countries share a number of characteristics, e.g. weak legal and regulatory frameworks and undeveloped capital markets, the model developed in this research could be tested in another developing country.

In this research, the guidelines for effective corporate governance recommended by CMSA and the Steering Committee on Corporate Governance in Tanzania have been reviewed and challenged as regards their relevance in addressing the core corporate governance problem in Tanzania: the potential expropriation of minority shareholders by large ones. This should be the basis for improving these guidelines to fit the context

of Tanzania.

A comparison of the empirical findings from this research and the recommended guidelines has been made, and areas in which companies need to improve current practices to fully comply with the guidelines identified. These include the independence of directors, formal evaluation of directors and the orientation of newly-appointed directors and director training. This could be the basis for companies to reform and further improve their corporate governance practices.

The research has highlighted the need to consider the implications of privatisation for corporate governance and the subsequent position of a large number of shareholders in the decision-making processes. It has pointed out that privatisation through strategic investors weakens local shareholders, rather than empowering them, and exposes them to the expropriation problem.

## 7.8 Issues for further research

*Survey research*

This study has employed a case study approach focusing on companies listed on the Dar es Salaam stock exchange. The results highlighted general issues which, to a certain extent, are also valid for companies considering listing on the Dar es Salaam stock exchange. Further research with a study based on a survey, particularly with respect to non-listed firms, will provide a stronger base for generalisation over a wide range of companies.

*International comparison*

This research can also be extended by using the same methodological approach in a different setting/country and then comparing the findings. This will generate additional insight on the general development of corporate governance in developing countries.

*The role of government directors in privately-controlled companies*

The issue of government directors in privately owned or controlled companies has emerged in this research. In each of the privatised companies in Tanzania, the government still retains a certain level of ownership. These shares entitle the government to representation on the boards of these corporations. However, this research has shown that major shareholders (usually foreign, multinational companies) dominate decision-making processes. The issue of the role of a government-appointed director in a company controlled by a major shareholder is not addressed in detail. Research in this area would shed more light on corporate governance in Tanzania.

*The problem of accountability between business and society*

The inclusion of senior civil servants on the decision-making boards of companies controlled by private shareholders highlights problems in the accountability of business

to society. Further research on this issue should to provide additional insights into corporate governance practices and accountability in Tanzania.

*Practical application of the notion of stakeholding in Tanzania*

The notion of stakeholding in Tanzania is one that is discussed widely with respect to the public sector but also in the context of privately-owned companies. The Company Act of 2002 introduces the notion of stakeholding to all companies by requiring directors to consider the interests of employees as one of their duties and to treat these in addition to those of shareholders. Despite this, 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.

*Motivation for implementing the recommended guidelines*

Research could also be carried out to gain insights about the motivation, if any, for companies to adopt and implement the recommended guidelines recommended by the CMSA or those by the Steering committee on Corporate Governance in Tanzania.

*Corporate governance in SMEs*

This research has focused on large listed companies only. Similar research could be adapted and applied in the context of small and medium size enterprises.

*Applying the OECD Principles to assess corporate governance in Tanzania*

The OCED principles for effective corporate governance discussed in Chapter 3 can be applied as a framework for the 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.

*Research in other sectors of the economy*

This research focused on industrial corporations. Research on corporations operating in other sectors such as the financial sector, the public sector and executive agencies, which are a recent phenomenon, is expected to provide additional insights on corporate governance practices in Tanzania.

# REFERENCES

Alchian, A.A. and Demsetz, H. 1972. Production, information costs, and economic organization. In Barney, J. B. and Ouchi, W. G. (Eds.). 1988. *Organisational economics: Toward a new paradigm for understanding and studying organizations*. San Fransisco, London: Jossey-Bass Publishers.

AMA. 2003. *American Management Association, corporate governance survey.*

Amani, H. K.R. 1992. Agricultural market reforms in Tanzania: Evolution, performance and future policy issues, in Bagachwa M.S.D, Mbele, A.V.Y, Van Arkadie, B (Eds.), *Market reforms and parastatal restructuring in Tanzania*. Dar es Salaam: Economic Research Bureau.

Auerbach, N.E. 1973. Audit commitees: New corporate institution. In Tricker R.I (Ed.). 2000. *History of management thought: Corporate governance.* Aldershort, Burlington USA, Singapore, Sydney: Ashgate Publications Limited.

Bagachwa M.S.D., Mbele, A.V.Y. and Van Arkadie, B. (Eds.). 1992. *Market reforms and parastatal restructuring in Tanzani.* Dar es Salaam: Economics Research Bureau.

Bagachwa, M.S.D.1992. Background, evolution, essence and prospects of the current economic reforms in Tanzania. In Bagachwa M.S.D, Mbele, A.V.Y, and Van Arkadie, B. (Eds.), *Market reforms and parastatal restructuring in Tanzania*. Dar es Salaam: Economic Research Bureau.

Bakari, A.H. 1993. *Economic reforms and the state of the law in Tanzania: A compromise or conflict? The case of banks and financial institutions*. Paper presented at a conference on: On the Road to a Market-based Economy in Tanzania, Dar es Salaam.

Barney, J.B. and Ouchi, W.B. (Eds.). 1988. *Organisational economics: Toward a new paradigm for understanding and studying organisations.* San Fransisco, London: Jossey-Bass Publishers.

Baums, T. 1993. Banks and corporate control in Germany. In McCahery, J., Picciotto, S and Scott, C. (Eds.), *Corporate control and accountability.* Oxford: Oxford University Press.

Baysinger, B.D., and Butler, H.N. 1985. Corporate governance and the board of directors: Performance effects of changes in board composition. In Tricker, R.I. (Ed.). 2000. *History of management thought: Corporate governance*. Aldershort, Burlington USA, Singapore, Sydney: Ashgate Publications Limited.

Bebchuk, L. A., Roe, M. J. 1999. *A theory of path dependence in corporate governance and ownership*. Working Paper 13, Columbia Law school, Center for law and economic studies.

Becht, M. 1999. European corporate governance: Trading off liquidity against control. *European Economic Review* (43): 1071-1083.

Berle, A.A and Means, G.C. 1932. The Modern corporation and private property, Précis (1993). In Tricker, R.I. (Ed.). 2000. *History of management thought: Corporate governance*. Aldershort, Burlington USA, Singapore, Sydney: Ashgate Publishing Limited.

Berlof, E and Claessens, S. 2004. *Enforcement and corporate governance.* Draft discussion paper. http://www.gcgf.org, accessed January 2005.

Bradley, M. Schipani, C. A., Sundaram, A.K. and Walsh, J. P. 1999. The purposes and accountability of the corporation in contemporary society: Corporate governance at crossroads. http://www.law.duke.edu/, accessed October 2000.

Brealey, R.A., Myers, S.C, and Marcus, A. J. 1995. *Fundamentals of corporate finance*. New York: McGraw-Hill Inc.

Brennan, M.J.1995b. Corporate finance over the past 25 years. *Financial Management,* 24: 9-22

Burrell, G. and Morgan, G. 1979. S*ociological paradigms and organizational analysis.* Aldershort, Burlington USA, Singapore, Sydney: Ashgate Publishing Limited.

Cadbury, A. 1992. *Codes of best practice: Report from the committee on financial aspects of corporate governance*. London: Gee Publishing.

CACG. 1999. *Principles for corporate governance in the Commonwealth, CACG guidelines.* In Tricker, R.I (Ed.). 2000. *History of management thought: Corporate governance.* Aldershort, Burlington USA, Singapore, Sydney:Ashgate Publications Limited.

Carlsson, R. H. 2003. The benefits of active ownership. *Corporate Governance,* 3 (2): 6-31

Chachage, S. L. C. 2003. *Going beyond rhetoric: Why is Tanzania still poor 40 years after independence?* A keynote address to the annual convocation symposium of the University of Dare-es-Salaam, Dar es Salaam

CIPE. 2002. *Instituting corporate governance in developing, emerging and transitional economies.* http://www.cipe.org, accessed June 2002

Claessens, S. 2003. *Corporate governance and development.* The International Bank of Reconstruction and Development/World Bank, Washington DC.

Clark, B. 1998. *Political economy: A comparative approach*. (2nd ed.). London: Praeger Publishers.

Clarke, T. 1993. Corporate governance: The state of the art. *Managerial Auditing Journal,* 8 (3): 3-7.

Clarke, T. and Clegg, S. 1998. *Changing paradigms: The transformation of management knowledge for the 21st century*. London: HarperCollinsPublishers.

Coarse, R.H. 1937. The nature of the firm. In Barney, J.B and Ouchi, W.G (Eds.). 1988. *Organisational economics: Toward a new paradigm for understanding and studying organisations*. Jossey-Bass Publishers.

Cochran, P.L. and Wartick, S.L. 1988. Corporate governance: A review of the literature. In Tricker, R. I (Ed.). 1994. *Corporate governance: An international review.* Oxford: Blackwell Publishers.

Coffee, J.C. 1999. *The future and history: The process of global convergence in corporate governance and its implications*. Working Paper, Center for Law and Economic Studies, Columbia University.

Conyon, M., Gregg, P., Matchin, S. 1995. Taking care of business: Executive compensation in the United Kingdom. In Tricker, R.I (Ed.). 2000. *History of management thought: Corporate governance.* Aldershort, Burlington USA, Singapore, Sydney: Ashgate Publications Limited.

Crouch, C. and Marquand, D. (Eds.) 1993. *Ethics and markets: Cooperation and competition within capitalist economies.* Oxford: Blackwell Publishers.

Cyert, R. M. and March, J. G. 1963. *A behavioural theory of the firm.* N.J, Eaglewood Cliffs: Prentice-Hall, Inc.

Daily, C., Dalton and D.R. 1997. Separate, but not independent: Board leadership structure in large corporations. *Corporate Governance,* 5 (3): 126-136.

Demb, A. and Neubauer, F.-F. 1992. The corporate board: Confronting the paradoxes. In Tricker R.I (Ed.). 2000. *History of management thought: Corporate governance.* Aldershot: Ashgate Publishing Limited.

Denise, K.D. 2001. Twenty-five years of corporate governance research … and counting. *Review of Financial Economics,* 10: 191-212.

Denise, K.D and McConnell, J.J. 2003. *International corporate governance.* Working Paper No 05/2003. http://www.ecgi.org/wp, accessed October 2003.

Djankov, S.,Glaeser, E., LaPorta, R., Lopez-de-Silanes, F. and Shleifer, A. 2003. *New comparative economics.* World Bank Policy Research Working Paper, 3054.

Donaldson, L. and Davis, J. H. 1991. Stewardship theory or agency theory: CEO governance and shareholder returns. *Australian Journal of Management,* 16 (1).

Donaldson, L., Davis, J. H. 1994. Boards and company performance: Research challenges the conventional wisdom. In Tricker, R.I (Ed.). 2000. *History of management thought: Corporate governance.* Aldershot: Ashgate Publishing Limited.

Dore, R. 1993. What makes the Japanese different? In Crouch, C. and Marquand, D. (Eds.), *Ethics and markets: Cooperation and competition within capitalist economies.* Oxford: Blackwell Publishers

Dyck, A. 2001. Ownership structure, legal protections, and corporate governance. In Pleskovic, B. and Stern, N. (Eds.), *Annual World Bank Conference on Development Economics 2000.* Washingon: The international Bank for Reconstruction and Development/the World Bank.

Easterbrook, F.H. 1984. Two agency-cost explanations of dividends. *American Economic Review,* 650-659.

Eisenhardt, K.M. 1989. Building theories from case study research. *Academy of Management Review*, 14(4): 532-550.

Eggertsson, T. 1990. *Economic behaviour and institutions: Cambridge survey of economic literature*. Cambridge: Cambridge University Press.

Etukudo, A. 1999. Issues in privatisation and restructuring in Sub-Saharan Africa. http://www.ilo.org/, accessed November 2000

Fama, E.F.1980. Agency problems and the theory of the firm. *Journal of Political Economy*, 88 (2): 288-307.

Fama, E.F. and Jensen, M.C. 1983. Separation of ownership and control. In Tricker, R.I (Ed.). 2000. *History of management thought: Corporate governance*. Aldershot: Ashgate Publication Limited.

Fischer, C. and Lovell, A. 2003. *Business ethics and values*. London: Pearson Publishers.

Frederick, R. 1999. Corporate governance and the OECD. *Accounting and Business,* June: 26-27

Freeman R. E. and Evans, W. M. 1990. Corporate governance: A stakeholder interpretation. *Journal of Behavioural Economics,* 19 (4): 337-359.

Garrod, N. 2000. Environmental contingencies and sustainable modes of corporate governance. *Journal of Accounting and Public Policy*, 19: 237-261.

Gathinji, N. 2002. *The role of ECSAFA in promoting corporate governance in member countries.* Paper presented at the International Seminar on: Corporate Governance and Development of Appropriate National Codes Programme, Dar es Salaam.

Gillham, B. 2000. *Case study research methods.* London: TJ International Ltd.

Gilpin, R. 2001.*Global political economy: Understanding the international economic order.* Princeton, New Jersey: Princeton University Press.

Grant, G. H. 2003. The evolution of corporate governance and its impact on modern corporate America. *Management Decision,* 41 (9): 923-934.

Gummesson, C. 2000. *Qualitative methods in management research*. (2nd ed.). Thousand Oaks, London, New Delhi: Sage Publications.

Hart, O. 1995. Corporate governance: Some theory and implications. *Economic Journal*, 105(430): 678-689.

Hartmann, J. 1990. The rise and rise of private capital. In O'Neill, N. and Mustafa, K.(Eds.), *Capitalism, socialism and the development crisis in Tanzania.* Aldershot, Bookfield USA, Hong Kong, Singapore: Grower Publishing Company Limited.

Hazanaki, M. and Liu, Q. 2003. *The Asian crises and corporate governance: Ownership structure, debt financing, and corporate diversification.* CEI Working Paper Series, No. 2003-18.

Herman, E. S. 1981. *Corporate control, corporate power: A Twentieth century fund study.* Twentieth Century Fund, Inc.

Hoa, T.V. 2000. *The Asian financial crisis: Causes, impact, governance and prospects.* IBRI Working Paper No.7. Paper presented at the London School of Economics, Centre for Study of Global Governance conference on: Financial Crises and Global Governance.

Holderness, C.G. and Sheehan, D.P. 1988. The role of majority shareholders in publicly held corporations: An exploratory analysis. *Journal of Financial Economics,* 317-346.

Hollis, M. 2000. *The philosophy of social science: An introduction.* Cambrigde: Cambridge University Press

Hopt, K. J and Leyens, P. C. 2004. *Board models in Europe. Recent developments of internal corporate governance structures in Germany, the United Kingdom,*

*France and Italy*. Working Paper No 18/2004. http://www.ecgi.org/wp, accessed January 2005.

Jarrell, G.A and Poulsen, A. B. 1988. Dual-Class recapitalisations as antitakeover mechanisms: The recent evidence. *Journal of Financial Economics,* 129-152.

Jensen, M. C. 1993. The modern industrial revolution, exit, and the failure of internal control systems. *Journal of Finance*, 48 (3): 831-880.

Jensen, M. C. and Meckling, W.H. 1976. Theory of the Firm: Managerial behaviour, agency costs and ownership structure. In Barney, J. B. and Ouchi, W. G.(Eds.). 1988. *Organisational economics: Toward a new paradigm for understanding and studying organisations*. San Fransisco, London: Jossey-Bass Publishers

Jensen, M. C. and Murphy, K. J. 1990. Performance pay and top management incentives. *Journal of Political Economy*, 98 (2): 225-264

Jensen, M. C. and Ruback, R. S. 1983. The market for corporate control: The scientific evidence. *Journal of Financial Economics,* 5-50.

Jensen, M. C and Warner, J. B. 1988. Distribution of power among corporate managers, shareholders and directors. *Journal of Financial Economics,* 2-24.

John, K. and Senbet, L. W. 1998. Corporate governance and board effectiveness. *Journal of Banking and Finance,* 22: 371-403.

Kaplan, S. N. and Rishus, D. 1990. Outside directors and corporate performance. *Journal of Financial Economics,* 27 (2): 389-410.

Kay, J. and Silberston, A. 1995. Corporate governance. In Tricker, R.I (Ed.). 2000. *History of management thought: Corporate governance.* Aldershort, Burlington USA, Singapore, Sydney: Ashgate Publication Limited.

Keat, R. 1993. The moral boundaries of the market. In Crouch, C. and Marquand, D. (Eds.), *Ethics and markets: Co-operation and competition within capitalist economies.* Oxford: Blackwell Publishers.

Kendal, N. and Sheridan, T.1991. *Finanzmeister, financial manager and business strategist.* London: Pitman Publishing.

Kester, W.C. 1994. Industrial groups as systems of contractual governance. In Tricker R.I (Ed.). 2000. *History of management thought: Corporate governance*. Aldershort, Burlington USA, Singapore, Sydney: Ashgate Publication Limited.

Kihiyo, H. 2002. *Corporate governance and corruption- the case of Tanzania, governance and corruption in parastatals*. Paper presented at the International Seminar on: Corporate Governance and Development of Appropriate National Codes Programme, Dar es Salaam.

Kiondo, A.S.Z. 1993. *Political implications of Tanzania's economic reforms: 1982-1992*. Paper presented at a conference on: On the Road to a Market-based Economy in Tanzania, Dar es Salaam.

Kiure, N. J. 2002. *Corporate governance practices in Tanzania: An exploratory study.* MBA dissertation, University of Dar es Salaam.

Kothari, C.K. 1985. *Research methodology: Methods and techniques*. (2nd ed.). New Delhi: Wiley Eastern Limited.

La Porta, R., Lopez-de-Silanes, F., Shleifer, A., and Vishny, R. W. 2000. Investor protection and corporate governance. *Journal of Financial Economics,* 58:3-27.

La Porta, R., Lopez-de-Silanes, F., Shleifer, A. and Vishny, R.W. 1997. Legal determinants of external finance. *Journal of Finance,* 52: 1131-1150.

Lazonick, W. and O'Sullivan, M. 2000. Maximising shareholder value: A new ideology for corporate governance. *Economy and Society*, 29, (1): 13-35.

Lazonick, W. and O'Sullivan, M. 2000. *Corporate governance: Innovation and economic performance.* Report presented to the European Institute of Business Administration (INSEAD), Boulevard de Constance.

Letza, S., Kirkibride, J. and Sun, X al. 2002. *Shareholding versus stakeholding: A Critical review of Corporate Governance.* Paper presented at Queen's University Belfast International Conference for Corporate Governance, Belfast.

Lin, C. 2000. *Public vices in public places: Challenges in corporate governance development in China*. OECD Development Centre, informal workshop on Corporate Governance in Developing Countries and Emerging Economies.

Lipumba, N. H. I. 1992. Nature and prospects of current economic reforms in Tanzania: An overview. In Bagachwa M.S.D, Mbele, A.V.Y and Van Arkadie, B. (Eds.), *Market reforms and parastatal restructuring in Tanzania.* Dar es Salaam: Economic Research Bureau.

Lorch, J. and MacIver, E. 1989. *Pawns or potentates: The reality of American corporate boards.* Cambridge, MA: Harvard University Press.

Maassen, G.F. 1999. *An international comparison of corporate governance models.* Ph.D. dissertation, Elst.

Mace, M.L. 1971. The president and the board of directors. In Tricker R.I (Ed.). 2000. *History of management thought: Corporate governance.* Aldershort, Burlington USA, Singapore, Sydney: Ashgate Publishing Limited.

Manne, H.G. 1965. Mergers and the market for corporate control. In Tricker, R.I. (Ed.). 2000. *History of management thought: Corporate governance.* Aldershort, Burlington USA, Singapore, Sydney: Ashgate Publishing Limited.

March, J.G. and Simon, H.A. 1958. *Organisations*. New York: Wiley.

Marquand, J. 1993. Human resources and human ingenuity. In Crouch, C. and Marquand, D. (Eds.), *Ethics and markets: Co-operation and competition within capitalist economies.* Oxford: Blackwell Publishers.

McColgan, P. 2001. Agency theory and corporate governance: A review of the literature from the UK perspective, http://accfinweb.account.strath.ac.uk/, accessed April 2003.

Melyoki, L. L. 2004. Corporate governance in Tanzania: some recent developments and the remaining challenges. *The Accountant*, 17 (3): 20-32.

Miliband, D. 1993. The new politics of economics. In Crouch, C. and Marquand, D. (Eds.), *Ethics and markets: Co-operation and competition within capitalist economies.* Oxford: Blackwell Publishers.

Mintzberg, H. 1984. Who should control the corporation? In Tricker R.I. (Ed.). 2000. *History of management thought: Corporate governance.* Aldershort, Burlington USA, Singapore, Sydney: Ashgate Publishing Limited.

Morck, R., Shleifer, A. and Vishny, R.W. 1988. Management ownership and market valuation: An empirical analysis. *Journal of Financial Economics,* 20: 293-315.

Monks R.A.G. and Minow, N. 2000. *Relationships investing*. http://www.lens-library.com, Accessed September 2000.

Monks R.A.G. and Minow, N. 2002. *Corporate governance* (2nd ed. (reprint)). Oxford: Blackwell Publishing Ltd

Moldoveanu, M. and Martin, R. 2001. *Agency theory and the design of efficient governance mechanisms*. A report prepared for the joint committee on corporate governance, Toronto.

Mmuya, M. 1998. *Tanzania political reform in eclipse: Crises and cleavages in political parties.* Dar-es-Salaam: Friedrich Ebert Stiftung.

Mndolwa, E.B., Binamungu, C.S. and Kashonda, M.A. 2002. The Companies Act (No 12) of 2002 and the peoples expectations: The mismatch and missed opportunities; accounting, liquidation and governance aspects of the law, *The Accountant*, 15 (1): 19-28.

Mukangara, D. R.1993. *Market reforms and industrialisation policies with reference to Tanzania*. Paper presented at a conference on: On the Road to a Market-based Economy in Tanzania, Dar es Salaam.

Mtatifikolo, F. P. 1992. The social context of reforms: Poverty and poverty alleviation in Tanzania. In Bagachwa M.S.D, Mbele, A.V.Y, and Van Arkadie, B. (Eds.), *Market reforms and parastatal restructuring in Tanzania.* Dar es Salaam: Economic Research Bureau.

Mwapachu, J.V. 1983. *Management of public enterprises in developing countries: The Tanzania experience.* New Delhi, Bombay, Calculat: Oxford & IBH Publishing Co.

Ngemera, A. R. 1993. *Parastatal performance in Tanzania: the case for restructuring of the industrial parastatal enterprises*. Paper presented at a conference on: On the Road to a Market-based Economy in Tanzania, Dar es Salaam.

Nyangetera, B.M. 1992. Reforming and restructuring the financial sector in Tanzania. In Bagachwa M.S.D, Mbele, A.V.Y, and Van Arkadie, B (Eds.), *Market reforms and parastatal restructuring in Tanzania.* Dar es Salaam: Economic Research Bureau.

Nyerere, J.K. 1968. *Freedom and socialism.* Arusha: Oxford University Press.

OECD. 1999. *The OECD principles of corporate governance*. http://www.oecd.org, accessed September, 2000.

OECD .2003. *White paper on corporate governance in South Eastern Europe.* http://www.oecd.org, accessed November, 2003.

OECD. 2004. *The OECD principles of corporate governance*. http://www.oecd.org, accessed June 2004.

Okeahalam, C. C. and Akinboade, O.A. 2003. *A Review of corporate governance in Africa: Literature, issues and challenges*. Paper presented for the Global Corporate Governance Forum, the Hague.

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

Pape, J. 1999. *Commercial lending in different corporate governance systems.* Ph.D. dissertation, Enschede.

Patton, E. and Appelbaum, S.H. 2003. The case for the case studies in management research. *Management Research News*, 25(5): 60-71.

Perrow, C. 1994. Economic theories of organisations. In Wheeler, S. (Ed.), *A reader on the law of the business enterprise, selected essays.* Oxford: Oxford University Press

Peters, J. F. M. 1997. *Corporate governance in the Netherlands: Forty recommendations.* Amsterdam.

Pratt, C. 1976. *The critical phase in Tanzania 1945-1968: Nyerere and the emergence of a socialist strategy.* Cambrigde: Cambridge University Press

Pfeffer, J. 1972. Size and composition of corporate boards of directors: The organisation and its environment. In Tricker R.I (Ed.). 2000. Aldershort, Burlington USA, Singapore, Sydney: *History of management thought: Corporate governance.* Ashgate Publishing Limited.

Prowse, S. 1998. *Corporate governance: Emerging issues and lessons form East Asia*. Paper presented at a Joint ESCAP, World Bank, Asian Development Bank and IMF, Bangkok.

PSCGT. 2003. *3-day Induction course on corporate governance for company directors in Tanzania*, Nairobi.

Remenyi, D., Williams, B., Money, A. and Swartz, E. 1998. *Doing a research in business and management: An introduction to the process and method.* London: Sage Publications Ltd.

Renneboog, L. 2000. Ownership, managerial control and the governance of companies listed on the Brussels stock exchange. *Journal of Banking and Finance* 24:1959-1995.

Roe, M. J. 2003. *Political determinants of corporate governance: Political context, corporate impact.* Oxford: Oxford University Press

RHI. Inc. 2003. *White paper on: The impact of the Sarbanes-Oxley Act on Private Business.*

Rose, P. S. 1997. *Money and capital markets: Financial institutions and instruments in a global marketplace.* ($6^{th}$ ed.). Chicago, Bogota, Boston, Buenos Aires, Caracas, London, Madrid, Mexico City, Sydney, Toronto: McGraw-Hill Companies Companies Inc.

Rowley, J. 2002. Using case studies in research. *Management Research News*, 25(1): 16-27.

Rubach, M.J. and Sebora, T.C. 1998. Comparative governance: Competitive implications of an emerging convergence. *Journal of World Business*, 33 (2): 167-184.

Rugumamu, S. M. and Mutagwaba, B.B. 1999. Entrepreneurship development in Africa: Some reflections from Tanzania. In Rutashobya, L.K and Olomi, D.R (Eds.), *African entrepreneurship and small business development.* Dar es Salaam: Dar es Salaam University Press.

Rwegasira, K. 2000. Corporate governance in emerging capital markets: whither Africa? *Corporate Governance: An International Review,* 8 (3): 258-267**.**

Scott, C. 1993. Privatisation, control and accountability. In McCahery, J., Piccioto, S. and Scott, C. (Eds.), *Corporate control and accountability.* Oxford: Oxford University Press.

Scott, J. 1996. Corporate business: Comparative perspectives. http://privatewww.essex.ac.uk/, accessed September 2000.

Scott, J. 1997. *Corporate business and capitalist classes.* Oxford: Oxford University Press.

Shleifer, A. and Vishny, R.W. 1986. Large shareholders and corporate control, *Journal of Political Economy*, 461-488.

Shleifer, A and Vishny, R. W. 1997. A survey of corporate governance. *Journal of Finance,* 52(2): 737-783.

Simba, I. 2003. *Going beyond the rhetoric: why is Tanzania still Poor 40 years after independence*? Paper presented at the Annual Convocation Symposium of the University of Dar es Salaam, Dar es Salaam

Smith D.G. 1996. Corporate governance and managerial incompetence: Lessons from Kmart. http://www.laclark.edu/, accessed September 2000.

Sloan, R.G. 2001. Financial accounting and corporate governance: A discussion. *Journal of Accounting and Economics*, 32: 335-347.

Stake, R. E. 1995. *The art of case study research.* London: Sage Publications Limited.

Stapledon, G. P. 1995. The structure of share ownership and control: The potential of institutional investor activism. In Tricker, R.I (Ed.). 1999. *History of management thought: Corporate governance.* Aldershort, Burlington USA, Singapore, Sydney: Ashgate Publishing Limited.

Starr, P. 1988. The meaning of privatisation. http://www.princeton.edu, accessed January 1997.

Stiles, P. and Taylor, B. 2002. *Boards at work: How directors view their roles and responsibilities.* Oxford: Oxford University Press

Stulz, R.M. 1988. Managerial control of voting rights: Financing policies and the market for corporate control. *Journal of Financial Economics,* 20 (1): 25-54.

Tam, O. K. 1999. *The development of corporate governance in China*. Cheltenham, Camberley: Edgar Elgar Publishing Limited.

TANU. 1967. *The Arusha Declaration and the TANU's policy on socialism and self-Reliance.*

Tricker, R. I. (Ed.). 1994. *Corporate governance: An international review.* Oxford: Blackwell

Tricker, R.I. 1984. The evolution of the company- how the idea has changed. In Tricker, R.I (Ed.). 2000. *History of management thought: Corporate governance.* Aldershort, Burlington USA, Singapore, Sydney: Ashgate Publishing Limited

Tricker, R.I (Ed.). 2000. *History of management thought: Corporate governance.* Aldershort, Burlington USA, Singapore, Sydney: Ashgate PublishingLimited

Tripp, A. M. 1997. *Changing the Rules: The politics of liberalisation and the urban informal economy in Tanzania.* California: University of California Press

Turnbull, S. 1997. Corporate governance: Its scope, concerns and theories. In Tricker, R. I. (Ed.). 2000. *History of management thought: Corporate governance.* Aldershort, Burlington USA, Singapore, Sydney: Ashgate PublishingLimited

Turnbull, S. 1999.Governance codes are misleading. *Charter*, December:36-37.

URT. 1932. *Companies ordinance (Cap. 212)*, Dar es Salaam: Government Printer

URT. 1991. *The Banking and Financial Institution Act, 1991*. Dar es Salaam: Government Printer

URT.1992. *Public Corporations Act, 1992.* Dar es Salaam: Government Printer.

URT. 1995. *Sheria ya Maadili ya Viongozi wa Umma, Na. 13, ya 1995.* Dar es Salaam: Mpiga chapa wa Serikali.

URT. 1996. *Presidential Commission of Inquiry: Report on the state of corruption in the country.*

URT. 1999. *Development Vision, 2025*; President's office, Planning and Privatisation Commission. Dar es Salaam: Government Printer.

URT. 2000. *Privatisation in Tanzania, annual review 2000/2001 and action plan 2001/2002.* Dar es Salaam: PSRC.

URT. 2002. *Companies Act*, 2002. Dar es Salaam: Government Printer.

URT. 2003. *Small and medium enterprise development policy.* Ministry of Industry and Trade.

URT. 2004. *Economic survey for the year 2003*. President's office, Planning and Privatisation Commission. Dar es Salaam.

URT. 2005. *Economic survey for the year 2004*. President's office, Planning and Privatisation Commission. Dar es Salaam.

URT. 2004. *Economic survey for the year 2003.* President's Office- Planning and Privatisation Commission, Dar es Salaam.

URT. 2005. Macroeconomic Policy Framework for the plan/budget 2005/6-2007/8.

Vafeas, N. 1995. Board meeting frequency and firm performance. *Journal of Financial Economics,* 53:113-142.

Verschuren, P., Doreewaard, H. 1999. *Designing a research project*. Utrecht: Lemma.

Vinten, G. 2003. Enronitis- dispelling the disease. *Managerial Auditing Journal,* 18(6/7): 448-455.

Wangwe, S. M. 1992. Nature and extent of parastatal restructuring: the case of industrial parastatals in Tanzania. In Bagachwa M.S.D, Mbele, A.V.Y. and Van

Arkadie, B (Eds.), *Market reforms and parastatal restructuring in Tanzania.* Dar es Salaam: Economic Research Bureau.

Warioba, J.S. 2003. *Remarks at the opening of the University of Dar es Salaam Annual Convocation Symposium*, Dar es Salaam.

Warner, J. B., Watts, R.L., and Wruck, K.H. 1988. Stock prices and top management changes. *Journal of Financial Economics*, 25-54.

Weimer, J. 1995. *Corporate financial goals: A multiple constituency approach to a comparative study of Dutch, US and German Firms.* Ph.D. dissertation, Enschede.

Weimer, J. and Pape, J. 2000. Inside Western systems of corporate governance. *Executive Talent,* 1 (3), Fall.

Weisbach, M. S. 1988. Outside directors and CEO turnover. *Journal of Financial Economics,* 20 (1/2): 431-460.

Weisskopft, T.E. 1972. Capitalism and inequality. In Edwards R.C., Reich, M and Weisskopf, T.E (Eds.), *The capitalist system: A radical analysis of American society.* Englewood Cliffs: Prentice-Hall, Inc.

Weston, J.F., Chung, K.S., and Hoag, S. E. 1990. *Mergers, restructuring, corporate control.* Englewood Cliffs: Prentice-Hall, Inc.

Williamson, O.E. 1987. The transaction cost approach. *American Journal of Sociology,* 37 (3): 548-577.

Williamson, O.E. 1981. Corporate finance and corporate governance. *Journal of Finance*, 43(3): 567-591.

Williamson, O.E. 1981.The modern corporation: origins, evolution, attributes. *Journal of Economic Literature,* 19 (4): 1537-1568.

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

World Bank. 2002. *Tanzania at the turn of the century: Background papers and statistics*: A World Bank Country Study, Washington.

Yin, R.K. 1994. *Case study research design and method: Applied social research methods Series,* (2$^{nd}$ ed.). Sage Publications.

Zuberi, A. 1993. *Private sector development during the structural adjustment programme (1986-1992)*. Paper presented at the a conference on: On the Road to a Market-based Economy in Tanzania, Dar es Salaam.

***Other websites***

*http://news.bbc.uk/ accessed August, 2003*
*http://www.jei.org, accesses August, 2003*
*http://www.wpkn.org/campaignfinance , accessed April, 2004*

# ADDENDUM

This addendum provides clarifications and further information on some of the issues that have been covered for further elaboration on: how transaction costs economics theory has been used in the thesis, the expropriation thesis that large dividend pay out ratios in three of dividend paying companies point to and the importance of the issue of ethics and moral values as the basis upon which effective corporate governance in Tanzania should be anchored.

## 1. How and extent to which transaction cost economics has been applied

It is stated (Summary and Chapter 7) that transaction cost economics and agency theories have been applied to analyse corporate governance in the Tanzania context. Transaction cost theory in this research has been used to show the limitations of certain governance mechanisms identified in Chapters 3 and 4. Transaction costs are a key justification for not recommending the use of contracts or bonding solutions for resolving governance problems as it would involve writing perfect contracts which is impossible in practice due to transaction costs as well as because of bounded rationality (see Chapter 3).

External mechanisms of corporate governance – i.e. external to the firm such as laws and regulation were not suggested for empirical investigation because the use of such mechanism involves large transaction costs (e.g. courts are expensive and inefficient to address governance problems). Thus, transaction cost economics theory offers an explanation of why 'voice[i]' or state apparatus of violence (e.g. the courts of law and police) generally offer less 'acceptable' ways of exercising discipline over senior management of companies than for example 'exit[ii]'. Thus, whilst shareholders may not actually do the calculations to weigh up the financial pros and cons of going to court versus applying an exit strategy, their behaviour can be interpreted as if they actually do.

Given the limitations of exit options in the case of Tanzania (such as lack of competitive capital markets with efficient systems of information such as those found in developed capital markets of the US and UK - see Chapter 4), it is more fruitful to concentrate on the behaviour of executive management and in particular those mechanisms which offer the prospect of inducing the behaviour of executive management toward attainment of shareholder interests. This has been undertaken through the lens of agency theory. In this sense, transaction cost theory is used to justify focus upon agency theory, but not using transaction cost theory in any more substantial way. Agency theory is so central to an understanding of the many manifestations of

contemporary corporate behaviour, particularly the self-centred managerial behaviour borne of ethical egoism.

## 2. Does the dividend pay out ratios of the companies' researched support the expropriation thesis?

The conclusion in Chapter 7 on the expropriation thesis in the companies researched is a key point of tension. The large dividend payout ratios shown in Table 5.1 for TBL, Table 5.11 for TATEPA and Table 5.16 for TCC point to the expropriation thesis. This issue was raised with the management, directors and some shareholders of these companies as well as regulatory authorities because it was considered unusual to effect such large payout levels. The response was, from the legal point of view, the dividend levels being paid out are not illegal- the Company Ordinance (Cap. 212) empowers directors to propose levels of dividend to the annual general meetings and which must be passed by shareholders. According to the Company Ordinance directors can recommend any amount of dividend as long as there are profits from which the dividends can be declared. Table A of the First Schedule of the Company Ordinance which covers issues concerning regulations for management of a company limited by shares including declaration and payment of dividends (companies covered in this research are all limited by shares) provides for the discretion as stated in the relevant sections of the Table:

> 89. The company in general meeting may declare dividends, but no dividend shall exceed the amount recommended by the directors.
>
> 90. The directors may from time to time pay to the members such interim dividends as appear to the directors to be justified by the profits of the company.
>
> 91. No dividends shall be paid otherwise than out of profits.
>
> 93. The directors may before recommending any dividend, set aside out of the profits of the company such sums as they think proper as a reserve or reserves which shall, at the discretion of the directors, be applicable for meeting contingencies, or for the equalising of dividends, or for any other purpose to which the profits of the company may be properly applied, and pending such application may, at the like discretion either be employed in the business of the company or be invested in such investments (other shares than shares of the company) as the directors may from time to time think fit.

It is useful to note that Table A of the first schedule is one that the minister who is a senior government officer responsible for the application of the Ordinance cannot change. This is consistent with the classical liberal approach to corporate governance in

which the state is not permitted to interfere in the ‘freedom of choice’ of the individuals. It is argued that individuals should be allowed to exercise free choice including in economic spheres provided they do so within the law (see Chapter 2). Therefore in terms of the question of large dividend payouts in the said companies, it can be argued that it is the shareholders who are deciding to take/share among themselves such large portions of profits.

In terms of decision making processes which lead to the approval of dividends, one of the issues on the agenda of each company in the dividend paying companies is the approval of dividends (see Chapter 5). Certainly, annual general meetings are also dominated by large shareholders as stated in the thesis and it can be argued that they would press for large payouts. However, there has not been any reported complaint by minority shareholders on the issue of dividend levels to suggest that they feel large dividend payments could mean a bad future for their companies. It is stated in the thesis that minority shareholders are happy with the situation at TCC because of dividend levels it pays them (see Chapter 5).

As regards the repatriation of profits by foreign firms/persons which is taking place also in three of the companies researched, the Investments Act of 1997 is the relevant law (see Table 2.3). This Act imposes no limitations on the amounts of dividends that can be repatriated. Sec. 21 of this Act states that:

> Subject to this section, a business enterprise to which this Act applies shall be guaranteed unconditional transferability through any authorised dealer bank in freely convertible currency of –
>
> a) Net profits or dividends attributable to the investment;
> b) Payment in respect of loan servicing where a foreign loan has been obtained
> c) Royalties, fees and charges in respect of any technology transfer agreement registered under this Act;
> d) The remittance of proceeds (net of all taxes and other obligations) in the event of sale or liquidation of the business enterprise or any interest attributable to the investment;
> e) Payments of emoluments and other benefits to foreign personnel employed in Tanzania in connection with the business enterprise.

The discussions with management and directors on the issue were even more interesting. They state that these companies are really extensions of large multinationals and therefore keeping some of the reserves at these companies is not necessary because if expansion in terms of additional investments funds is required, funds can easily be obtained from the parent companies. In terms of transaction costs economics theory, it can be argued that generally relatively high profit retention rates might be justified on the basis that it is cheaper to retain profits within the corporation for reinvestment

purposes than to have to repeatedly go to the market to raise capital. However, in a developing economy with low capital formation and a relatively illiquid market as in the case of Tanzania (see Chapter 2) and many other developing economies this argument has less strength and might support the high payout figures displayed in the tables cited.

The other argument used by management to justify large pay out ratios and which has some theoretical appeal, is that profits are the right of shareholders and as long as there are no profitable investment to be pursued, there is not justification for not paying shareholders their moneys. Profits belong to shareholders! The dividend policies of these companies as set out in the prospectuses (which are approved by regulatory authorities) encourage very high levels of dividend payout ratios. These prospectuses state as follow:

- TBL – issued in May 1998: the historical policy of the Group has been to distribute regular and increasing dividends to its shareholders at payout ratio of up to 70% of attributable earnings. Dividends are payable 60 days of approval by the shareholders at the annual general meeting. The directors will review the Groups dividend policy from time to time in light of prevailing circumstances at such time.

- TOL - issued in December 1997: … in the absence of unforeseen circumstances, it is the intention of the directors to continue to recommend dividends in respect of each subsequent financial year of the company and maintain a consistent payout of not less than 50%. However, in determining the appropriate dividend pay out in any particular year, the directors will have regard to the company’s financial situation and anticipated funding needs.

- TCC - issued in September 2000: The Company intends to adopt a progressive dividend policy of distributing over 60% of attributable dividends for 2000, 2001, 2002 (and 50% thereafter) after considering expansion and cash flow requirements.

- TATEPA - issued in October 1999: the historical policy of the Company has been to distribute regular and increasing dividends. The future dividend policy is to distribute at least 50% of the attributable earnings to shareholders. Dividends are payable 60 days of approval by the shareholders at the annual general meeting. The directors will continue to review the Company dividend policy from time to time in light of prevailing circumstances at such time.

Thus, all the four companies have very liberal dividend policies. From these documents, it can on one hand be argued that indeed these companies promised their shareholders these large payouts and are only fulfilling what they promised. On the other hand, the large payouts constitute one of the ways of expropriating profits. Others include transfer pricing between the parent company and the subsidiary one where the parent might charge the subsidiary prices higher than would be paid in a competitive market,

royalties, and payment for management services by subsidiaries. However, the empirical evidence obtained in this research is viewed as not being sufficient to justify a wholesome declaration that expropriation is being pursued in the companies researched. Despite this, attention is drawn to the need to protect minority shareholders because they can potentially be exploited under the existing arrangements.

The large profits which could be ploughed back into the economy and which are now leaving the country as large shareholders are in fact absentee lords, may not augur well for the future of Tanzania. To this issue, attention is drawn to the need for a re-examination of the current corporate governance practices in the Tanzanian context (see Chapter 7).

In summary, the actions of the companies are legal[iii] and reflect the Anglo-Saxon notions of property rights which currently apply to Tanzania which are underpinned by the ethical egoist view of moral behaviour. As pointed out in Chapters 2 and 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 (Cap. 212) represents 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 Schipani (2002) assert that:

> 'The comfortable and traditional characterisation of corporations as profit maximisers within the confines of the law might be insufficient in today's world'.

Basu et al. (2002) cited by Lovell (2005) wrote an open letter to CEOs arguing that capitalism was/is facing a crisis and that simply repeating the mantra 'shareholder interest and only shareholder interests' is not acceptable. This is in light of the ever expanding power of the corporations and the role they play in modern societies (see Chapter 1 of the thesis) especially the threat they pose to democracy in modern states (Lovell, 2005). Bakan (2004) and Christian Aid (2004) both cited by Lovell (2005) posit that the malpractice of large corporations are not confined to just a few rogue, unrepresentative cow boy organisations. This means that such practices are in fact widespread. Lovell (2005) criticises the recent developments in corporate governance in the UK and America to address corporate governance issues as they have tended to take a narrow view of the corporation and argues for the need for this focus to be recognised as a problem and one that is significant.

While the shareholder perspective is being challenged, an alternative perspective - the 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. The King Committee's report on corporate governance states in paragraph 37 that:

> '… it 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' (King, 2002).

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. To put the debate into perspective, the two views of corporate governance can be shown on a continuum with a pure shareholder perspective on one end and a pure stakeholder (communitarian) perspective on the other. Positions on the continuum define the extent of orientation toward either shareholders or stakeholders and reflect the weight accorded to the respective interests in the managerial decision making processes of corporations. Figure 1 presents a pictorial way of viewing these perspectives.

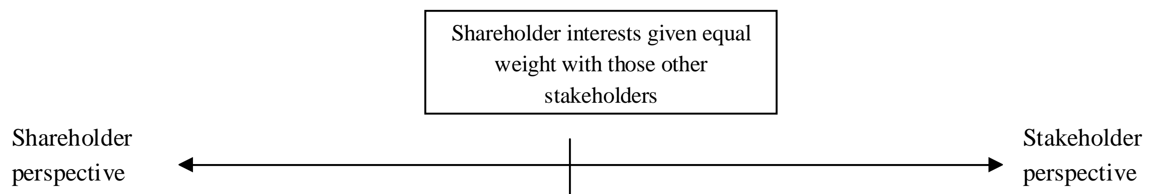



**Figure 1. Perspectives of corporate governance: shareholder versus stakeholder orientation**

As shown in figure 1 a pure shareholder perspective would be one in which other stakeholders' interests are not considered at all in the decision making processes and nothing would constrain shareholder wealth maximisation. This extreme position implies that management would do anything possible to maximise shareholder wealth including such acts a hiring a hitman to murder a key witness against the firm in a major product liability case (Dunfee, 1999). On the other extreme end, management would operate a corporation for the furtherance of social or altruistic objectives with little or no concern for the interests of shareholders.

Some writers argue that in practice there cannot be a purely shareholder approach or a purely stakeholder approach in the extreme sense. For example, Dunfee (1999) observes that no serious writings advocate the extreme positions on the shareholder-stakeholder continuum. This view can be challenged. The ongoing debate

over ‘sweat shop’ involving some corporations can be considered as extreme forms of shareholder orientation. Yet on paper, even the Anglo-American system of corporate governance which is usually considered to be exclusively shareholder oriented, the need to consider the interests of other stakeholders exists. This is reflected in the various state laws to protect consumers such as the Sherman Act, and Clayton Act both of which deal with anti-trust issues and fairness in competition.

Other laws that protect stakeholders include Civil Rights Act which protects employees, the Age Discrimination in Employment Act, the Occupational Safety Act, the Employee Retirement Income Security Act, the Employment Opportunities for Disabled Americans Act and the Employee Polygraph Protection Act. Other laws that protect consumers are Fair Credit Reporting Act, the Consumer Product Safety Act, the Equal Credit Opportunity Act, the Fair Credit Billing Act, the Magnuson-Moss Warranty Act, and the Fair Debt Collection Practices Act (Bradley et al., 1999). The proliferation of laws that try to protect other stakeholders reflect a recognition of the fact that corporations unless limited explicitly through laws may abuse or exploit other stakeholders in attempting to maximise the wealth of shareholders. This reflects the legalistic approach corporate governance in the US.

In addition, there are also attempts to factor in the managerial decision making processes of corporation the interests of other stakeholders. For example, Bradley et al. (1999) observe that a majority of States in the US statutorily permit directors to consider the interests of non-shareholders constituencies in making managerial decisions. These State statutes provide directors with discretion to consider the interests of other stakeholders such as employees, customers, suppliers and the community. For example the New York statute cited by Bradley et al. (1999) provides the following:

> In taking action, including, without limitation, action which may involve or relate to a change or potential change in the control of the corporation, a director shall be entitled to consider, without limitation, (1) both the long-term and short-term interests of the corporation and its stakeholders and (2) the effect that the corporation’s actions may have in the short-term or in the long-term upon any of the following:
>
> (i) the prospects of growth, development, productivity and profitability of the corporation;
> (ii) the corporations current employees;
> (iii) the corporations retired employees and other beneficiaries receiving or entitled to receive retirement, welfare or similar benefits from or pursuant to any plan sponsored, or agreement entered into, by the corporation;
> (iv) the corporation’s customers and creditors; and
> (v) the ability of the corporation to provide, as a going concern, goods, services, employment opportunities and employment benefits and otherwise to contribute to the communities in which it does business.

Nothing in this paragraph shall create any duties owed by any director to any person or entity to consider or afford any particular weight to any of the foregoing or abrogate any duty of the directors, either statutorily or recognised by common law or court decisions.

The American Law Institute (ALI[67]) cited by Bradley et al. (1999) began a corporate governance project in 1979 and defines the objective and conduct of the corporation in the following way:

(a) Subject to the provisions of subsection (b) and § 6.02 (Action of Directors That has Foreseeable Effect of Blocking Unsolicited Tender Offers), a corporation [§ 1.12] should have as its objective the conduct of business activities with a view to enhancing corporate profit and shareholder gain.

(b) Even if corporate profit and shareholder gain are not thereby enhanced, the corporation, in the conduct of its business:
   1. Is obliged, to the same extend as a natural person, to act within boundaries set by the law;
   2. May take into account ethical considerations that are reasonably regarded as appropriate to the responsible conduct of business; and
   3. May devote a reasonable amount of resources to public welfare, humanitarian, educational, and philanthropic purposes.

The above citations show that in terms of intention the issue of shareholder/stakeholder orientation is matter of degree and a model that is 100% shareholder oriented is rare. However, practice shows that some corporations may pursue an extreme form shareholder orientation. Viewed in this way, the efforts of those advocating a communitarian approach can be interpreted as attempts to widen the framework for decision making in corporations. For example, the need for inclusive corporate governance which is recommended by the King Committee in the case of South Africa can be viewed as an attempt to move some steps from the shareholder orientation position toward the stakeholder orientation on the shareholder-stakeholder continuum. It needs to be appreciated that as one moves from the left end toward the right of the continuum complexity and tension associated with attempts to balance the interests of stakeholders is encountered.

Whilst the communitarian approach to corporate governance reflects recognition of the rights of societies (stakeholders) in economic development, it raises the question of where on the continuum the proper position lie or should lie. This question will likely continue to be debated in the corporate governance literature for some time. Fischer and Lovell (2003) provide a range of views as given by various writers on the question of plurality in corporate decision making processes. They note that the views given range from those who argue for theories of decision making that recognise actual human

[67] ALI is a non-profit institute that seeks to simplify and clarify the law in the United States and includes representatives of legal practitioners, the judiciary and academics.

behaviour and instincts to make economic theorising more relevant and realistic to those who see the inclusion of the moral dimensions within business decision making as justifiable on the grounds of the level of ethicality endemic within society as a whole including organisations. Thus different writers including Casson 1991, Maclagan and Snell (1993), Maclagan (1998) all cited by Fisher and Lovell (2003) present varying notions of plurality in decision making processes. Maclagan and Snell argue that society as a whole needs organisational decision-makers who understand and can exercise moral judgement in complex situations. Etzioni (1998) also in Fisher and Lovell (2003) employs a moral justification for recognition of boarder perspectives in decision making processes beyond short-term profit motives.

In practice, the precise location on the shareholder-stakeholder continuum will likely change from time to time to reflect the power bases of the various stakeholders and the importance that will be attached to such concepts as participation, sense of responsibility and individual rights vis-à-vis those of others. This will be a dynamic process. The tension that exists in this approach - that of actually operationalising inclusiveness in practice is recognised in the King's report. In paragraph 5.1 of the reports it is noted that:

> '….. The 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….'

There are writers who do not accept the stakeholder orientation and are continually challenging it. Pritchett, III (1983 cited by Fort and Schipani, 2002) criticises the tendency to ask management to consider the interests of other stakeholders in addition to those of shareholders. These writers argue that doing so might give management a free reign to promote its own self-interest under the guise of promoting social responsibility. Practices regarding inclusive corporate governance vary and range from asking directors/management to reflect these interests in decision making processes to actual representation of these interests in decision making boards of corporations. Even actual representation varies in terms of the percentage of directors that can represent a particular constituency (see Chapter 3). The King's report requires boards of directors to identify company's stakeholders including shareholders and agree a policy on how the relationship with those stakeholders can be managed in the interest of the company. This is in line with the CACG principles of corporate governance discussed in Chapter 3. However, this recommendation does not address the problem fully and indeed leaves a number of questions unanswered. For example, what would be the criteria for selecting particular stakeholders and who should legitimately define such criteria? How much weight to accord to the interests of a particular stakeholder group? Besides agreeing on a policy can be one aspect but questions can be asked regarding the

enforcement of the policy, i.e. do the stakeholders have mechanisms to enforce the policy?

The King (2002) report does not argue for representation of other stakeholders in the decision making processes of companies such as boards of directors as they currently are represented in some countries that embrace the stakeholding conception of corporations such as Germany, Netherlands, Austria and Scandinavian countries. In terms of the continuum in figure 1, corporate governance practices within these countries can be viewed as located on different positions on the continuum with Germany and Japan situated more to the middle while the other countries are located more to the left of the continuum. It was shown in Chapter 3 that stakeholders are involved in corporate decision making processes in varying degrees. The degree of involvement reflects the location of the system on the shareholder-stakeholder continuum.

In the context of Tanzania, it was pointed out in Chapters 2 and 7 that the new legal framework (yet to start being applied) encourages some limited form of stakeholding orientation in the governance of corporations – it requires directors to consider the interest of employees in addition to those of shareholders. The limitations of this approach to achieving stakeholder interest are pointed out in the last chapter of the thesis and actual representation is argued for because this is considered more effective. This is in view of the fact that stakeholder interests usually conflict – for example, large profits/dividends can mean paying employees poor salaries and vice versa. This recommendation can also be viewed as an attempt to move current practices toward a more communitarian perspective.

The implicit assumptions underpinning the requirement for directors to consider the interests of employees (in the case of Tanzania) in addition to those of shareholders need to be understood. It means the corporation is not viewed as one that must achieve the interests of shareholders alone but also of stakeholders who in this case are employees. However, whether these interests should be ranked at par or in order of priority with those of shareholders coming first is a subject of debate. The notion of inclusiveness being advocated in law can be interpreted to mean going beyond the usual 'contract' between employees and the company. But going beyond the contract is tantamount to applying a stakeholding conception of a corporation and not a contractarian one that is highlighted in Chapter 1 and discussed in detail in Chapter 3. The contractarian perspective limits the attention of directors and management to the observance of the terms of contract and not going beyond. Currently this new law only requires employees' interests to be considered but no justification has been given for limiting such consideration to employees' interests. It can thus, be argued that other stakeholders such as suppliers, customers, lenders, Government, and the community also need to have their interests considered.

In conclusion, while the broader perspective is gaining currency, the challenges inherent in it must be recognised. The recommendations given for the further development of corporate governance in Tanzania include those that seek the broadening of the scope of corporate decision making processes to allow for representation of other stakeholders in corporate boards of directors to make corporate governance effectively more inclusive. Realising the challenges that confront the implementation of this perspective, it is further recommended here that debate be initiated to re-examine the current practices and agree on practical ways to make corporate governance more inclusive. This will create the opportunity for assessing large dividend payouts discussed earlier among other things and the long term implications of such developments. It should be noted that dividends represent one way of distributing the benefits/outcomes of business activity.

It is observed in Chapter 2 that the current system of corporate governance in Tanzania and most other developing economies was imposed. Corporate governance did not evolve locally to reflect the local conditions including values and cultural practices. The current approach to develop corporate governance in the Tanzanian context does not seem to recognise this limitation. For example, the principles recommended by the Capital Markets and Securities Authorities (CMSA) do not even mention any of the cultural values that need to be taken into account by directors of corporations in carrying out governance issues. The King Committee recognises the importance of cultural practices and encourages directors of South African Corporations to uphold these values. The King's report states on paragraph 38 that:

> 'Governance in any context reflects the value system of the society in which it operates. Accordingly, it would be pertinent to observe and take account of the African worldview and culture in the context of governance of companies in South Africa, some aspects of which are set out as follows:
>
> 38.1 Spiritual cohesiveness is prized over individualism. This determines the communal nature of life, where households live as an interdependent neighbourhood.
>
> 38.2 An inclination toward consensus rather than dissension helps to explain the loyalty of Africans to their leaders.
>
> 38.3. Humility and helpfulness to others is more important than criticism of them.
>
> 38.4. In the main, African culture is non-discriminatory and does not promote prejudice. This explains the readiness with which Africans embrace reconciliation at political and business levels.

38.5 Co-existence with other people is highly valued. The essence of ubuntu (humanity) that cuts across Africa is based on the premise that you can be respected only because of your cordial co-existence with others.

38.6 There is also an inherent trust and belief in fairness of all human beings. This manifests itself in the predisposition toward universal brotherhood, even shared by African-Americans.

38.7 High standards of morality are based on historical precedent. These are bolstered by the close kinship observed through totem or clan names and the extended family system.

38.8 An hierarchical political ideology is based on an inclusive system of consultation at various levels. The tradition of consultation as practiced by the chiefs since time immemorial should form the basis of modern labour relations and people management practices.

39.9 Perpetual optimism is due to strong belief in the existence of an omniscient, omnipotent, and omnipresent superior being in the form of the creator of mankind'.

The cultural values discussed in the King's report in the context of South Africa are also valid for Tanzania. Chapter 2 of the thesis discusses the path of development in Tanzania since independence to the present time. The Arusha Declaration of 1967 was described as a formal recognition of the way economic development needed to be achieved within the context of the African values of being society-oriented and in which the state was viewed as having a key role to play. While changes have been taking place, including introduction of a system of economic coordination that tends to encourage individualism, the values outlined in the Kings report still underpin daily economic relationships including within corporations in Tanzania. For example, employment practices in Tanzania that tend to be based on kinship (see Kihiyo, 2002) largely reflect the communal type of life that prevails in this context. This means these values need to be reflected more in the efforts to develop corporate governance. In reviewing the corporate governance principles by CMSA and other similar initiatives, these values need to be stressed more forcefully.

## 3. The importance of ethics and values in underpinning effective corporate governance

Ethics and values are important aspects that deserve adequate attention especially because they form the bedrock on which effective corporate governance should be based. A summary of the key variables in the thesis which form the basis of the final

recommendations are displayed in Table 4 (Chapter 4). The checks and balances reflected in the table all represent external forms of discipline (external that is in terms of the individual). Internal forces, such as ethics and values, are noticeable by their absence. This is because in the current state of economic, social and political development in Tanzania, these elements are unreliable and inappropriate as forms of discipline in contemporary Tanzanian corporate governance. They are currently weak and hence their irrelevance in answering the central research question in this research.

The levels of corruption pointed out by Judge Warioba, clearly show that ethics and values are weak aspects in Tanzania (Chapter 4). The ongoing presidential, parliamentary and councillorship campaigns for the October, 2005 elections as reported in the media are tainted with corruption. Yet, this is a strange phenomenon because people (at least in Tanzania) complain about it when they are not part of the system of power but when they join it, they do the same things they have been complaining about as 'outsiders' (with respect to the system of power). So this moral decay has a way of feeding and perpetuating itself. This means a sound ethical base for effective corporate governance is lacking in Tanzania and presents a major challenge to implementation of other initiatives that could lead to development of effective corporate governance including development and enforcement of laws that protect minority shareholders. This challenge is alluded to under the discussion on the problematic business-society relationship. The weak moral base could also explain why foreign investors prefer/tend to acquire majority shareholding in companies they invest in so that they have more or less a final say on issues including of hiring and replacing senior management as well as directors. The prevalence of a weak moral base in the Tanzanian context despite the existence of values cited in the King's report and which are argued to also apply to this context presents a 'paradox' and calls for an empirical investigation.

The issue of poor accountability of business to society pointed out in the last chapter are part of the weak ethical/moral values in Tanzania involving highly placed people in society's system of political/government power. The appointment by a private South African Company of the Speaker of the National Assembly to board chairmanship of its subsidiary in Tanzania is an interesting example given in Chapter 7. Whilst most people think the appointment is not appropriate, the Speaker is not touched by these concerns. His refusal to see the inappropriateness can be interpreted as a reflection of a weak ethical/moral base. Still no body came out in the government system to criticise/ discuss this issue. Even the media did not give this issue wide coverage as it would have done in Europe or America. Again, this shows that internal forces of constraints to behaviour are weak and cannot be expected to be the source of discipline in corporate life (as corporate life is part of broader social life) hence the need to focus on external forces (in terms of the individuals) or mechanisms of control for inducing appropriate behaviour as displayed in Table 4 in the thesis. This means for Tanzania as in many other places in the world, these internal forces need to be

developed. A recommendation is given for decoupling governmental/political decision making processes from those of business as a way of enhancing business accountability to society via government. There needs to be a debate around the decoupling of government decision making processes from those of corporations to take into account the ethicality/morality of such initiative.

**Conclusion**

The foregoing discussions imply that the approach to corporate governance in the Tanzanian context to develop checks and balances need to be formal, transparent, and legally enforceable. A similar approach is recommended in the King (2002) report with respect to the appointment of directors (see paragraph 2.2.2 of the report). This approach to corporate governance is different from the approach in the UK where the approach particularly with respect to recommended principles is ‘comply or explain’. The recommended approach in the Tanzania context fits more with the legalistic American approach to corporate governance (see Chapter 3 on the discussion on Sarbanes Oxley Act, 2002).

For further development of corporate governance, the various options that exist in terms of disciplining effects can be viewed as ranging from the internally (within individuals) generated principal- based ethics, those based within organisations but external to an individual including ownership structure, boards of directors, contracts and performance based incentives to the numerous sources external to a firm. Mechanisms external to the firm include legal and regulatory framework (including the courts of law), and markets (and their robustness, liquidity). Various other mechanisms which have disciplining effect on management of corporations include various media forms, pressure groups; other governments – (development partners[iv]), including inter-governmental organisations (such as IMF, World Bank and WTO) national and supra-national bodies (such as OECD and CACG). Table 1 presents a summary of various options that can be considered for further development of corporate governance in Tanzania as well as the assessment of each option. It is against this background assessment that recommendations for further development of corporate governance were made.

**Table 1. Summary of the various governance mechanisms**

| **Broad Category** | **Typical forms** | **Assessment of their effectiveness currently in Tanzania** |
|---|---|---|
| Internally (within individuals) generated forces/mechanisms of control | Principles based ethics and values | Currently weak and unreliable for effective corporate governance. There is need to evolve sound ethics which should underpin effective corporate governance. |
| Externally based forces/mechanisms of control | Outside the firm<br>- Laws and regulations<br>- Competitive markets for capital, product and labour | Enforcement is a major problem in the case of laws and regulations. Some laws are dated and need revising (Chapter 2). Capital markets are underdeveloped; product markets are still developing but generally considered not effective in controlling poor behaviour of managers and; labour markets are not competitive and hence not effective (Chapter 4). |
| | Within the firm<br>Ownership structure | Ownership structure is the main feature and key mechanism of control in the companies researched (Chapters 2 and 5). This mechanism is both a solution and a problem. It creates opportunities for extraction of private benefits. This calls for protection of minority shareholders. |
| | Boards of directors | The effectiveness of boards varies in the companies but also depends on the involvement of large shareholders. Various factors influence the effectiveness (Chapters 4, 5). Currently representation is limited to shareholders only. Representation of other stakeholders especially employees is advocated. This is shifting the boundaries of governance to include other stakeholders. This view is in line with the Tanzania development vision where inclusion is argued for (Chapter 2) |
| | Contracts | Not effective mechanisms because of transaction costs and also because they depend on enforcement which is weak in the Tanzanian situation (Chapters 3 and 4). |

| **Broad Category** | **Typical forms** | **Assessment of their effectiveness currently in Tanzania** |
| --- | --- | --- |
| | Performance based incentives | These are judged as not currently effective because they depend on the development of markets. These may become important as competitive capital markets develop. |
| | Role of pressure groups and media | Pressure groups interested on corporate governance are yet to evolve in Tanzania. The media is developing but needs to be sensitised on corporate governance issues to enhance monitoring and reporting on these issues. |
| | The role of national bodies | National bodies are increasingly taking interest in corporate governance initiatives mainly the National Board of Accountants and Auditors (NBAA). An institution has been formed to spearhead development of corporate governance in Tanzania – the Tanzania Institute of Corporate Governance (TICG). It has yet to begin working on its mission. |
| | Government – Inter-governmental organisations- (i.e. IMF, World Banks, WTO) and Supra-national bodies and development partners) | The influence of inter-governmental organisations, Supra-national bodies and development partners on corporate governance can be significant in a donor dependent country like Tanzania. Currently corporate governance has not been viewed by the donor community as urgent. The broad governance issue mainly in the public sector domain is seen as important and efforts are directed at fighting corruption although this is still rampant. |
| | | Intergovernmental organisations, supra-national bodies and other development partners can support local initiatives to develop corporate governance and the underlying sound ethics. |

| Broad Category | Typical forms | Assessment of their effectiveness currently in Tanzania |
|---|---|---|
| | | The interest of these organisations in the development of corporate governance needs to be moderated because they may not necessarily be interested in a system that fits the Tanzania society but one that may benefit the large corporations which are usually behind them. Lovell (2005) provides examples of situations which should give cause for concern in this regard. |

Table 1 shows that mechanisms for encouraging sound behaviour within corporations need to be developed at the level of an individual, firm and the overall context in which corporations operate. Moreover, corporate governance needs to be made to become inclusive. The new Company law in Tanzania has made a step toward this direction but more still needs to be done to actually achieve inclusiveness in practice. The ethical and moral justification for this notion of corporate governance is that it is more in line with the values of the Tanzanian society and the African in general. These values are well captured in the King (2002) report discussed earlier. In addition, the unacceptable focus on shareholders in corporate decision making processes as pointed by Bakan (2004), Christian Aid (2004) and Lovell (2005) provide a moral justification for making governance of corporations more inclusive. As pointed out by these authors, the power of modern large corporations and the effect of their activities on society provide a moral justification for involving other stakeholders in the decision making processes of corporations because their well being is at stake. For Tanzania as in other countries, the extent to which corporate governance practices can move toward the stakeholder end of the shareholder-stakeholder continuum need to be actively debated urgently.

**References:**

Lovell, A. 2005. *Some thoughts on amoral, apolitical, corporate governance*. Paper to be presented at Queens University, Belfast

Fort, L. T. and Schipani, C. A. 2002. Adapting corporate Governance for sustainable peace. *Vandebilt Journal of Transnational Law*, 36, 377- 426

Dunfee, T. W. 1999. Corporate Governance in a market with morality. www.law.duke.edu/, accessed October, 2005

# APPENDIX 1 DATA COLLECTION AT THE COMPANIES

## Tanzania Breweries Limited (TBL)

This case study was initially conducted during Autum 2002 and additional data were collected during March 2003 and December 2004. Twelve people were formally interviewed including: one quasi-executive director, two non-executive directors and the company secretary. These interviewees are also shareholders in the company. However, they were interviewed in their capacity as directors and officers of the company. Two representatives of institutional shareholders and five individual shareholders were also interviewed. Interviews were held with officers from the Capital Market and Security Authority (CMSA) and the Dar es Salaam Stock Exchange (DSE) provided additional insights on the company. A number of informal interviews were also held with people in Tanzania who had specific knowledge about the company. Observations of the company were made at a shareholder extraordinary meeting and by examining videocassettes of annual general meetings held in previous years. Company records referred to include extracts from internal files, prospectuses, annual reports, and a circular to shareholders. Records maintained by the DSE were also consulted.

## Tanzania Oxygen Limited (TOL)

This case study was conducted in October 2002, December 2003 and in December 2004. The techniques applied for data collection were similar to those employed in the preceding company. The checklist supported open interviews and observations were applied. Fourteen formal interviews were held including with the chief executive officer, the company secretary and five non-executive directors. A number of shareholders were also interviewed. Interviews with officers from CMSA and DSE were also helpful in understanding the governance processes of the company. Each of the interviews lasted for one and half hours. Additional information was obtained from informal interviews with a number of people. Publicly available information, such as the company prospectus, annual reports, and minutes of annual general meetings were accessed and used. Videocassettes of earlier annual general meetings were also used. In addition, the researcher attended the company annual general meeting in 2003. Some information from company files was also accessed and used during this research.

## Tanzania Tea Packers (TATEPA)

This case study was conducted in January 2003, November 2003 and July 2004. Methods applied in colleting data included checklist-based open interviews and a review of company records and publicly available information: the company prospectus, annual reports and internal records were used. Four non-executive directors, who are also senior managers of major institutional investors with shares in TATEPA, the

company secretary and financial controller were also interviewed. Officers from CMSA, DSE and a number of individual shareholders were further interviewed. DSE records provided additional information about the company.

### Tanzania Cigarette Company (TCC)

This case study was initiated in October 2002. Data was also collected in December 2003 and December 2004. Various methods for collecting data were used: checklist-based interviews and review of company documents - annual reports, company prospectuses and company newsletters. People interviewed included: the chief executive officer, who is also chairman of the board, the company secretary, one senior member of management and a non-executive director. The other executive directors were not interviewed because they are only recently employed (less than a year). Attempts to interview the non-executive director who lives in Tanzania were not successful even after a number of initiatives were made. The other non-executive director is based in Geneva and could not be contacted. A number of minority shareholders were also interviewed. Interviews with officers from CMSA and DSE provided additional information about the company. Informal interviews were also held with a number of people, providing further insights into bout the company.

# APPENDIX 2 CASE STUDY PROTOCOL

Determinants of corporate governance in Tanzanian

**Section 1: Dependent variables**

| *Variable indicator* | *Analysis & Conclusions* |
|---|---|
| **i) Board Control** | |
| 1. Ability to hire and replace senior management, especially the CEO<br>2. Setting the CEO's compensation<br>3. Discussing and approving strategy | |
| ***ii) Shareholder Control*** | |
| 1. Access to key information about the organisation<br>2. Influence on the appointment of and access to, key people: the CEO and chairman<br>3. Influence on key decisions of the board/management<br>4. Veto power over decisions<br>5. Direct involvement in the management of the company | |

**Section 2: Independent variables**

| Variable indicator | Analysis & Conclusion |
|---|---|
| **i) Ownership structure**<br>1. Identity of the shareholders<br>2. Percentage of equity shareholding held | |
| **(ii) Board constitution** | |
| 1. Proportion of executive and non-executive directors on the board of directors | |
| **iii) Director independence** | |
| 1. Absence of business relationships between a director and the firm in which he/she is director<br>2. Absence of social relations between board members and CEO<br>3. Procedure for selecting board members | |
| **(iv) Board leadership structure** | |
| 1. The separation/combination of the positions of the CEO and board chairman | |
| **v) Board meeting** | |
| 1. Procedures for running meetings | |
| 2. Information to directors before meeting date | |
| 3. Formal evaluation of board members and board activities | |
| **vi) Board audit Committee** | |
| 1. Resolution to establish board committees | |
| 2. The constitution of committee (types of directors) | |
| 3. Operation of the committees | |

# APPENDIX 3 INTERVIEW SCHEDULE: OPEN-ENDED AND CLOSED QUESTIONS

## SECTION I: HISTORY AND PROFILE OF THE COMPANY

1. When the company was established
2. Description of the founding shareholders
3. Current performance:
   i) Profitability
   ii) Dividend payment to shareholders
   iii) Book value of assets
   iv) Market capitalisation

4. Overview of governance arrangements

## SECTION II: DEPENDENT VARIABLES: OPEN-ENDED AND PROBING QUESTIONS

### A. Shareholder control

1. Can shareholders make the final decision on matters affecting the company? Explain.

2. Do the shareholders influence the selection of the chairman of the board, (the directors) or the CEO?

3. Do shareholders influence the formulation of goals, which the organization must achieve within a particular time frame?

4. Do they have individual access to the chairman, (especially the large shareholders) for consultation? Please elaborate.

5. Do all shareholders present at the annual general meetings exercise their voting rights?

6. How do large shareholders influence various board decisions?

7. What type of information is provided to shareholders? Please explain

8. What are the arrangements for providing information to shareholders?

9. How frequently (number of times a yea) do shareholders get company reports and updates?

**10.** Is the extent, in terms of depth of information provided considered enough to enable them make decisions?

**11.** Do large shareholders get information that other shareholders do not? Please elaborate.

**Aspects relating to shareholder control**

| Indicate your response on the following statements | **Not at all** | **Sometimes** | **Always** |
|---|---|---|---|
| Directors fulfil their duty of reporting to the shareholders at the annual shareholder meeting | | | |
| Annual audited reports are sent to all shareholders before the annual general meeting | | | |
| Half-yearly reports are produced and made public | | | |
| Invitations to the annual general meeting are sent to shareholders in time | | | |
| Shareholders attending the annual general meeting exercise their right to vote on directors' proposals | | | |
| Large shareholders exercise considerable influence at the annual general meeting | | | |
| All decisions at annual general meetings made by voting | | | |
| The influence of large shareholders on director selection/appointment results in their control of the enterprise | | | |
| The controlling shareholders have access to key people in the organization | | | |
| Shareholders have the power to challenge or change the decisions of management and/or director | | | |

**B. Board control**

1. Does the board appoint the CEO? Can it directors discipline management, especially the chief executive officer? Please explain
2. Do directors, during board meetings, ask the management discerning questions about strategy?
3. Do the directors discuss and decide on the remuneration of the chief executive officer? Please elaborate.
4. Does the board evaluate its activities, the individual directors and the CEO?

**Aspects relating to board control**

| Indicate your response on the following statements | Not at all | Sometimes | Always |
|---|---|---|---|
| Directors make the decision to hire a CEO | | | |
| Directors can discipline/fire the CEO | | | |
| Directors discuss and approve the strategy of the company | | | |
| Directors make decisions about the CEO's (CED's) remuneration | | | |
| Directors formally evaluate their activities, the CED and the individual directors | | | |

**SECTION III: INDEPENDENT VARIABLES: OPEN-ENDED AND PROBING QUESTIONS**

**Ownership structure**

i. Please, describe the main shareholders of the company

ii. Please describe the ownership stakes of major shareholders in terms of ownership percentage.

## Board effectiveness with respect to board control: open questions

**(a) Board constitution**

1. How many directors are full time employees of the company and how many are not full time employees?

2. Does the proportion of non-executive directors influence the level of board effectiveness and how?

**(b) Director independence**

1. Do the current directors have any business relations with the company or social relations with the company CEO? Please explain.

2. Would social relations between the CEO and a person make that person ineligible for appointment as Non-executive director (NED) Please explain.

3. Do you think these affiliations influence board effectiveness in terms of control over management? Please explain.

4. Please explain a typical process of selecting directors/chairman here at your company?

5. Does the manner in which selection of directors is conducted influence effectiveness of the board and in what respects?

**(c) Board leadership structure**

i. Does the company have a separate chairman of the board and chief executive officer?

ii. If yes, how useful in this practice in relation to the boards ability to the boards supervision of management?

**(d) Board Meetings**

i. Does the board have an approved procedure for running its meetings? Please explain.

ii. Is information sent to directors before the date of the meeting? How long usually?

**(e) Board audit committee**

i. Does the board have a board committee? If yes, what is the constitution of the committees- in terms of executive and non-executive directors?

ii. If no, please, explain why the committee has not been formed.

iii. If a board audit committee has been established, please briefly explain how the committee operates: how often they meet, or what mandate they have, how they report to the board etc?

iv. Do you think the committees influence the effectiveness of the board in terms of control of management?

**Aspects relating to board effectiveness**

| Indicate your response on the following statements | Not at all | Sometimes | Always |
|---|---|---|---|
| Non-executive directors constitute the majority on the board of directors | | | |
| Economic and social affiliations between directors and the company or the company's top management or large shareholders exist | | | |
| The posts of chairman and CEO are separated and held by different individuals | | | |
| Directors have established an audit committee | | | |
| The majority of members of the audit committee are non-executive directors | | | |
| The process of selecting/appointing directors is known to all shareholders | | | |
| Explicit criteria for selecting/appointing directors exist | | | |
| The directors have a clear and approved procedure for running board meetings | | | |
| Information (board papers) is sent to all directors in time for the meetings | | | |

## ADDITIONAL QUESTIONS TO REGULATORY AUTHORITIES CMSA and DSE

- Currently, in Tanzania, there are two sets of principles of good corporate governance; one set developed by the steering committee on corporate governance and another set by CMSA.
  - Why this duplication of effort?
  - How are the companies encouraged to adopt these principles?

- In the context of Tanzania, especially after privatisation, there have emerged major shareholders who exercise significant control on organizations.
  - Is it an issue of concern that large shareholders may abuse minority shareholders?
  - How do you protect minority shareholders against potential abuse by large shareholders?

---

[i] Voice as used by Hirschman (see Barney and Ouchi, 1988) would imply shareholders pointing out management problems in a firm with the addressing these problems by implanting change and improve performance.

[ii] Exits also as used by Hirschman would imply shareholders changing firms by selling their shares and absorb the associated costs of doing so.
[iii] Note that  the law is a social construct and thus anything can be made 'legal', and has been at different times, such as slavery, child abuse etc
[iv] The term development partners is increasingly being used to replace the term 'donors' as this term is thought too limited to capture in a positive way what is involved in the development process.