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**Towards Good Corporate Governance: An Analysis of
Corporate Governance Reforms in Uganda**

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I hereby declare that I have read and understood the regulations governing the submission of Master of Laws dissertations, including those relating to length and plagiarism, as contained in the rules of the University, and that this dissertation conforms to those regulations.

Signature

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Abstract

The recent onslaught of corporate scandals has compelled the world to acknowledge the profound impact of corporate governance practices on the global economy. Corporate governance has become important for the survival of companies and indeed of national economies in the increasingly global economy. Corporate governance is of particular concern in developing economies, where the infusion of international investor capital and foreign aid is essential to economic stability and growth. For transition economies, such as Uganda's, which are faced with the challenge of restructuring for greater efficiency and creating a foreign investment-friendly environment, good corporate governance is crucial for success.

This research highlights corporate governance initiatives in Uganda, focusing on the proposed corporate governance reforms. An analysis of the major corporate governance reforms is done including; statutory reforms, development of codes of conduct and best practice and institutional reforms. The evolution of Uganda's corporate structure and the forces driving corporate governance reform is examined. It is noted that corporations in Uganda cannot shield themselves from the global movement that is shaping standard principles governing corporations. Therefore the global principles of corporate governance are examined concerning how they can serve as models for enhancing corporate governance standards in Uganda. The analysis is based on the need to bring Uganda's corporate governance reforms in line with internationally accepted standards but considering the best interests of Uganda and its citizens.

Dedication

To my children; Daniel, Edgar and Joan.

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List of abbreviations

CJRP	Commercial Justice Reform Programme
CLR	Company Law Review
CMA	Capital Markets Authority
COMESA	Common Market for Eastern and Southern Africa
CACG	Common Wealth Association for Corporate Governance
EAC	East African Community
GDP	Gross Domestic Product
ICGN	International Corporate Governance Network
ICGU	Institute of Corporate Governance of Uganda
IMF	International Monetary Fund
IoD	Institute of Directors of South Africa
IPO	Initial Public Offer
JLOS	Justice Law and Order Sector
JSE	Johannesburg Stock Exchange
NGO	Non-governmental Organization
OECD	Organization of Economic Corporation and Development
PERD	Public Enterprise Reform and Divestiture
SMEs	Small and Medium-sized Companies
USE	Uganda Securities Exchange
ULRC	Uganda Law Reform Commission

1. INTRODUCTION

1.1 The background to corporate governance

At its most elementary, corporate governance is simply about the interaction and relationship among the various participants, or stakeholders, in determining both the performance and the direction of companies.¹ The modern company is a relatively recent creation of the common law and its genesis may be traced back to 1897² in the landmark pronouncement of the English House of Lords in *Salomon v Salomon & Co Ltd*,³ where it was held that ‘a company has a legal existence with rights and liabilities of its own, whatever may have been the ideas and schemes of those who brought it into existence’. The foundation of modern company law lies in the Salomon’s case, as the veil of incorporation effectively segregates the owners from the management of the company.

The company may therefore be viewed as a conduit with two masters, namely, the board of directors deciding as a collective unit and the members deciding at a general meeting.⁴ While this may, at first glance, raise conceptual difficulties as regards the precise scope of the respective authority of the board of directors and of the general meeting, the issue is deflected by the articles of association conferring wide powers of management of the affairs of the company to its board of directors. The general meeting may not override the directors and involve itself in the management of the company.⁵ In short, while shareholders have the theoretical right to elect persons of their choice to the board, they do not have the ability to instruct such persons on matters that pertain to the affairs of the company.⁶

¹ Low Chee Keong ‘Disclosure Reporting, and Derivative Actions: Empowering Shareholders in Southeast Asia’ in Ho Khai Leong (ed) *Reforming Corporate Governance in Southeast Asia: Economics, Politics, and Regulations* (2005) ISEAS Publications at 38.

² John Farrar *Corporate Governance in Australia and New Zealand* (2001) Oxford University Press, at 23.

³ [1897] AC 22

⁴ Keong (note 1) at 39.

⁵ See the case of *Automatic Self-Cleansing Filter Syndicate Co v Cunnigham* [1906] 2 Ch 34.

⁶ Keong (note 1) at 39.

The modern corporate environment has resulted in the division of ownership and control in many companies so that a company's directors have taken the place of its *de facto* owners (its shareholders) in directing and controlling the affairs of the company.⁷ Traditional corporate doctrine has assumed the separation of ownership from control as the core problem of corporate governance.⁸ In this view, the primary function of corporate law is to devise strategies and mechanisms to ensure that those in control of shareholders' property apply it strictly for the benefit of shareholders. This separation of ownership and control together with the increasing involvement of other stakeholders who have an interest in the business of the company – financiers, surrounding communities and employees for instance – has accordingly given rise to the need for a predictable, uniform and comprehensive system of control based on the overarching principles of transparency, fairness, responsibility and accountability.⁹

1.2 The research question

The research question to be addressed by this study is whether the corporate governance reforms in Uganda are sufficient to meet internationally accepted standards and whether international standards are good for Uganda. The research further analyses codes of corporate governance versus legislating corporate governance principles in determining the best approach for Uganda.

1.3 Scope of the Study

This paper seeks to analyse the proposed corporate governance reforms in Uganda as contained in the Study Report on Company Law, the Companies Bill, 2004 and the Code of Good Corporate Governance; and their effectiveness in addressing corporate governance issues in the country and as an international competitor in the 21st century. The scope of this analysis generally covers the principles of good corporate

⁷ Ramani Naidoo *Corporate governance: An Essential Guide for South African Companies* (2002) at 2

⁸ Ibid

⁹ Ibid

governance as they have come to be widely accepted, but will concentrate more on the board, individual directors and their duties, the rights of shareholders and stakeholders, compliance and enforcement; but will not include risk management, disclosure and reporting. The study also analyses the corporate governance institutional framework in Uganda.

In assessing the proposed corporate governance reforms and whether they are in harmony with reforms in other jurisdictions, the paper makes a comparison with South Africa which is about to overhaul its company law, in some cases basing this on the recommendations contained in the King Report by the King Committee¹⁰ on corporate governance and in other cases on the provisions of the Companies Bill, 2007. In the international arena, the corporate governance reforms of the United Kingdom as contained in the Companies Act, 2006 and the Combined Code¹¹ on corporate governance are examined.

1.4 Corporate governance: An overview

1.4.1 What is corporate governance?

Corporate governance has become an issue of global importance, but exactly what constitutes corporate governance and precisely where its boundaries lie are still subjects of debate.¹² It is an emerging discipline and one about which relatively little has been written especially in developing countries.¹³ The term corporate governance

¹⁰ The King Committee, formed in 1993 by the Institute of Directors in South Africa (IoD) was established to investigate the role of boards of directors in South African firms. The Committee was named after Mervyn E. King who chaired it. The committee released its first report on corporate governance in 1994 ('the Code' or 'King I') which included a Code of Corporate Practice and Conduct, the first of its kind in South Africa. The second King Report on corporate governance ('King II') was published in 2002 succeeding King I.

¹¹ The initial documents on corporate governance in UK were the Cadbury Report (1992) and the Greenbury Report (1995). Later, Hampel (1998) reviewed the implementation of the Cadbury and Greenbury Codes and the outcome of this report was the Combined Code 1998. There were further reports by Turnbull (1999) on internal controls, Higgs (2003) on the role of non-executive directors, and Smith (2003) on audit committees. In 2003, a new Combined Code was issued. This superseded the earlier code and drew on the Turnbull, Higgs, and Smith guidelines. A latest revision of the Combined Code took place in June 2006.

¹² Naidoo (note 7) at 1

¹³ Ibid

is often defined as the formal system of accountability by senior management to the shareholders. A more expansive definition includes the entire set of legal rules, relations and behaviors that constitute the system by which a company is controlled and directed.

Scholars and practitioners of corporate governance give the term a wide variety of definitions.¹⁴ Economists and social scientists tend to define it broadly as “the institutions that influence how business corporations allocate resources and returns” and “the organizations and rules that affect expectations about the exercise of control of resources in firms”.¹⁵ The definition focuses not only on the formal rules and institutions of corporate governance, but also on the informal practices that evolve in the absence or weakness of formal rules.

Corporate managers, investors, policy makers, and lawyers, on the other hand, tend to employ a more narrow definition.¹⁶ For them, corporate governance is the system of rules and institutions that determine the control and direction of the corporation and that define relations among the corporation’s primary participants. Thus the United Kingdom’s 1992 Cadbury Report’s often quoted definition is: “Corporate governance is the system by which businesses are directed and controlled.”¹⁷ As applied in practice, this narrower definition focuses almost exclusively on the internal structure and operation of the corporation’s decision-making process. It has been this narrower definition that has been central to public policy discussions about corporate governance in most countries.¹⁸

¹⁴ Jeswald W. Salacuse ‘Corporate Governance in the New Century’ (2004) 25 No.3 *The company Lawyer* at 69.

¹⁵ *Ibid*

¹⁶ *Ibid*

¹⁷ Report of the Committee on the Financial Aspects of Corporate Governance (Cadbury Report) Para.2.5 available at www.ecgn.org. accessed on 21st July 2007.

¹⁸ Salacuse (note 14) at 69.

1.4.2 Why corporate governance?

“Good corporate governance helps to prevent corporate scandals, fraud, and potential civil and criminal liability of the organization. It is also good business. A good corporate governance image enhances the reputation of the organization and makes it more attractive to customers, investors, suppliers, and in the case of non-profit organizations, contributors.”¹⁹

With the dawn of the twenty-first century, corporate governance has attained heightened importance and attention in government policy circles, academia, and the popular press throughout much of the world.²⁰ Various reasons explain its current prominence. The new century’s financial scandals affecting major American firms, such as Enron, WorldCom and Arthur Andersen, and the resulting loss of confidence of the investing public in the stock market led to dramatic declines in share prices and substantial financial losses to millions of individual investors.²¹ Both the public and the experts have identified failed corporate governance as a principal cause of the scandals.²²

Even before the recent scandals, significant efforts, propelled to a certain extent by earlier financial abuses, had been underway since the early 1990s within the OECD,²³ the European Commission²⁴ and individual European countries to understand the

¹⁹ Frederick D. Lipman and L Keith Lipman *Corporate Governance Best Practices: Strategies for Public, Private, and Not-for-Profit Organisations* (2006) at 3.

²⁰ Salacuse (note 14) at 69.

²¹ Ibid

²² Ibid

²³ Organisation for Economic Cooperation and Development, *OECD Principle of Corporate Governance* (endorsed by the Ministers at the OECD Meeting, May 26-27, 1999), Paris, OECD, 1999. also available at www.oecd.org. In the wake of the financial scandals in the United States and the growing international concern over corporate governance, the OECD Council at Ministerial level at its meeting of May 15-16 2002, launched a new initiative to strengthen corporate governance. OECD launched an assessment within the member countries and came up with new corporate governance guidelines in 2006.

²⁴ See Weil, Gotshal and Manges LLP, on behalf of the European commission, International Market Directorate General ‘comparative Study of Corporate Governance Codes Relevant to the European Union and its Member States (January 2002). Available at

economic consequences of corporate governance and to formulate recommendations on appropriate governance structures and practices. In emerging market economies, experience over the last decade has clearly shown that successful privatizations and the development of vibrant private sectors depend to a significant extent on the existence of effective systems of corporate governance.²⁵ More generally, the ability of countries to attract foreign capital is affected by their systems of corporate governance and the degree to which corporate management is compelled to respect the legal rights of lenders, bondholders, and non-controlling shareholders. Individual and institutional investors will refrain from providing capital or will demand a higher risk premium for their capital from enterprises in countries without effective systems of corporate governance than from similar enterprises in countries having strong corporate governance standards.²⁶ International investment not only provides corporations with expanding sources of capital, but also encourages the continued integration of sound corporate governance practices, which may help the corporations to gain the trust of investors, reduce their capital costs and induce more stable financial sources.²⁷

Corporate governance is also perceived as important mainly for companies whose shares trade on the stock market. In developing countries, the preponderance of small firms that do not have listed shares, on the one hand, and of large state-owned, foreign-owned and private family-owned companies whose shares are also not widely traded locally, on the other, helps explain why many people still doubt the significance of corporate governance for developing countries.²⁸

http://www.europa.eu.int/comm/internal_market/en/company/news/corp-gov [Accessed on 25 July 2007].

²⁵ See Alexander Dyck 'Privatisation and Corporate Governance: Principles, Evidence and Future Challenges' (2002) 16 *World Bank Observer* 59-84; Saul Estrin 'Corporate Governance and Privatisation: Lessons from Transition Economies' (2002) 11 *Journal of African Economies* 28; Saul Estrin 'Competition and Corporate Governance in Transition Economies' (2002) 16/1 *Journal of Economic Perspectives* 101-124.

²⁶ Salacuse (note 14) at 70.

²⁷ Melinda Vaughn and Lori Verstegen Ryan, 'Corporate Governance in South Africa: a bellwether for the continent?' *Corporate Governance: An International Review* (September 2006) Vol.14 No.5.

²⁸ OECD 'Corporate Governance in Development: The Experiences of Brazil, Chile, India, and SA.' Available at www.oecd.org/document/49/ [accessed on 3 March 2007].

However, for a firm to raise capital by selling equity at a price worthwhile to its owners, a firm needs credibly to promise to abide by both principles of good corporate governance—striving to maximize its future residuals and guaranteeing shareholders some determinable proportion of these residuals as dividends or other distributions. The expectation of eventually receiving such distributions is what makes worthwhile holding a share as a financial instrument and what induces outsiders to provide cash in return for shares.²⁹ A firm gains credibility in several ways: by developing a record of abiding by its promises, by being subject to a binding legal system, and by restructuring incentives so that managers gain if they fulfill their promises and suffer if they do not. If a firm acts contrary to its promises, it undermines its own record and becomes less able to acquire new equity financing. It should also be noted that when a legal system fails to punish such a firm, an individual firm’s decision to break its promises imposes externalities: investors become generally less willing to buy equity of other firms governed by the same legal system. In other words, weak corporate governance in existing firms poisons the well for new firms that hope to use equity markets.³⁰

2. THE CORPORATE GOVERNANCE INSTITUTIONAL FRAMEWORK IN UGANDA

2.1 Institutional framework

2.1.1 An overview of the economy

Uganda is a landlocked country located in East Africa, covering an area of 241,039 sq km with a population of 24.7 million.³¹ The country is bordered by Sudan in the north, Kenya in the east, the United Republic of Tanzania in the south, Rwanda in south-west and the Democratic Republic of Congo in the west.³² Uganda’s economy is dominated

²⁹ Merritt B. Fox and Michael A. Heller (eds) *Corporate Governance Lessons from Transition Economy Reforms* (2006) Princeton University Press at 6.

³⁰ Fox and Heller (note 29) at 7.

³¹ This information on Uganda’s economy is available on the Uganda Investment Authority website at <http://www.ugandainvest.com/guide.htm> [Accessed on 6 July, 2007].

³² Ibid

by the agricultural sector which accounts for 31.4% of the country's GDP. The reliance of the national economy on cash crops for foreign exchange is a legacy of Uganda's colonial period. At independence in 1962, Uganda was one of Africa's most economically promising states. It was self sufficient in food production and its manufacturing sector produced basic inputs and consumer goods. However, from 1971 to mid 1980 the economy fell into a crisis under the strain of civil wars and poor economic programmes such as the nationalization of industries and the expulsion of Asians who were the key players in the economy.³³ Uganda has substantial natural resources, including fertile soils, regular rainfall and sizable mineral deposits of copper and cobalt. Coffee is the major export crop and accounts for the bulk of export revenues.³⁴ Uganda falls among the countries classified as the world's least-developed countries.

Under the influence of the International Monetary Fund (IMF) and the World Bank, the Uganda government acted to rehabilitate and stabilise the economy by undertaking privatization of the industry and services, currency reform and the liberalization of the exchange rate system. Due to a combination of these reforms and a relative degree of security in the country, the economy has consistently enjoyed high rates of growth. Uganda has been one of Africa's recent success stories with its reports of economic growth. Uganda has for the last fifteen years pursued economic policy reforms that have imposed fiscal discipline, restructured public expenditure and liberalised the economy. Because of the prudent macro economic policies, Uganda has recorded an impressive economic performance over the last decade with an average real rate of annual growth in GDP recorded at 6 percent per annum.³⁵

During 1990-2001, the economy turned in a solid performance based on continued investment in the rehabilitation of the infrastructure, improved incentives for production and exports, reduced inflation, gradually improved domestic security, and the return of exiled Indian-Ugandan entrepreneurs. The government has facilitated

³³ Information available at <http://www.myuganda.co.ug/economy> [Accessed on 5 July 2007].

³⁴ Ibid

³⁵ Uganda Investment Authority (note 31).

foreign investment with attractive incentives and streamlined import and export procedures.³⁶ Yet Uganda still suffers from considerable economic difficulties. The economy is dependent on the continued flow of aid from external donors. Total external debt has risen and corruption is prevalent in the government and the private sector despite efforts to curtail its influence.³⁷

2.1.2 The Capital Markets Authority

The Capital Markets Authority (CMA) was established in 1996 following the enactment of the Capital Markets Authority Act.³⁸ The mandate of the CMA is to promote, develop and regulate the capital markets industry in Uganda. As observed by CMA chief executive officer Japheth Katto,³⁹ before 1996, the economy was not conducive for capital markets development because the key sectors like banking and insurance were dominated by government-owned enterprises. Liberalisation and privatisation created the right environment for the capital markets to start. In exercise of the powers conferred on the CMA by the Capital Markets Authority Act,⁴⁰ the CMA has made the Capital Markets Corporate Governance Guidelines, 2003.⁴¹ Rule 2 of the guidelines provides that the CMA developed the guidelines as a minimum standard for good corporate governance practices by public companies and issuers of corporate debt in Uganda. It is stated that the guidelines were provided in response to the growing importance of governance issues in emerging and developing economies and for promoting domestic and regional capital markets growth. It is also in recognition of the role of good governance in corporate performance, capital formation and maximisation of shareholders value as well as protection of investor's rights.

The objective of the Guidelines as stated in rule 6 is to strengthen corporate governance practices by listed companies in Uganda and promote the standards of self-

³⁶ Uganda Investment Authority (note 31).

³⁷ (Note 33).

³⁸ Chapter 84 Revised Laws of Uganda, 2000.

³⁹ As quoted in a Ugandan news paper, the New Vision of Wednesday, 11th July, 2007.

⁴⁰ Capital Markets Authority Act, Chapter 84 Revised Laws of Uganda, 2000, section 101.

⁴¹ The Corporate governance guidelines are available at the CMA website at <http://www.cma.co.ug>.

regulation in other public companies so as to bring the level of governance in line with international trends. The Guidelines require the directors of every listed company to undertake or commit themselves to adopt good corporate governance practices as part of their continuing listing obligations. Rule 10 provides that compliance with the Guidelines forms an essential part of disclosure obligations in corporate annual reports and disclosure of all areas of non-compliance or alternative practices also forms part of disclosure requirements. Rule 11 provides that where a company is not fully compliant with the Guidelines, the directors have to indicate the steps being taken to adhere to full compliance and the reasons for departure.

The Guidelines provide for the following corporate governance principles:

- best practices relating to the board of directors;
- best practices relating to the position of chairperson and chief executive;
- best practices relating to the rights of shareholders;
- best practices relating to the conduct of general meetings; and
- best practices relating to the accountability and the role of audit committees.

Clearly, according to rule 11, the CMA requires listed companies to comply with the Guidelines on Corporate Governance and where they have not complied, they must explain. As noted above, the guidelines apply to listed companies on the Uganda Stock Exchange, although all public companies are encouraged to follow the guidelines. Considering that only six local companies are listed on the securities exchange, the guidelines are not applicable to the majority of the companies in Uganda which are mainly small privately owned companies. However, it should be noted that these guidelines are essential in ensuring good corporate governance among the companies to which they apply.

2.1.3 The Uganda Securities Exchange and the listing requirements

The Uganda Securities Exchange (USE) is Uganda's only stock exchange. It was founded in June, 1997. The USE is operated under the jurisdiction of Uganda's Capital

Markets Authority, which in turn reports to the central bank of Uganda, the Bank of Uganda.⁴² The Exchange's doors opened to trading in January, 1998. At the time the Exchange had just one listing, a bond issued by the East African Development Bank.⁴³ The USE currently trades nine listed local and East African companies and has started the trading of fixed income instruments. There are six local companies listed on USE and these are: Uganda Clays Ltd, British American Tobacco (BAT) Uganda Ltd, Bank of Baroda (U) Ltd, DFCU Bank Ltd, New Vision Printing and Publishing Co. Ltd and Stanbic Bank Uganda Ltd. Cross border listings are: East African Breweries Ltd, Kenya Airways and Jubilee Holdings Ltd. The USE operates in close association with the Dar-es-Salaam Stock Exchange in Tanzania and the Nairobi Stock Exchange in Kenya.

There is some progress towards transparent corporate governance represented by the Uganda Securities Exchange's listing requirements. The USE listing requirements are contained in the Uganda Securities Exchange Listing Rules, 2003. The Listing Rules provide that issuers must comply not only with the Listing Rules of the Exchange but with the rules and regulations made under the Capital Markets Authority Act, the Companies Act and any other statutory requirements.

The mandate of administering the Listing Rules is given to the Listing Committee of the Governing Council of the Uganda Securities Exchange limited. Under rule 3, the Listing Committee is constituted by the Governing Council and its mandate is to grant, review, suspend or terminate a listing of securities. It is also the mandate of the Committee to prescribe from time to time listing requirements with which issuers must comply before listing and while a security remains listed. Under rule 4, the Committee has powers to suspend a listing of securities if in its opinion it is desirable to do so in the interest of market fairness, transparency or efficiency, or if the issuer has failed to comply with the Listing Rules. Rule 7 gives the Committee powers to de-list an issuer who has failed to satisfy conditions for listing. The Committee terminates listings

⁴² See information on Uganda's securities exchange at <http://www.use.or.ug> [Accessed on 9 July 2007].

⁴³ Ibid

subject to the approval of the Capital Markets Authority and is required to issue a public statement on the delisting of the security. In addition to the powers of suspension or termination, the Committee has powers under rule 9 to censure or impose penalties on an issuer for contravention of the Listing Rules.

The listing requirements provide for financial transparency, regular reporting and auditing requirements. The listing rules require directors and senior management of an issuer to have collective appropriate expertise and experience for the management of the business and details of such expertise should be disclosed in listing particulars by the issuer. In order to ensure proper accountability, the rules require financial statements to be prepared and independently audited in accordance with international accounting standards. Rule 51 requires an issuer to ensure that all the necessary facilities and information are available to enable shareholders to exercise their rights, such as, adequate notice for meetings, right to exercise their right to vote, and access to information.

2.1.4 The Institute of Corporate Governance of Uganda

The Institute of Corporate Governance of Uganda (ICGU) was incorporated in December 1998 as a company limited by guarantee and not having a share capital. Membership of the Institute is open to both corporate entities and individuals. In an interview with Vincent F. Kaheeru⁴⁴ the CEO of the Institute, he revealed that the Institute has a membership base of 42 corporate bodies and 306 individuals as at 31st July 2007. The ICGU was set up to complement the efforts other institutions are making towards improving the manner in which corporate entities operate. The mission of ICGU is to promote excellence in corporate governance principles and practice. The objectives of ICGU include:

- Training and promotion of commercial probity and effective management with emphasis on transparency and integrity in the business community;

⁴⁴ The interview was conducted on 14th August 2007 at the Institute of Corporate Governance of Uganda offices in Kampala.

- Enhancing performance of boards, individual directors and senior management in the private, public and NGO sectors by improving their knowledge, personal development and professional skills, particularly with regard to their rights, duties, responsibilities and liabilities, for the benefit of all stakeholders;
- Developing codes of best practice for good corporate governance within the public, private and NGO sectors;
- Contributing to capacity building in corporations by imparting good management practices to directors and senior managers;
- Providing an effective voice for company directors and senior management of enterprises in public affairs with effective interest in legislation, economic and social matters to ensure the preservation of basic commercial freedom and to prevent abuse of such freedom.

In its manual on corporate governance,⁴⁵ ICGU has provided a code of best practice and guidelines for good corporate governance for companies in Uganda. The guidelines set out the basic framework within which corporate governance can thrive. It is stated in the manual that the guidelines are generic in nature and each individual firm or organization is expected to develop its own code based on the provided framework to suit its peculiar circumstances. The ICGU recommends the guidelines for use by all corporate bodies in Uganda irrespective of the form of ownership and size of the entity. It should be noted that these guidelines are too flexible and the ICGU does not have any enforcement mechanisms in place to ensure compliance. In the interview with Vincent Kaheeru⁴⁶ the CEO of the Institute, he stated that all member corporations are required to abide by the guidelines thereby serving as an example to other organizations. Compliance with the guidelines is on a voluntary basis.

The ICGU's recommended guidelines for corporate governance in Uganda cover the following broad areas:

- The board of directors: objectives of the board; board composition, appointments and elections; induction, orientation and training of directors;

⁴⁵ Institute of Corporate Governance of Uganda *Manual on Corporate Governance: Incorporating Recommended Guidelines for Uganda* (2002).

⁴⁶ (Note 44).

board chairman and CEO; the board and other stakeholders; the board's sole responsibility for the company's performance; internal systems and controls; the audit committee; compliance with laws and regulations; communication; good faith and confidentiality; assessment of the company, board and management performance and codes of ethics;

- Shareholders: shareholders' meetings; communication; evaluation of the company's performance; shareholders' duties to each other; duties to employees and the community;
- Others include the roles of the following; audits, management, employees, Government, regulatory bodies, suppliers of a company, lenders, customers, investors and the community.

The activities of the ICGU include; development of a corporate governance manual for directors and managers, training of directors and managers in corporate governance, sensitization of stakeholders and advising government on essential legal reforms for promoting corporate governance. A crucial aspect of efforts to improve corporate governance standards involves investing in human resource capital. Promoting training and education at all levels is therefore necessary to ensure that corporate governance reforms take root in the country. The programmes seek to enhance the effectiveness of directors in discharging their duties, and ensure that they are continuously updated on developments in the securities industry, particularly in areas of corporate governance and other regulatory developments.

The Institute of Corporate Governance of Uganda seeks to complement the promotion of corporate governance by organizing training, education and research. It conducts seminars, workshops and other training and education for a wide-ranging of audience that includes directors and other managers. It publishes educational materials and provides general information on corporate governance. In 'Sustainable Wealth Creation', a quarterly publication of the Institute of Corporate Governance of Uganda, there is a lot of information which educates investors, directors and other stakeholders on issues including: shareholder rights, investment and wealth creation, practicing

corporate governance, corporate social responsibility, and corporate fraud, among others.

2.2 The history of corporate law in Uganda and the need for reform

2.2.1 Uganda's corporate history

For most of the post independence period, Uganda's major institutions were state-owned.⁴⁷ There was no opportunity of creating an environment for checks and balances considering the manner state-owned institutions operated. Some of the parastatal organizations were actually mandated to perform a dual role both as regulators and as business entities.⁴⁸ For example, statutory entities in the communications, energy and agricultural sectors were mandated to regulate business in those sectors while at the same time doing business in those same sectors. Under such circumstances, it was not easy to enforce any principles of corporate governance.⁴⁹

Secondly, the dominance of government in the business sector through the prevalence of parastatal bodies in the economy meant that business activities were overly politicized.⁵⁰ The appointment of directors for parastatal organizations and that of the chief executive officers was vested in government. For that reason, such appointments took a political dimension. This politicization of business tended to undermine the rationale of effectiveness and efficiency in those organizations.⁵¹ In some instances, the powers of the parastatal organization's board of directors were not defined; there existed a plethora of agencies claiming authority over the parastatal body. Such agencies included: the holding corporation, the parent ministry, parliament and numerous other state agencies. It was difficult to state where the powers of one agency stopped and those of another started.

⁴⁷ J Ddumba-Ssentamu and Adam Mugume *The Privatisation Process and its impact on Society* (2001) Uganda National NGO Forum, structural Adjustment Participatory Review Initiative (SAPRI) at 5.

⁴⁸ The Institute of Corporate governance of Uganda (note 45) at 23.

⁴⁹ Ibid

⁵⁰ Ibid

⁵¹ Ibid

The capacity to monitor and effectively evaluate performance in the private sector was also very low. The big private multinational corporations and the locally based foreign owned small and medium companies remained closed to public scrutiny. Once they complied with the licensing authorities, paid the taxes, satisfied the minimum labor and health standards, the rest was a preserve of the managers and shareholders. Issues of corporate governance as we know them today were of little consequence then.

Despite the privatization and liberalization measures that the government is currently implementing, the country still has a sizeable state-owned economic sector.⁵² The government involvement in these organizations is on behalf of the people of Uganda, it is therefore a matter of public concern that these organizations operate with a measure of account ability, transparency, and other principles of corporate governance.⁵³ With regard to the private sector, most private companies in Uganda are family-owned and of small and medium size. For this reason, their leadership and management has also tended to be family oriented giving to those members utmost power.⁵⁴

The country is therefore faced with a situation that requires urgent reform to enhance corporate governance within the public and private sectors of the economy. The need for regulating corporate life in Uganda could never be more pressing than it is at the moment. The liberalization and privatization measures currently being implemented are inducing entry into the economy of a new variety of corporate bodies emanating from both within the country and outside. On the other hand, the introduction of the stock exchange has made the need to regulate corporate entities, particularly those intending to be listed on the stock exchange, even more urgent and important.

⁵² Information on Uganda's economy and privatization, available at <http://www.myuganda.co.ug> [Accessed on 2 July 2007].

⁵³ Institute of corporate governance of Uganda (note 45) at 23.

⁵⁴ Institute of corporate governance of Uganda (note 45) at 24.

2.2.2 The evolution of company law

The history of company law in Uganda is synonymous with Uganda's legal history whose roots lie within the British legal system and common law jurisprudence. Therefore, company law refers to the Companies Act⁵⁵ of Uganda and the relevant rules of English common law and doctrines of equity⁵⁶ which apply to Uganda by virtue of the Judicature Act.⁵⁷ Prior to the introduction of English company law, the Indian Companies Act of 1882 was the applicable law in Uganda.⁵⁸ The Companies Ordinance No. 6 of 1923 replaced the Indian Act. The Companies Ordinance No.6 of 1923 was repealed by the Companies Ordinance No.12 of 1935 which was also repealed by the current Companies Act. The current Companies Act of Uganda was enacted in 1958 as Act 1 of 1958 and it is a replica of the British Companies Act of 1948.

It remains to add that the Companies legislation of Britain on which the Uganda Companies Act is based has been overhauled several times over by amending and supplementing legislation in order to keep abreast of changes in that society.⁵⁹ The British Companies Act of 1948 was replaced in 1985 and again in 2006. Save for a few isolated amendments, the Uganda's Companies Act has not been revised in a comprehensive manner since its enactment. Minor amendments have been made to the Uganda's Companies Act; in 1993 when the Public Enterprise Reform and Divestiture Act⁶⁰ introduced new provisions aimed at bringing certain public enterprises within the Companies Act, and in 1996 when the Capital Markets Authority Act⁶¹ revised the registration and regulation of public companies in Uganda. Despite these changes to the Companies Act, most aspects of company law had remained unchanged, prior to

⁵⁵ Chapter 110, Revised Laws of Uganda, 2000.

⁵⁶ J D Bakibinga 'Company Law and Business Development in Uganda' (June 2004) 2 No.1 *The Uganda Living Law Journal* at 31.

⁵⁷ Chapter 13 Revised Laws of Uganda, 2000.

⁵⁸ Uganda Law Reform Commission 'A Study Report on Company Law' ULRC Publication No.35 of 2004 at 7.

⁵⁹ J D Bakibinga *Company law in Uganda*, Kampala: Fountain Publishers, 2001 at 1. (It should be noted that the United Kingdom now has a new Companies Act, chapter 46 of 2006)

⁶⁰ Chapter 98, Revised Laws of Uganda, 2000.

⁶¹ Chapter 84, Revised Laws of Uganda, 2000.

the current reform process. It should be noted that the company law reform process in Uganda covered the entire Companies Act, however, this study is only concerned with the reforms in relation to corporate governance issues.

2.2.3 The need for reform

*'Internationally, company law review is a continuous process that ensures that laws are reflective of market practices and societal needs.'*⁶²

Company law reform in Uganda was undertaken by the Uganda Law Reform Commission (ULRC). The Commission was established in 1990 by the Uganda Law Reform Commission Act.⁶³ Prior to this enactment, law reform was the responsibility of the Department of Law Reform and Law Revision under the Ministry of Justice. In 1995, with the promulgation of the Constitution, the Commission became a constitutional body by virtue of article 248 of the Constitution.⁶⁴ This enhanced the mandate of the Commission to undertake law reform. The main function of the commission as provided in section 11 of the Uganda Law Reform Commission Act is to study and keep under constant review the Acts and other laws of Uganda with the view of making recommendations for their systematic improvement, development, modernization and reform with particular emphasis on the development of new areas in the law by making the laws responsive to the changing needs of the society in Uganda.

The Government of Uganda, through the Uganda Law Reform Commission, embarked on the implementation of the Commercial Justice Reform Programme (CJRP). The CJRP is a component of a Sector Wide Approach Programme that brings together all the institutions within the Justice Law and Order Sector (JLOS) aimed at improving institutional efficiency and service delivery. One of the components of the CJRP is the

⁶² The Department of Trade and Industry 'South African Company Law for the 21st Century: Guidelines for Corporate Law Reform.' (May 2004). Available at <http://www.dti.gov.za/ccrdlawreview/companylaw.htm>, [Accessed 15 June, 2007].

⁶³ Chapter 25, Revised Laws of Uganda, 2000.

⁶⁴ The Constitution of the Republic of Uganda, 1995.

reform and the modernization of commercial laws including those that govern companies, cooperatives, joint ventures and partnerships.

The commercial law reform begun in 1996 as a sub-component under the legal sector component of the Uganda institutional capacity building project. The project engaged an American consultancy firm, Reid and Priest who reviewed commercial laws under their terms of reference. The consultants produced a report in 1997 in which they made proposals for the amendment of the Companies Act. No action was taken on the report until 2001 when the Uganda Law Reform Commission accessed funding from JLOS to complete the Companies Act reform process. The commission set up a task force which reviewed the background paper of the consultants and carried out further consultations with all the stakeholders. The task force made recommendations upon which the Companies Bill, 2004 was based.

The reformers of company law in Uganda identified as their key objective for the reform, the need to have a modern law supporting a competitive economy in a coherent and accessible form, not only providing maximum freedom for participants to perform their proper functions but also recognizing the case for high standards and ensuring appropriate protection for all parties. It was also recognized that there is need to take into account current changes particularly globalization, harmonization of laws in the region, and modern patterns of regulation and ownership.⁶⁵ As indicated earlier, the reform process covers the entire Companies Act, but this research is only concerned with corporate governance issues as contained in the Study Report on Company Law, the Companies Bill, 2004, and the Code of Corporate Governance.

2.2.4 A changing environment

As indicated earlier, the Uganda Companies Act is more than half a century old and has not been subjected to a comprehensive review to reflect the fundamental developments that have taken place in Uganda and elsewhere. The domestic and global

⁶⁵ Uganda Law Reform Commission (note 58) at 1.

environment for enterprises has changed markedly since the 1950s. Corporate structures and financial instruments have undergone significant developments. Many old concepts have been abandoned or modified and new concepts have been developed. We now live in a world of greater globalization, increased electronic communication, greater sensitivity to social and ethical concerns, fast changing markets, greater competition for capital, goods and services. Uganda cannot afford to be left behind in this global changing environment.

There is a growing recognition by companies and governments that there is a need for higher standards of corporate governance and ethics and greater interdependence between enterprises and the societies in which they operate. A number of corporate failures around the world have revealed serious defects in the prevailing standard of corporate governance and the administration of the law and have resulted in investors suffering extensive losses.

2.2.5 Company law for a competitive economy

In a study report on company law, the Uganda Law Reform Commission (ULRC)⁶⁶ observes that mobility of international capital has highlighted the need for domestic laws to be investor friendly and competitive with international trends. The rise in international trade and foreign investment since has made necessary the harmonization and modernization of company law, as well as the need to make specific provision for foreign companies to operate in Uganda. The growth of the small business sector has also created a need for simpler and more accessible laws.

The Institute of Corporate Governance of Uganda (ICGU)⁶⁷ observes that Uganda, like other transition economies, now increasingly recognizes that corporate governance is an essential tool for prosperity and economic growth. Past microeconomic difficulties have been exacerbated by inadequate corporate governance, stemming from weak legal

⁶⁶ Uganda Law Reform Commission (note 58) at 2.

⁶⁷ Institute of Corporate Governance of Uganda (note 45) at 11.

and regulatory systems, inconsistent auditing standards, poor banking practices, unregulated capital markets, inefficient boards of directors and ignoring rights of minority shareholders.

Corporate governance both in the public and private sector is critical to economic and social progress. Investors base decisions to invest not only on a company's outlook, but increasingly also on its reputation and good corporate governance practices. As the public sector and state owned companies increasingly find it difficult to finance recurrent and development commitments from internal and budget resources, it is already well accepted that the private sector will be the vehicle for future growth in Uganda. To attract large investors and to increase public participation in the privatisation programmes in developing economies, sound corporate governance principles and practices must be in place.⁶⁸

2.2.6 Regional co-operation

The East African Community is the regional intergovernmental organisation of the Republics of Uganda, Kenya and Tanzania, with its headquarters located in Arusha, Tanzania. The East African heads of state signed the treaty for the establishment of the East African Community in Arusha on 30th November 1999.⁶⁹ The three East African countries cover an area of 1.8 million square kilometers and have a population of 82 million people who share a common history, language, culture and infrastructure. These advantages provide the partner states with a unique framework for regional cooperation and integration. Rwanda and Burundi signed the treaties of accession into the East African Community on 18th June 2007, formally joining Kenya, Uganda and Tanzania in the now enlarged regional economic community of a combined population of 115 million people.⁷⁰

⁶⁸ Institute of Corporate Governance of Uganda (note 45) at 12.

⁶⁹ East African Community website at <http://www.eac.int> [Accessed on 26 July 2007].

⁷⁰ Ibid

Prior to re-launching the East African Community in 1999, Uganda, Kenya and Tanzania had enjoyed a long history of corporation under successive regional integration arrangements. These have included the customs union between Uganda and Kenya in 1917, which the then Tanganyika now Tanzania later joined in 1927; the East African High Commission (1948-1961); the East African Common Services Organization (1961-1967); the East African Community (1967-1977); and the East African Cooperation (1993-1999).⁷¹

Uganda's membership in the East African Community (EAC) and the Common Market for Eastern and Southern Africa (COMESA) has two relevant consequences. First, the increasing openness of Ugandan markets and that of its partners is part of the globalization process. The second is that Uganda has become party to the community legal harmonisation programme which is part of the single market enterprise. Although harmonization of the laws in the region does not mean that such laws should be identical, nevertheless, the laws should not be in conflict. With the customs union for East African States and cross-listing on the stock exchanges of the member states, corporate governance reforms would best serve the region by being undertaken collectively.⁷²

2.3 The significance of corporate governance in Uganda

Corporate governance is an effective policy instrument in many areas of the operation of the national economy. While it should certainly not be perceived as some sort of panacea, the widespread practice of good corporate governance can help to achieve multiple objectives in both developed and developing countries.⁷³ Uganda, like other transition economies, now increasingly recognizes that corporate governance is an essential tool for prosperity and economic growth. Past economic hardships in the

⁷¹ Ibid

⁷² Ateker Ejalu 'EAC States should reform company law jointly' Business opinion in The East African News Paper of 6th -12th July 1998 available at <http://www.nationaudio.com> [Accesses on 20 February 2007].

⁷³ Ameke Anyaoku 'Corporate Governance and the Enterprise culture: Pointers for Nigeria's Transition Economy.' Available at http://www.nigerdeltacongress.com/articles/corporate_governance.htm. [Accessed on 3 May, 2007].

country have been exacerbated by weak or inadequate corporate governance measures, stemming from weak legal and regulatory systems, inconsistent auditing standards, unregulated capital markets, inefficient boards of directors and ignoring the rights of shareholders and stakeholders.

Nations compete for investment capital, and the assurances investors seek as they decide whether to provide that capital are universal. Investors ultimately choose to place their capital where they can understand the risks and believe their investment is most likely to be protected from fraud or other misuse.⁷⁴ In Uganda, corporate governance both in the public and private sector is crucial to economic and social progress. As indicated above, investors base their decision to invest not only on the company's outlook, but increasingly also on its reputation and good corporate governance practices. As the public sector and the remaining state owned companies increasingly find it difficult to finance recurrent and development commitments from internal and budget resources, it is well accepted that the private sector will be the vehicle for future growth of the economy. To attract large investors, sound corporate governance principles and practices must be in place. The economic strategy of Uganda is modernization of the economy through relying on markets and the efforts of entrepreneurs as the basis for efficient and productive economic activity. The government's major role in Uganda's private sector driven economy is mainly to provide the necessary legal policy and physical infrastructure for private investment to flourish.⁷⁵

The Institute of Corporate Governance of Uganda⁷⁶ put down some of the advantages that would accrue to Uganda as a result of having a managerial regime that adheres to the principles of good corporate governance. The following advantages are identified:

⁷⁴ Peter Cornelius 'Good Corporate Practices in Poor Corporate Governance Systems: Some Evidence from the Global Competitiveness Report.' Available at <http://www.emeraldinsight.com/Insight/html> [Accessed on 5 July, 2007].

⁷⁵ Information on the efforts Uganda is making to attract foreign investment and boost economic growth is available on the Uganda Investment Authority website at <http://www.ugandainvest.com/guide.htm>. [Accessed on 10th July, 2007].

⁷⁶ Institute of Corporate Governance of Uganda, Manual on Corporate Governance, Incorporating Recommended Guidelines for Uganda, 2002.

- Companies benefit from having a levelled field upon which to conduct their competitive business. Once there is a known set of standards by which corporate entities are judged, it becomes easier for individual corporations to formulate their own standards of behavior;
- Corporate governance directly attacks corruption to which most corporate entities are opposed;
- Corporate governance recognizes and upholds the legitimate interests of all stakeholders of a company, including shareholders, boards of directors, managers, employees, creditors and others;
- Good corporate governance is one pillar of good governance at the political level. The growth of corporate governance therefore signifies the growth of standards of transparency, accountability, probity, and integrity in the political and administrative spheres countrywide;
- Corporate governance is essential for sustainable and long-term wealth creation for enterprises; and
- Good corporate governance presumes the existence of sound societal norms that emphasise community/communal responsibility.

It is important that Uganda puts in place and enforces principles of good corporate governance to reap the benefits associated with it.

It is now well established that to reduce poverty and sustain stable societies, economies in every country should have stronger enterprises that can generate and increase employment, produce goods and services and create revenue for the investors. To strengthen companies, whether private or state owned; small, medium or large; listed on the stock exchange or not; there must be continuous investment of capital and human resources as well as consumer satisfaction and public confidence in the enterprises. To achieve these objectives, companies must have more than a track record of producing goods and services. They must have more than a share of the market. They must have good and effective management and must also be perceived to be properly managed. Corporate governance has therefore become very important in

the world not only for developed countries, but also the developing countries like Uganda.

3. AN ANALYSIS OF CORPORATE GOVERNANCE REFORMS IN UGANDA IN COMPARISON WITH REFORMS IN SOUTH AFRICA AND THE UNITED KINGDOM

3.1 Introduction

Corporate governance reviews have formed the core of many of the international corporate law reform processes. The focus has been on ensuring increased transparency and accountability and in a number of countries a host of additional requirements, especially in terms of reporting, have been adopted. The analysis of corporate governance reforms in Uganda is based on the principles of shareholder and investor protection; responsibilities of the board of directors; rights of stakeholders and compliance and enforcement of corporate governance guidelines.

There are a lot of lessons for developing and emerging economies in the way corporate governance has been practiced in developed economies.⁷⁷ Corporate governance law is reformed to keep abreast of developments in the world and the changing business landscape. It is critically important that enabling legislation that is compatible with international best practice is put in place. It is desirable that as Uganda seeks to reform one of the most important pieces of legislation, it should harmonize with other jurisdictions. Harmonizing is important because it reduces the cost and increases certainty both for overseas companies and investors, and for the local companies involved in international trade and investment. In this regard, a comparison of corporate governance reforms in Uganda is made with reforms that have been

⁷⁷ Madhav Mehra 'Corporate Governance: An Alternative Model' in Ho Khai Leong (ed) *Reforming Corporate Governance in Southeast Asia: Economics, Politics and Regulations* (2005) at 14.

undertaken in South Africa and United Kingdom. It should be noted that this comparative analysis is based on specific corporate governance aspects which the researcher considers relevant to Uganda. It is therefore not the purpose of this study to set out and analyze comprehensively all the corporate governance principles and guidelines.

3.2 Sources of corporate governance guidelines in Uganda

Over the recent years, like in other developing economies, Uganda has embarked on the reform of the corporate governance regulatory framework. The Ugandan corporate governance regulatory framework can be divided into statutory and non-statutory controls. Statutory controls consist of legal provisions while the non-statutory regulations include written codes and rules. This study analyses the most important principles of corporate governance as contained in the Study Report on company law, the subsequent Companies Bill, 2004 and the Code of Corporate Governance. As stated earlier, other bodies like Capital Markets Authority and the Institute of Corporate Governance of Uganda have come up with guidelines on corporate governance which apply to particular companies. However, these guidelines are not intended to be a subject of a comparative analysis in this study.

As indicated earlier, company law reform in Uganda was carried out by a taskforce of the Uganda Law Reform Commission⁷⁸ which reviewed the background and working papers produced by the consultants.⁷⁹ The report of the Commission contains proposals and recommendations upon which the Companies Draft Bill, 2004 was based. The reform process involved the review of the Companies Act⁸⁰ with a view to replacing it with a modern Companies Act that is in line with government policies of private sector development, increasing business efficiency, creating a conducive environment for

⁷⁸ The Uganda Law Reform Commission is a Constitutional body established by virtue of article 248 of the 1995 Uganda Constitution. The main function of the commission as set out in section 10 of the Uganda Law Reform Commission Act, Chapter 25, Revised Laws of Uganda, 2000, is to study and keep under constant review the Acts and other laws of Uganda with the view of making recommendations for their systematic improvement, development, modernization and reform.

⁷⁹ The Uganda Law Reform Commission (note 58) at xiv.

⁸⁰ Chapter 110, Revised Laws of Uganda, 2000.

investment and increasing Uganda's competitiveness both in regional and international markets.⁸¹ The Bill seeks to replace the existing Companies Act.⁸² The reformers observed that while the present law in its entirety is relevant to the Ugandan situation, some parts of it needed to be updated to fit current trends. Therefore, the proposed law is not totally new because it does not seek to change the fundamental and underlying principles of company law. The Companies Bill is presently before Cabinet for approval before it is forwarded to Parliament for discussion.

In Uganda most of the corporate governance principles are contained in a Code of Corporate Governance⁸³ which has been included as Table F in the Schedule to the Companies Bill. Section 11 of Uganda's Companies Bill which provides for the application of the Code provides that;

‘A company may, at the time of registration of its articles or subsequently, adopt and incorporate into its articles all or any of the codes of good corporate governance contained in Table F and in a case where a company adopts all or any of the codes in Table F, a printed copy for that table shall be annexed to or incorporated in each copy of its articles of Association.’

This provision means that application of the Code is voluntary and only applies to a company which chooses to include the Code in its articles of association. It should be noted that once a company has incorporated the Code in its articles of association, it will be bound by it. On the other hand, the section has an option of a company choosing which of the provisions in the Code to include in the articles. Unlike in other jurisdictions⁸⁴ where the Codes are voluntary and there is an option of comply or explain, in Uganda, companies will have the option of choosing to be bound by the Code or not, by including or excluding the Code or part of it from the articles. However, once a company has included the provisions of the code in its articles, then it must comply with those provisions. On the whole, the Code provides good corporate governance guidelines for those companies which choose to be bound by it.

⁸¹ (Note 58) at 2.

⁸² Chapter 110 Revised Laws of Uganda, 2000.

⁸³ The Code is included as Table F in the First Schedule to the Companies Bill as contained in the ULRC Study Report on Company law at p.217.

⁸⁴ Refer to South Africa and the United Kingdom.

3.3 Corporate governance principles

In the wake of the financial scandals in the United States and the growing international concern over corporate governance, the Organization of Economic Corporation and Development (OECD)⁸⁵ Council, at Ministerial level at its meeting of May 1999 in Paris, endorsed the OECD Principles on Corporate Governance. In 2002, the OECD Council of Ministers launched a new initiative to strengthen corporate governance by carrying out an assessment within the member countries and came up with new corporate governance guidelines in 2006. The OECD principles of corporate governance⁸⁶ cover five areas:

- The rights of shareholders.

The corporate governance framework should protect shareholders rights.

- The equitable treatment of shareholders.

The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.

- The role of stakeholders

The corporate governance framework should recognize the right of stakeholders as established by law and encourage active cooperation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financial sound enterprises.

- Disclosure and transparency

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.

⁸⁵ OECD is an international organization helping governments tackle the economic, social and governance challenges. It originated in 1948 as the Organization for European Economic Cooperation (OEEC) to help administer the plan for the reconstruction of Europe after World War II. Later its membership was extended to non-European states and in 1961 it was reformed into the Organization for Economic Cooperation and Development. The OECD currently has thirty full members.

⁸⁶ OECD Principles of Corporate governance (2004). Available at <http://www.oecd.org/dataoecd/32/18/31557724.pdf> [Accessed on 27 June 2007].

- The responsibility of the board

The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

Ho Khai Leong⁸⁷ opined that 'the OECD principles are by no means carved in stone' in that they provide a general framework, enabling states to mould them according to their unique developmental experiences to build their own rules.

As the King Committee⁸⁸ observed, companies are governed within the framework of the laws and regulations of the country in which they operate. Since countries differ in culture, regulation, law and generally the way business is done, there can be no single generally applicable corporate governance model. However, there are international standards that no country can escape in the era of global investor. Thus, international guidelines have been developed by the OECD, the International Corporate Governance Network (ICGN),⁸⁹ and the Commonwealth Association for Corporate Governance (CACG).⁹⁰ The four pillars of fairness, accountability, responsibility and transparency are fundamental to all these international guidelines of corporate governance.⁹¹

The principles are intended to assist OECD and non-OECD governments in their efforts to evaluate and improve the legal, institutional and regulatory framework for corporate governance in their countries and to provide guidance and suggestions for

⁸⁷ Ho Khai Leong (ed) *Reforming Corporate Governance in Southeast Asia: Economics, Politics and Regulations* (2005) at xxii.

⁸⁸ King Committee on Corporate Governance *King Report on Corporate Governance for South Africa* (2002) at 15 para 23.

⁸⁹ The International Corporate Governance Network, founded in 1995 at the instigation of major institutional investors, companies, financial intermediaries, academics and other parties interested in the development of global corporate governance practices. Its objective is to facilitate international dialogue on the issues concerned. Through this process, the ICGN holds, companies can compete more effectively and economies can best prosper. The organization's charter empowers it to adopt guidelines when it feels they can contribute to achieving this objective.

⁹⁰ The Common Wealth Association of corporate governance was established in 1998 with the objective of promoting the best international standards germane to a country on corporate governance through education, consultation and information throughout the Commonwealth as a means to achieve global standards of business efficiency, commercial probity and effective economic and social development. The CACG also aims to facilitate the development of institutional capacity that promotes good corporate governance by education, consultation and information in all Commonwealth countries.

⁹¹ Ibid

stock exchanges, investors, corporations, and other parties that have a role in the process of developing good corporate governance. It is stated that the principles are not intended to substitute for government, semi-government or private sector initiatives to develop more detailed “best practice” in corporate governance. Therefore the analysis of the corporate governance reforms in Uganda is based on the internationally accepted principles of corporate governance of which the OECD principles form par

3.4 The board and the directors

3.4.1 The role and composition of the board

The Uganda Code of corporate governance which I will refer to as ‘the Code’, provides that the board is accountable for the performance and affairs of the company, and in the performance of its duties is expected to act in good faith, with due diligence and care and in the interest of the company.⁹² The Code further provides that the board should be composed of a balance of executive and non executive directors, where the non-executive directors are the majority and sufficient non-executive directors should be ‘independent’ directors. An independent director is defined by the Code as a non-executive director who:

- does not represent or was not nominated by a major shareholder;
- was not employed by the group in the past three financial years;
- is not an immediate family member of a person who is, or was in the past three financial years, employed in an executive capacity;
- is not a professional advisor;
- is not a significant supplier to, or customer of the group;
- has no significant contractual relationship with the group; and
- is free from any business or other relationship, which could materially interfere with his/ her ability to act independently.

In South Africa, the King Code has a similar provision on the role and the composition of the board. The King report summarises the role of the board thus:

⁹² The Uganda Code on Corporate Governance para 2.1.1.

‘The board should be able to exercise objective judgment on the corporate affairs of the company, independent of management but with sufficient management information to enable a proper and objective assessment to be made by the directors collectively. The board should guide and set the pace of the company’s current operations and further development and in so doing should regularly review the present and future strengths, weaknesses and opportunities of, and threats to the company.’⁹³

The UK Combined Code provides that the board should include a balance of executive and non-executive directors and in particular independent non-executive directors such that no individual or small group of individuals can dominate the board’s decision taking. The Code further provides that ‘except for smaller companies, at least half the board, excluding the chairman, should comprise non-executive directors determined by the board to be independent. It is stated in the Code that a smaller company should have at least two non-executive directors. This distinction between small and big companies is important especially for small companies which do not require big boards.

The requirement for a big number of independent non-executive directors may not be easily applied in Uganda because of lack of sufficiently experienced directors to take on directorship.⁹⁴ Accordingly, there is a risk that the few available persons who possess the required qualifications may over-commit themselves by accepting numerous directorships. This may lead to inefficiency because of work overload. Secondly, the applicability of this provision to private companies will of course depend on the size of the board. However, the general recommendation of including non-executive independent directors on the board is important for ensuring transparency and accountability. There is growing recognition by business communities across the world that, if companies are to attract long term capital, they

⁹³ King Report (note 88) at 47.

⁹⁴ Tom Wixley and Geoff Everingham *Corporate Governance* 2ed (2005) at 23. The authors argue in relation to the King recommendation which is similar to the one in the Uganda Code regarding non-executive directors, that in South Africa there is a relatively small pool of persons possessing the requisite business acumen and experience who are available to act as non-executive directors.

need to demonstrate transparency both in their internal structures and their communications with the market. The appointment of suitably qualified non-executive and independent directors is a critical factor for good corporate governance in Uganda. For private companies, especially family-owned businesses which dominate the economy, independent directors can assist in resolving disputes involving management or family members; can assist the company in its business operations by providing dispassionate advice; and through the selection of the independent auditor, can create credibility for the company's financial statements in the minds of the banks, other financial institutions, and investors.

3.4.2 Chairperson and chief executive officer

There are two distinct tasks at the top of every company: the running of the board and the executive responsibility for running the company's business.⁹⁵ It is further argued⁹⁶ that the role of the chairman of the company, who is responsible for the former, should be separated from that of the chief executive officer, who is responsible for the latter; there should be a clear and unambiguous division of responsibility at the helm of the company to ensure a balance of power and authority.

The chairperson of the board plays a central role in ensuring the proper functioning of the board; he acts as an important channel of communication between the board and management of the company, it is his duty to ensure that the board is properly briefed on the issues arising at board meetings so that directors are able to ask the right questions and to make informed decision.⁹⁷

The Uganda Code⁹⁸ states that there should be a clear division of responsibilities at the head of the company, ensuring a balance of power and authority, so that no one

⁹⁵ Naidoo (note 7) at 61.

⁹⁶ Ibid

⁹⁷ Naidoo (note 7) at 62 while commenting on the recommendations of King II on the role of the chairman and the separation of the role of the chairman and that of the chief executive officer. The recommendation of King II is similar to the one of the Ugandan Code.

⁹⁸ (Note 58) at 218

individual has ‘unfettered powers or authority’ (Code 2.3.1(b)). This is aimed at preventing a chief executive with a dominating personality imposing his or her will on the board by acting as chairperson as well. The Code further states that where the roles of the chairperson and chief executive are combined, there should be either an independent non-executive director serving as deputy chairperson, or a strong independent non-executive director element on the board. Furthermore, where these roles are combined, this needs to be justified each year in the company’s annual report.

The UK Combined Code has a similar provision which states that ‘there should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company’s business. It is further indicated that no one individual should have unfettered powers of decision. The Code provides that if exceptionally a board decides that a chief executive should become chairman, the board should consult major shareholders in advance and should set out its reasons to shareholders at the time of the appointment and in the next annual report.

In Uganda, most companies are private and the role of the chairperson and the chief executive officer are combined and vested in one person. For these private and family owned companies, the recommendation may not be of concern. The size of most of these companies does not require the separation of the roles of the chairman of the board and that of the chief executive officer. Secondly, most of these companies do not have the resources necessary for the separation of those roles. However for the few public companies and the large private companies, the recommendation is important to guard against concentration of power in the hands of a single individual.

3.4.3 Appointment of directors

At common law, a person’s appointment as director is complete on his appointment to the office by those having the authority to do so and his acceptance or consent to such

appointment.⁹⁹ It is a rule of company law that irrespective of the degree of control which a person may exercise over the affairs of the company, he does not in law occupy the position of director in the absence of actual appointment on proper authority.¹⁰⁰ The process for the appointment of directors in Uganda is essentially controlled by the controlling shareholders. Section 184 of the Companies Act, which provides for the appointment of directors to be voted on individually, states that it must be done at a general meeting of the company. The same provision has been retained in the Companies Bill, 2004 as section 192. Unlike in other jurisdictions¹⁰¹, there is no recommendation made in the Report or the Code aimed at improving and strengthening the selection process especially of non-executive directors.

In the case of UK, the Combined Code provides that there should be a formal, rigorous and transparent procedure for the appointment of new directors to the board. It is further provided that appointments to the board should be made on merit and against objective criteria. The Code has an important provision that ‘care should be taken to ensure that appointees have enough time available to devote to the job’. This provision will stop directors from taking on numerous appointments where they will have no time to concentrate on the affairs of the company.

3.4.4 Meetings of the board

A board of directors should meet sufficiently often to enable the directors to discharge their statutory and common law duties towards the company. The actual procedures for board meetings will be laid down in the articles, which will deal with matters such as the quorum required, voting procedures, etc.¹⁰²

⁹⁹ Cilliers and Benade *Corporate law* 3rd Ed (2000) Butterworth Publishers (SA) at 118.

¹⁰⁰ *Ibid.*

¹⁰¹ King Report (note 88) at 64 recommends that the procedure for appointment to the board should be formal and transparent, and a matter for the board as a whole, assisted where possible by a nomination committee.

¹⁰² Wixley and Everingham (note 94) at 44.

The Uganda Code provides that the board should meet at least once every three months and the number of meetings held and attendance of each director at meetings should be recorded in the annual report. The Code further provides that non-executive directors should have access to management without the executive directors being present. The provisions of the King Code in relation to board meetings are almost similar to the provisions of the Ugandan Code. The King report recommends that the board should meet 'regularly, at least once a quarter, if not more frequently as circumstances require'. The frequency of meetings will depend on the complexity of the company, the volatility of the markets in which it operates, the amount of business that can reasonably be handled at a single meeting, and travelling considerations where directors are not all located in the same city as the company's head office. In its commentary, the King report observes that boards have traditionally met at least once a quarter. However, King states that there is increasing evidence that this is not sufficient, given the heavy demands placed on the directors. Consequently, boards of large and complex enterprises meet up to six or eight times a year, based on up to five formally scheduled meetings and another two or so impromptu ones for consideration of special matters.

In case of the UK, the Combined Code¹⁰³ provides that the board should meet sufficiently regularly to discharge its duties effectively. There should be a formal schedule of matters specifically reserved for its decision. It further provides that the annual report should include a statement of how the board operates, including a high level statement of which types of decisions are to be taken by the board and which are to be delegated to management. It should be noted that the Combined Code does not offer guidance as to what "regular" means in terms of the frequency of the meetings of the board. Clearly this is something which will differ from company to company. It has been said that many companies have delegated quite large areas of responsibility to small committees of the board which meet on a monthly basis, reporting to main board meetings on a quarterly basis.¹⁰⁴

¹⁰³ Paragraph A.1.1 of the UK Combined Code on Corporate Governance, 2006.

¹⁰⁴ Richard Smerdon *A Practical Guide to Corporate Governance* (1998) London Sweet and Maxwell at

For board members to exercise informed, intelligent, objective and independent judgments on corporate affairs, they must have access to accurate, relevant and timely information.¹⁰⁵

The Uganda Code does not make provision for the access of information by the board members prior to board meetings. It should be noted that in order for the directors to be able to contribute adequately at the meetings, particularly in the case of non-executive directors, it is important that directors have all the relevant information and have had time to apply their minds to it.¹⁰⁶ The King report¹⁰⁷ requires efficient and timely methods for informing and briefing board members prior to meetings; this will be the responsibility of the company secretary in most cases. Conversely, each board has a responsibility to be satisfied that, objectively, they have been furnished with all the material facts before making a decision.

The provision in the King Code requiring boards to ‘meet at least once a quarter or frequently as circumstances require is important in that it does not restrict boards on the number of times they should meet. Therefore, the number of meetings will vary from organization to organization, depending on the circumstances of each organization. In principle, board meetings should be event-driven, rather than calendar-driven. For the board members to carry out their duties effectively, it is also important that the boardroom atmosphere is conducive for them to express their views without fear or favour. The chairman should not dominate the meetings and each member should be given an opportunity to express his/ her views.

24.

¹⁰⁵ Private Sector Initiative for Corporate Governance, ‘Principles of Corporate Governance in Kenya.’ Available at www.corporategovernance.kenya.htm [Accessed on 15 July 2007].

¹⁰⁶ Tom Wixley and Everingham (note 94) at 46.

¹⁰⁷ King Code on Corporate Governance (note 88) para. 2.6.2.

3.4.5 Board committees

To justify the need for focused committees, T Wixley and G Everingham¹⁰⁸ state that ‘the board of directors of a typical listed company meets together for less than 24 hours a year, a surprisingly short time to accomplish all that is expected of it.’ The authors further argue that although the modern company’s affairs are run on a day-to-day basis by management, the formal board meeting is the time when the board as a whole, executives and non-executives, comes together for the sole purpose of discussing the company’s strategy and its implementation.¹⁰⁹ Given that the time available to the board to accomplish all its tasks in a single meeting is not sufficient, some issues need to be dealt with in a focused way at subcommittee level, and then later presented to the board as a whole.

There is recognition by business communities across the world that, if companies are to attract long-term capital, they need to demonstrate transparency both in their internal structures and in their communications with the market. A resourceful and dedicated audit committee, given full support by management, can enhance the credibility of business’ communication and help to promote effect internal control.

The King report¹¹⁰ requires that ‘at a minimum, each board should have an audit and remuneration committee’ and indicates in its model terms of reference for board committees that ‘unless the board is small’, it should also have a nomination committee. It also recommends that other board committees may be appropriate depending on ‘industry and company specific issues’. In South Africa, the only statutory requirement under the Companies Act is for a company to have a board of directors. The provisions for board committees arose entirely as a result of the recommendations in the King report. According to the King report, committees may either be standing committees appointed to perform a continuing function or *ad hoc* committees constituted for a specific task. The King report recommends that board

¹⁰⁸ Wixley and Everingham (94) at 58.

¹⁰⁹ Ibid

¹¹⁰ King Report (note 88) at 69.

committees should have clear mandates and areas of authority including written terms of reference, which should specify their composition, role and responsibilities, objectives, powers and authority, term of existence, the frequency of their meetings, and the manner in which reports back to the full board are to be dealt with.

Following on the recommendations of the King Committee, the Companies Bill contains a provision for a statutory requirement of an audit committee. Section 87 of the Companies Bill provides that the board of a company may appoint any number of committees of directors and delegate any of the authority of the board subject to any limitation in the company's memorandum of association. Section 100 of the Bill specifically requires the appointment of an audit committee by a public interest company. An audit committee is required to have at least two members who must be directors of the company but not involved in the day-today management of the company or related to any person involved in management of the company. The section further requires members of the audit committee to act independently in the performance of the committee's functions.

It has been argued¹¹¹ that the danger of incorporating corporate governance requirements into legislation will have the effect of making the omitted requirements appear to be of less value. According to this argument, the inclusion of the audit committee into the Companies Bill will make other committees appear less important. According to the King Report,¹¹² an audit committee is appointed 'to assist the board in discharging its duties relating to the safeguarding of assets, the operation of adequate systems, control processes and the preparation of accurate financial reporting and statements in compliance with all applicable legal requirements and accounting standards'. The existence of a sound audit function is regarded as crucial to good corporate governance, and the audit committee from the point of view of corporate

¹¹¹ Institute of Chartered Secretaries and Administrators of South Africa, Presentation to the Department of Trade and Industry on the Draft Companies Bill, March 2007 at 1 available at <http://www.icsa.co.za/assets/presentations/companiesbill/final.pdf>. [Accessed on 5 June 2007].

¹¹² King Report (note 88), Model terms of reference for board committees, 182-212.

governance, should be seen as the most important of the board committees.¹¹³ The audit committee provides an important channel of communication between the board, management, and the internal and external audit functions of the company.

In Uganda, the provisions regarding audit committees are contained in the Code on corporate governance. This means that the provision only applies to those companies that choose to include the Code in their articles of association. It should be noted that the provision for audit committees as contained in the codes of best practice should remain as a guide to companies to comply or explain and if companies do not comply but explain why, that should be acceptable. Legislating for some board committees as South Africa has done for the audit committees, will first of all have the effect of making the omitted committees appear less important and secondly, it will create an inflexible structure which may be problematic to implement.

3.5 Director's common law duties

Mervyn King¹¹⁴, on the relationship between the company and its directors, states that:

‘While the board has collective authority, each director has individual responsibility. Consequently, if a decision of the board subsequently turns out to have been a bad business judgment call and it is contended that this amounts to a failure in the duty of care, the law looks at the conduct of each director and his level of experience in deciding whether or not that director is responsible.’

Another important area of corporate governance relates to the directors' duties. The directors' duties in Uganda are largely regulated by the common law and doctrines of equity.¹¹⁵ The principles of directors' duties are, therefore scattered in a mass of decided cases which may not be accessible to both shareholders and directors or stakeholders of the company. Yet awareness of these principles is critical to their

¹¹³ Naidoo (note 7) at 72.

¹¹⁴ Mervyn King *The Corporate Citizen: Governance for all entities* (2006) at 36.

¹¹⁵ Bakibinga (note 56) at 42.

enforcement by the affected individuals. For the purposes of good corporate governance, it is important for company law adequately to clarify rules governing the conduct of directors and the remedies available in case of violation of those rules. It should be noted that directors play a fundamental role in ensuring good corporate governance and their duties to the company should clearly be spelt out.

3.6 Codifying directors' common law duties

The United Kingdom has codified the common law fiduciary duties of directors as well as the duty of care, skill and diligence. In the explanatory notes¹¹⁶ to the Companies Act¹¹⁷ the reasons advanced for the codification as recommended by the Company Law Review (CLR) include:

- to provide greater clarity on what is expected of directors and make the law more accessible. In particular, they sought to address the key question 'in whose interests should companies be run?' in a way which reflects modern business needs and wider expectations of responsible business behavior;
- to make development of the law in this area more predictable (but without hindering development of the law by the courts);
- to correct what the CLR saw as defects in the present duties relating to conflicts of interests.

Section 170(1) of the UK Companies Act makes it clear that, as in the existing law, the general duties are owed by a director to the company. It follows therefore that only the company can enforce those duties. However, the Act provides for derivative claims and actions by members which describe the mechanism whereby members may be able to enforce the duties on behalf of the company.

On the question of 'who are the duties owed by', it is stated that the duties are owed by every person who is a director of a company as defined in section 250. They are therefore owed by a de facto director in the same way and to the same extent that they

¹¹⁶ The United Kingdom Explanatory Notes to the Companies Act at 45, available at the Department of Trade and Industry website at <http://www.dti.gov.uk>. [Accessed on 22 June 2007].

¹¹⁷ United Kingdom Companies Act, Cap.46 of 2006.

are owed by a properly appointed director.¹¹⁸ In terms of section 170(2), some aspects of the duty to avoid conflict of interest and the duty not to accept benefits from third parties continue to apply even when a person ceases to be a director. This is necessary to ensure that a director does not exploit an opportunity of which he became aware while managing the company's business without the necessary consent simply by resigning his position as director.¹¹⁹ The closing words of section 170(2) provide that these duties apply to a former director subject to necessary adaptations. This is to reflect the fact that a former director is not in the same legal position as the actual director.¹²⁰

The following duties of directors have been codified: duty to act within power,¹²¹ duty to promote the success of the company,¹²² duty to exercise independent judgment,¹²³ duty to exercise reasonable care, skill and diligence,¹²⁴ duty to avoid conflict of interest,¹²⁵ duty not to accept benefits from third parties,¹²⁶ and duty to declare interest in proposed transaction or arrangement.¹²⁷

Section 170(4) provides that the general duties shall be interpreted and applied in the same way as common law rules or equitable principles, and regard shall be had to the corresponding common law rules and equitable principles in interpreting and applying the general duties. This means that the wealth of jurisprudence available in decided cases is not lost and is to be referred to in interpreting the codified duties. It is also acknowledged¹²⁸ that the statutory duties do not cover all the duties that a director may owe to the company. Many duties are imposed else-where in legislation, such as the duty to file accounts and reports with the registrar of companies. Other duties remain

¹¹⁸ Explanatory notes on the UK Companies Act (note 116) at 47.

¹¹⁹ *Ibid*

¹²⁰ *Ibid*

¹²¹ The UK Companies Act, Cap 46 of 2006, s 171.

¹²² *Ibid* s 172

¹²³ *Ibid* s 173

¹²⁴ *Ibid* s 174

¹²⁵ *Ibid* s 175

¹²⁶ *Ibid* s 176

¹²⁷ *Ibid* s 177

¹²⁸ Explanatory notes on the UK Companies Act (note 116) at 47.

uncodified, such as any duty to consider the interests of creditors in times of threatened insolvency.

In the case of South Africa, it is acknowledged in the policy document¹²⁹ that it is important to clarify the rules governing the conduct of directors and the remedies available for the violation of the rules. It is stated that a statutory standard for conduct and a clear statement of duties would assist in capturing case law set out in other jurisdictions and would give directors a degree of certainty about their duties, the standard for their conduct and associated liabilities.

While recommending codification of directors duties, the policy document¹³⁰ acknowledges fears that codification may be difficult because there is little consensus in the legal community as to what precisely is the content of fiduciary duties of directors, which exist in common law. Furthermore, it is argued that some of the cases in this area are irreconcilable and this makes it difficult to point to the existing legal position with precision or certainty. It is recommended in the policy document¹³¹ that the benefits of a statutory standard for conduct of directors should be evaluated against the constraints it will place on the development of common law.

Section 91 of the South African Companies Bill provides for standards of directors duties. The section states that a director, when acting in that capacity or as a member of a committee of directors, is subject to a duty to exercise the degree of care, skill and diligence and a fiduciary duty to act honestly and in good faith, and in a manner the director reasonably believes to be in the best interests of, and for the benefit of, the company. The section further provides that in addition to the general duty of care, and fiduciary duty, a director must comply with the Act and the company's memorandum of incorporation, and communicate to the board any material information that comes to his attention. Section 91(6) provides that the provisions of the section are in addition

¹²⁹ DTI policy document (note 62) at 39.

¹³⁰ DTI Policy document (note 62) at 39.

¹³¹ DTI Policy document (note 62) at 40.

to, and not in substitution for, any duties of the director of a company under the common law. This means that like in the case of UK, regard will be had to common law duties of directors in aspects not covered under the Bill.

It has been argued that it is important to codify directors' common law duties but the difficulty lies in deciding whether the codification should be an exhaustive one or a partial codification intended to be primarily educational.¹³² Michele Havenga¹³³ argues that partial regulation would be the most appropriate for South Africa. She further argues that partial regulation serves the purpose of making the law easily accessible, whilst retaining some flexibility. On the other hand, the Institute of Chartered Secretaries and Administrators of South Africa¹³⁴ has argued that the danger of incorporating corporate governance requirements into legislation includes; 'the omission of important requirements from legislation will be seen as making the omitted requirements of less value.'

It should be noted that both South Africa Companies Bill and UK Companies Act acknowledge that despite the attempted codification, some of the duties remain uncodified. In both cases reference is made to the common law duties. However, the Companies Act of UK provides a more detailed statutory standard for directors' duties than the South African Companies Bill. As indicated earlier, Uganda has not attempted to codify directors' duties and no guidelines have been provided in the Code in respect of directors' duties. It is proposed that Uganda follows the example of the UK to codify directors' common law duties. This is preferred because it gives a detailed statutory standard for directors' duties which is a good reference point for all the directors and others who may require that information. A provision should be included to make reference to common law duties in cases where gaps exist and regard should be had to common law in interpreting the codified duties. Such a move will not only make the law accessible and go some way to ensure that directors are clear about their

¹³² Michele Havenga, 'Regulating conflicts of interest and South African Company Law Reform' University of South Africa, available at <http://www.law.usyd.edu.au/parsons/CLTA/HavengaPaper.pdf>, at 7. [Accessed on 19 June, 2007].

¹³³ Ibid

¹³⁴ Institute of Chartered Secretaries and Administrators of South Africa (note 111) at 1.

obligations, but it would clarify to foreign and domestic investors which rules govern the behavior of directors and what remedies are available when those rules are violated.

3.7 Statutory duties of directors

In addition to their common law responsibilities, directors have a number of statutory duties towards their company.¹³⁵ These include; disclosure by directors of interests in contracts in terms of s 200 of the Companies Act; prohibition on loans to directors under s 191. These provisions have been retained in the Companies Bill, 2004 in sections 222 and 199 respectively. In addition, the Bill makes provision for substantial property transactions involving directors under section 223, duty of director to disclose shareholdings in own company in terms of section 229. Remedies in case of breach of these provisions are also provided in terms of sanctions and fines.

In South Africa, sections 234-241 of the Companies Act¹³⁶ provide that there must be disclosure of interest any director may have in a contract involving the company. Such disclosure is required to be made to the board by the affected director. The director may be considered to be interested in a contract with another company if, for example, he is a director or shareholder of that company. It is important that these disclosures be provided, because if they are not given, the contract may be voidable and the director may be liable to various charges under the Act. Section 226 of the Companies Act contains a general prohibition on the making of loans to directors. There are a number of exemptions, for example where the company carries on the business of money lending. There is also a general exemption where the consent of all shareholders is given; this is particularly helpful in the case of public companies seeking to lend money to their directors. Where such loans are made, there are disclosure requirements in terms of section 295 of the companies Act.

¹³⁵ These statutory duties are contained in the current Companies Act, Cap.110, revised laws of Uganda, 2000. Similar provisions have been included in the Companies Bill, 2004.

¹³⁶ Act No. 61 of 1973.

On the other hand, section 175 of the UK Companies Act provides that transactions or arrangements with the company do not have to be authorized by either the members or by the board; instead interests in transactions or arrangements with the company must be declared under section 177 (in the case of proposed transactions) or under section 182 (in the case of existing transactions) unless an exception applies under those sections. Section 175 further permits board authorization of most conflicts of interest arising from third party dealings by the director, for example, personal exploitation of corporate resources and opportunities. Such authorization is effective only if the conflicted directors have not participated in the taking of the decision or if the decision would have been valid even without the participation of the conflicted directors. Board authorization of conflicts of interest will be the default position for private companies, but public companies will need to make provision in their constitutions to permit this. Board authorization is not permitted in respect of the acceptance of benefits from third parties under section 176.

3.8 Recognizing the rights of stakeholders

Directors in the twenty-first century have to be seen to be directing companies to be good corporate citizens. The inclusive approach recognizes that a company is a link that brings together the various stakeholders relevant to the business of the company.

Mervyn King,

The Corporate Citizen: Governance for all entities (2006)

A company's stakeholders are 'those whose relations to the enterprise cannot be completely contracted for, but upon whose cooperation and creativity it (the company) depends for its survival and prosperity'.¹³⁷ This includes investors (the source of the company's financial capital), the employees (the source of the company's intellectual and human capital), customers (the source of the company's revenue), suppliers and business partners, and the surrounding communities, government and society at large

¹³⁷ Naidoo (note 7) at 130.

(the source of the company's 'licence' to operate). Defining the company's stakeholders, identifying their sometimes conflicting interests, and maintaining a balance between these and the collective good of the company in which these stakeholders' interests converge in equilibrium, are all integral to good corporate governance.¹³⁸ It has been argued that participation by various stakeholders may complement other internal and external monitoring mechanisms and thereby promote greater managerial accountability.¹³⁹

A vital step in the strategic planning process is the definition of key stakeholders.¹⁴⁰ A company's stakeholders are 'those whose relations to the enterprise cannot be completely contracted for, but upon whose cooperation and creativity the company depends for its survival'.¹⁴¹ This includes investors, employees, customers, suppliers and business partners, and the surrounding communities, government and society at large. It has been argued that satisfying stakeholders is both morally desirable and makes good business sense.¹⁴² Firms which build good relations with stakeholders gain competitive advantage.

The corporate governance reform guidelines in Uganda as contained in the Report on company law, the Companies Bill, 2004 and the Code of corporate governance do not make provision for stakeholders' involvement. It should be noted that companies in Uganda do not operate in a vacuum and cannot therefore shield themselves from a person or group interested directly or indirectly in the outcome of a company's activities.

¹³⁸ Ibid

¹³⁹ The Department of Trade and Industry and King's College London, 'Key Drivers of Good Corporate governance and the Appropriateness of UK Policy Responses' (2007) at 68, available at <http://www.berr.gov.uk/files/file36671.pdf> [Accessed on 26 July 2007].

¹⁴⁰ Wixley and Everingham (note 94) at 17.

¹⁴¹ Slinger and Deacon, ESRC Centre for Business Research, quoted in King Report on Corporate Governance (2002) (note 88) at 103.

¹⁴² The Department of Trade and Industry and King's College London, 'Key Drivers of Good Corporate governance and the Appropriateness of UK Policy Responses' (2007) at 69, available at <http://www.berr.gov.uk/files/file36671.pdf> [Accessed on 26 July 2007].

In UK, the Companies Act¹⁴³ explicitly states that it is the directors' duty to promote the success of the company for the benefit of its members as a whole, and in fulfilling this duty the directors must have regard to both short and long term factors and wider interests including employees, trade partners, the community and the environment. This approach is consistent with the view that stakeholder involvement is likely to influence long-term company performance¹⁴⁴ and maximize overall wealth protection and wealth creation for all the stakeholders.¹⁴⁵

It has been argued that the relevant sections of the UK Companies Act on stakeholders will take sometime to bed down and will undoubtedly be subject to interpretation by the courts. The view that stakeholders other than shareholders have an interest in corporate governance is given some limited support in other laws, codes and documents. In the case of employee stakeholders, it is supported by certain aspects of employment law, which give employees the right to information and the right to consultation.¹⁴⁶ While the Companies Act obliges managers to give due consideration to stakeholder interests, the regulation of specific rights for stakeholders or obligations is relatively dispersed and somewhat limited. Besides the new developments in the Companies Act, in other areas such as the Listing Rules, the Combined Code and in professional standards, one can find little systematic notion of broader stakeholder interests. However, this is not to say that there are no other forms of regulation, which play some part here, such as regulation of particular sectors, such as the employment, environment, which go some way to fill any gap on a sectoral needs basis.

In South Africa, the King report states that although the principle that 'directors and boards owe their duty to the company and thereby are accountable to the shareholders, as owners of the corporation capital' remains paramount, 'it must be acknowledged that global awareness is growing that any company's long-term commercial success is inextricably linked to the development of the social and economic communities within

¹⁴³ The UK Companies Act, Cap 46 of 2006, section 172.

¹⁴⁴ Salacuse (note 14) at 75.

¹⁴⁵ The Department of Trade and Industry and King's College London (note 139) at 149.

¹⁴⁶ Ibid

which it operates.’ One of King’s focal points on stakeholders is the move from single to triple bottom line accountability. The approach aims at achieving a balance between the needs of organizational prosperity, the human needs associated with the company’s business, and the needs of the environment – the people, planet and profit triad. It implies responsible development that ‘meets the needs of the present without compromising the ability of future generations to meet their own needs’, engenders good corporate citizenship, and improves a company’s risk management practices – thus improving the company’s chances of sustainability.¹⁴⁷

Stakeholder participation in corporate governance certainly has important costs associated with it. Disclosure of corporate social responsibility or environmental impacts greatly increases the scope of information to be included in company reporting and raises issues of establishing objective and comparable standards across firms. Likewise, stakeholder voice may also have considerable impact on decision-making processes within the firm. In particular, employee involvement may slow down decision times. However, stakeholder involvement may have offsetting benefits of speeding up implementation once decisions have been made, since stakeholders will have higher levels of information and greater consensus around those decisions. This will have the effect of complementing other internal; and external monitoring mechanisms thereby promoting greater managerial accountability. It is therefore important that Uganda makes provision for stakeholders in the corporate law reform process. Provisions on stakeholders should be included in the Code of Good Corporate Governance following examples from South Africa and the UK.

3.9 Shareholders’ rights and engagement

Shareholders have a key role to play in driving long-term company performance and economic prosperity.¹⁴⁸ Informed, engaged shareholders or those acting on their behalf are the means by which the directors are held to account for business strategy and

¹⁴⁷ Ramani Naidoo (note 26) at 132.

¹⁴⁸ ‘The UK Companies Act, 2006, Regulatory Impact Assessment, January 2007.’ Available at <http://www.dti.gov.uk/files/file29937.pdf>. [Accessed in 26 June 2007] at 11.

performance and by which investment decisions are taken that reflect the most efficient allocation of capital.¹⁴⁹ The investment chain has become complex making communication up and down the chain difficult. On the other hand, rapid growth in the use of new information and communication technologies over the recent years presents greater opportunities to reduce costs and enhance the immediacy and transparency of dialogue between companies and shareholders.

The UK Companies Act¹⁵⁰ extensively provides for shareholder engagement in the governance of companies. This is done through enhancing the power of proxies and enfranchising indirect investors. Such provisions include: access to timely and transparent company information,¹⁵¹ exercising rights through proxy,¹⁵² facilitating e-communication,¹⁵³ shareholders' right to sue directors for negligence (derivative claims),¹⁵⁴ and the right to petition against unfair prejudice.¹⁵⁵ The Combined Code outlines a number of further guidelines for shareholder activism that go beyond voting at AGMs and legal actions against directors. These principles are based on the principle of continuous engagement of shareholders.

In the case of South Africa, four basic rights of shareholders are identified:¹⁵⁶ a right to capital, a right to income, a right to vote and a right to information. It is recommended that the ambit of these rights should be determined in legislation, but recognizing that only a right to vote and a right to information are absolute. Thus in the explanatory memorandum,¹⁵⁷ it is stated that 'the law should protect shareholder rights, advance shareholder activism and provide enhanced protection for minority shareholders. The Companies Bill provides for shareholder meetings, right to information, facilitation of proxy voting and electronic voting.¹⁵⁸ The Bill also provides for shareholder remedies

¹⁴⁹ Ibid

¹⁵⁰ The UK Companies Act, Chapter 46 of 2006.

¹⁵¹ Ibid ss 146-151, 423-432, 1145.

¹⁵² Ibid ss 324-331.

¹⁵³ Ibid s 147(4), Parts 3 & 4 of Schedule 5.

¹⁵⁴ Ibid s 260.

¹⁵⁵ Ibid s 994.

¹⁵⁶ DTI Policy Document (note 62) at 37.

¹⁵⁷ Explanatory Memorandum to the South Africa Companies Bill, 2007 at 5.

¹⁵⁸ Companies Bill, 2007, ss 77-83

including; shareholders' right to information,¹⁵⁹ application to protect shareholders' rights,¹⁶⁰ application to declare a director delinquent or under probation,¹⁶¹ application for relief from oppression or prejudicial conduct,¹⁶² dissenting shareholders' appraisal rights,¹⁶³ and derivative actions.¹⁶⁴

The King report¹⁶⁵ recommends the encouragement of corporate-governance-focused shareholder activism, particularly amongst institutional investors. An environment should be created for shareholders to be more than speculators, to be owners concerned with the well-being of the company in which they invested, and constantly to check whether the directors of the company practice good corporate governance.¹⁶⁶ To encourage shareholder activism, King Report recommends; educating shareholders in corporate governance, introduction of class actions and a contingency-fee system to encourage legal action, review of quorum requirements to encourage participation at general meetings, establishment of shareholder watch-dog organizations to look after the interests of minority shareholders, and the role of institutional investors in achieving successful corporate governance.

In addition to the provisions on shareholder rights to vote and to a proxy which have been included in the Companies Bill, Uganda's company law reform should make provision for; access to timely and transparent company information, minority shareholders' rights, right to apply to court for redress on behalf of the company, and in this era of information technology, e-communication should be encouraged. It is recommended that Uganda follows the examples of UK and South Africa to enhance shareholder enhancement in the governance of companies with the necessary modifications to suit Uganda's circumstances.

¹⁵⁹ Ibid s 27.

¹⁶⁰ Ibid s 162.

¹⁶¹ Ibid s 163.

¹⁶² Ibid s 164.

¹⁶³ Ibid s 165.

¹⁶⁴ Ibid s 166.

¹⁶⁵ King Report (note 88) at 149.

¹⁶⁶ Conrad Rademeyer and Johan Holtzhausen 'King II, Corporate Governance and Shareholder Activism' (2003) 120 Issue 4 *SALJ* Vol, at 768.

3.9.1 Shareholder remedies

The majority shareholder rule states that where it is legally necessary to enforce a duty owing to the company, the only plaintiff is the company itself.¹⁶⁷ However, since the company is in reality a fiction, the power to litigate on its behalf must be vested in some person or group, which has been identified as the majority of the shareholders in a general meeting.¹⁶⁸ Low Chee Keong¹⁶⁹ argues that shareholder suits are far and few between due to the decision in *Foss v Harbottle*. The rules, i.e. the proper plaintiff rule and the internal management rule, in the case have had the unintended consequence of placing a major obstacle in the way of minority shareholders given that companies are unlikely to bring an action against their directors or majority shareholders for breach of duty or acts of bad governance. However, the door is not completely closed on minority shareholders as they are, in limited circumstances, allowed to sue on behalf of the company by way of a derivative action or to bring personal actions.¹⁷⁰ In terms of effective corporate governance, the rule in the *Foss* case and its exceptions where a shareholder may bring an action needs to be codified in Uganda.

3.9.2 The derivative action

The derivative action is an action brought by an individual shareholder on behalf of himself and other members except the wrong-doers to remedy a wrong done to the company and which cannot otherwise be corrected because of the reluctance or refusal of the majority wrong-doers to rectify the wrong.¹⁷¹ This remedy falls broadly within the fraud on the minority or company exception under the rule in *Foss v Harbottle*. In

¹⁶⁷ *Foss v Harbottle* (1843) 2 Hare 461; 67 E.R. 189 (Ch.) at 203-04.

¹⁶⁸ *McDougall v Gardiner* (1875) 1 Ch.D 13 (CA)

¹⁶⁹ Low Chee Keong 'Disclosure, Reporting and Derivative Actions: Empowering shareholders in Southeast Asia' in Ho Khai Leong (ed) *Reforming Corporate Governance in Southeast Asia: Economics, Politics and Regulations* (2005) at 43.

¹⁷⁰ The most important exception to the rule in *Foss v Harbottle* is 'fraud on the minority' where the wrong doers are in control of the company.

¹⁷¹ *Wallersteiner v Moir* (No.2) 1 All E. 849, 857 per Lord Denning.

terms of corporate governance in Uganda, this rule requires codification to clarify the circumstances under which a derivative action can be brought.

In South Africa, the Companies Bill, 2007¹⁷² abolishes any right at common law of a person other than the company to bring or prosecute any legal proceedings on behalf of the company. The section provides that a person may serve a demand upon a company to commence or continue legal proceedings, or take related steps, to protect the interests of the company if the person is a shareholder, a former shareholder, or a person entitled to registered as a shareholder, of a company or a related company; or a director or a registered trade union.

It must however be recognized that the path to litigation is fraught with practical difficulties for the minority shareholders. First, they must take cognizance of the fact that they are potentially liable for the costs of initiating the action in the name of the company. Secondly, they have no corresponding right to potential damages that may be awarded by the court since these go to the company. Thirdly, the courts have often been persuaded to give due regard to whether the alleged breach may be ratified by the general meeting. Lastly, the inability to access information, which flow is controlled by the directors, by the minority shareholders is a substantial obstacle to the commencement of a proper action.

It is for the forgoing reasons that the researcher recommends the introduction in the Uganda's Companies Act of the statutory derivative action that will empower the court to consider factors such as the good faith of shareholders and the interests of the company, rather than whether the case falls within the established exceptions to the rule in *Foss v Harbottle*, in determining whether a shareholder should be allowed to sue in the name of the company.

¹⁷² Section 166 of the Companies Bill, 2007.

3.9.3 The alternative remedy to winding up the company

Section 211 of the Companies Act, permits a member of the company who complains that the affairs of the company are being conducted in a manner oppressive to some part of the members, himself inclusive, to petition the court for relief. Bakibinga¹⁷³ argues that in its life in other jurisdictions, the corresponding provision was so restrictively interpreted that petitioners under it only succeeded in three cases.¹⁷⁴ He further argues that the provision has since been reformed in other Commonwealth countries¹⁷⁵ which would provide an example for the reform of section 211 in Uganda. It should be noted that the Companies Bill, 2004 has retained this provision¹⁷⁶ without any adjustment despite the recommendation made in the Report¹⁷⁷ to review it.

Ever since the landmark case of *Foss v Harbottle* it has become increasingly evident that minority shareholders in any corporate body need a certain amount of protection from the sometimes unfair actions of the majority shareholders who might even be the directors. According to the current law, the only remedy available to the minority shareholders is to petition for the winding up of the company on the “just and equitable” ground. This essentially means that the only way of addressing the grievances of the minority shareholder is to windup the company which may not necessarily be the solution that might be sought by a minority shareholder, especially if the company is a profitable one.

In South Africa, the Companies Bill, 2007 proposes to reform this principle. Section 164 of the Bill provides that a shareholder, creditor or director of a company may apply to court for relief if any act or omission of the company, or a related person, has had a result that is oppressive, unfairly prejudicial or disregards the interest of the applicant. The section further empowers court to order a wide range of remedies.

¹⁷³ Bakibinga (note 56) at 48.

¹⁷⁴ *Scottish Cooperative Wholesale Society Ltd v Meyer* [1958] 3 All ER. 66 H.L; *Re H.R Harmer* [1950] 1 W.L.R 62; *Re Jermyn Turkish Baths Ltd* [1970] W.L.R 1194

¹⁷⁵ Bakibinga (note 56) at 48 makes reference to the Companies Acts of various Commonwealth countries that have reformed this provision.

¹⁷⁶ Companies Bill, 2004, s.251.

¹⁷⁷ (Note 58) at 40.

Section 162 of the Bill also provides that a shareholder of a company may apply to a court for a declaratory order determining any rights of a shareholder in terms of the Act, the company's memorandum of incorporation or any rules of the company for appropriate orders to protect the rights of the shareholder or rectify any harm done to the shareholder by the company. In terms of section 159 of the Bill, where any person is entitled to apply for a remedy under the Act, that right extends to persons acting on his behalf, a person acting as a member of, or in the interest of, a group or class of persons, a person acting in public interest, or an association acting in the interest of its members.

In South Africa and the United Kingdom where the provision has been reformed, the category of petitioners who have *locus standi* to apply in respect of oppressive or unfairly prejudicial conduct against a petitioner has been widened to include officers and creditors of the company, personal representatives of the deceased member and any other person deemed appropriate to petition the court. The reinforcement of section 211 in the Uganda's Companies Act will provide an individual shareholder additional power for enforcing the company's duties.

3.10 Corporate governance in private businesses and other small organizations

In the wake of corporate scandals, widespread unethical behavior, and illegal activity in some of the most respected organizations, corporate governance has become important in both public and private organizations.¹⁷⁸ Privately-owned companies especially those with a serious desire to grow and perhaps someday get stock exchange listings of their own, should consider adopting key elements of corporate governance simply because it will be good for business.¹⁷⁹ Private enterprises especially those with employee owners need to ground their organizations upon solid foundations of fiscal and management responsibility to avoid problems that could interfere with their

¹⁷⁸ Lindsay Moore 'Corporate Governance in Private Organisations.' Available at <http://www.klminc.com>, [Accessed on 25 July 2007].

¹⁷⁹ 'Governance and Small Business.' Available at <http://www.visa.ca/samllbusiness/articles> [Accessed on 19 July 2007].

future.¹⁸⁰ Good corporate governance will help private companies to gain access to good advice, talent and money. It also sets to rest the concerns of service providers the company deals with. Accountants, bankers, consultants and venture capitalists, to name four of the most prominent handmaidens to company growth, all like to see well-established processes and systems in place because they imply order and stability.¹⁸¹ Private companies need to adopt “best practices” and transparency to assure private investors, employee owners, workers, and their society of their integrity, as well as to suit themselves for possible or eventual IPOs, mergers, or acquisition by a public company. While the various new rules and regulations are extensive, some of the most important new practices that apply to private boards and enterprise governance require: new and significant levels of director independence, directors that have financial knowledge, increased work and due diligence on the part of directors, establishing written guidelines and codes of ethics, and in some cases, that directors conduct performance appraisals of the CEO and a self-appraisal of themselves.¹⁸²

Unlike public companies, which increasingly have the specifics of governance spelled out for them by laws and regulations, small and medium-sized private companies first have to figure out what governance means to them and then adopt the structures and processes they need. Even though well-developed governance processes are not mandatory for private companies, the recent corporate scandals have led service industries such as accountancy to expect higher standards in the companies they serve, both public and private. And for growing companies that will need access to capital, good governance may not be an option.

Although the King Code does not apply to organizations other than listed companies, banks, insurance companies, public entities and other state bodies, it does suggest that those organizations which fall outside its net should consider applying its principles.

¹⁸⁰ Lindsay Moore (note 178)

¹⁸¹ (Note 179)

¹⁸² Ibid

To a small business owner, corporate governance may seem an unnecessary luxury. The simple battle to survive is enough for many people. More rules and procedures are seen to add extra complications and increase the risk of failure.¹⁸³ It is a well documented fact that the vast majority of new ventures fail within the first year of their establishment.¹⁸⁴ First among the reasons for failure is the difficulty of obtaining finance; next is the need to master all the different skills required by even the smallest business. Poor corporate governance is seldom seen as a reason for the failure of a small business.

As private companies continue to seek equity capital from sources other than the pockets of the founders, many providers of development capital to small companies believe governance procedures are an aid to sound management.¹⁸⁵ Accordingly, some capital providers commonly require specific provisions for corporate governance to be built into the contractual relationship governing the terms upon which they introduce capital to private companies.¹⁸⁶ These include:

- the right to appoint an independent director or directors;
- a requirement that board meetings should be held regularly;
- a requirement that paper work for meetings should be comprehensive and formal;
- monthly management accounts comprising a profit and loss account, balance sheet and cash flow forecast;
- sometimes new auditors.

In addition, investors clearly have a legitimate interest in the size of salaries and other payment made to the directors and senior staff.¹⁸⁷ This may not justify the appointment of a remuneration committee, but the principle of accountability to shareholders is the same. Similarly, there is no need for an audit committee, but high standards of auditing and relationship with the auditors are important. The presence of non-executive

¹⁸³ Wixley (note 94) at 164.

¹⁸⁴ Ibid

¹⁸⁵ Richard Smerdon *A practical Guide to Corporate governance* (1998) London Sweet and Maxwell at 19.

¹⁸⁶ Ibid

¹⁸⁷ Ibid

directors on the boards of private companies requires a particularly sensitive approach. There may be a mismatch of expectations which can be alleviated by setting out terms of the appointment in a simple letter, with detailed preliminary discussions between the director concerned and senior staff.

The impact of company law on business development in Uganda is in some respects tied up with the regulation of small companies. At the moment, the regulatory requirements for both private and public companies are similar.¹⁸⁸ The need for instance to comply with the statutory requirements to: hold annual general meetings,¹⁸⁹ keep accounts and appoint auditors,¹⁹⁰ have a company secretary,¹⁹¹ file annual returns¹⁹² tend to be unduly burdensome for many private small companies. The Companies Bill, 2004 has retained similar provisions. Bakibinga¹⁹³ states that a private sector survey revealed that on average, 15% of management time was consumed by regulatory compliance activity, with some firms reporting as much as 40%. This has to change given the critical role played by small firms in Uganda in creating employment, experimentation and innovation that leads to technological improvement and economic growth. Therefore, although corporate governance is important for both private and public companies, the application and enforcement of corporate governance principles among small private companies should be relaxed.

3.11 Administration, compliance and enforcement

Section 386 of the Uganda Companies Act, cap. 110, provides for the designation of a registrar to be responsible for the registration of companies under the Act. The section further makes provision for such deputy and assistant registrars, clerks and servants to assist the registrar in carrying out his duties under the Act. Section 389 of the Act

¹⁸⁸ Companies Act, Cap 110, Part V, ss.107-163.

¹⁸⁹ Ibid ss. 130-146.

¹⁹⁰ Ibid ss 147-163

¹⁹¹ Ibid s 178

¹⁹² Ibid ss 125-129

¹⁹³ Bakibinga (note 56) at 50.

provides for the enforcement of the duty of a company to make returns to the registrar. The Companies Bill, 2004 retains the same provisions.

The problem with the Act is that it does not adequately provide for the duties and functions of the registrar. While in some jurisdictions there is a special body to administer the Companies Act, in Uganda, the administration of the Act remains under the Registration Services Bureau in the Ministry of Justice and Constitutional Affairs. The Bureau, headed by the registrar general, is not equipped to investigate alleged breaches contained in the Companies Act and does not have the capacity to police all the companies in Uganda. There is need to establish a specialized institution to monitor the progress of enforcement of corporate governance regulations and guidelines in addition to the role of criminal and civil courts in company law enforcement.

The King Committee¹⁹⁴ made the following observation regarding compliance and enforcement; '[a]ll principles embodied in a code of corporate governance are effective only if adequate remedies and sanctions exist to enforce compliance with those principles.' Rules are only as effective as their enforcement.¹⁹⁵ Thus, while social and cultural dimensions are significant, the importance of improving the enforcement of existing laws and regulations cannot be overemphasized. There is need to have the necessary infrastructure in place to enable effective enforcement. Besides regulations and codes of conduct, corporate governance reforms have to aim at progressively strengthening the existing institutional framework to ensure compliance and enforcement.

Company law reform should ensure that through a proper system of corporate governance, disclosure and exposure to market forces, wrongdoing is discouraged and punished. It was observed¹⁹⁶ that traditionally, company laws have left the enforcement of their provisions to shareholders, the liquidator in winding-up, and the

¹⁹⁴ King Report (note 88) at 153.

¹⁹⁵ Cheah Kooi Guan 'Corporate Governance Reforms in Malaysia: Issues and Challenges' in Ho Khai Leong (ed) *Reforming Corporate Governance in Southeast Asia: Economics, Politics and Regulations* (2005) at 94.

¹⁹⁶ Department of Trade and Industry, South Africa (note 62) at 45.

Director of Public Prosecutions. It was further noted that ‘experience has shown that these methods of enforcement are inherently defective’.¹⁹⁷ It was established that an independent and suitably empowered body is necessary, charged with the duty to ensure compliance with the provisions of the Act that wrongdoers are brought to book effectively and efficiently.¹⁹⁸ In South Africa, the Companies Bill makes provision for a new institutional framework consisting of a Companies and Intellectual Property Commission aimed at ensuring proper administration, compliance with, and enforcement of the provisions of the Companies Act. It is recommended that Uganda puts in place a specialized body charged with the administration of company matters especially with regard to corporate governance issues.

3.11.1 Application of codes of best practice

The King report¹⁹⁹ provides that the Code applies to business enterprises as stated in the code. These include: all companies with securities listed on the JSE securities exchange, banks, financial and insurance entities, and public sector enterprises and agencies that fall under the Public Finance Management Act. King report also encourages other companies not mentioned to give due consideration to the application of the code insofar as the principles are applicable. It is stated that the code should be applied in addition to requirements contained in statutes, regulations and other authoritative directives regulating the conduct and operation of such enterprise.

Some tenets of the King code of corporate governance are now compulsory for companies listed on the Johannesburg Stock Exchange (JSE), those companies must report compliance with the Code in their annual statements. Each company director must certify that he or she is satisfied that the company has complied with the listing requirements. The JSE Listing Requirements²⁰⁰ provides that applicant issuers must include in the pre-listing statement, a narrative statement of how it has applied the

¹⁹⁷ Department of Trade and Industry, South Africa (note 62) at 46.

¹⁹⁸ Ibid

¹⁹⁹ King Report (note 88) at 21.

²⁰⁰ JSE Listing Requirements, Section 7.F.5.

principles set out in the King Code, a statement of the company's compliance with the Code and the reasons for each and every instance of non-compliance. The Listing rules further state the specific requirements concerning corporate governance that listed companies must disclose their compliance therewith in their pre-listing statements.

In its preamble, the UK Combined Code states that the Code applies to listed companies with a requirement that companies make a disclosure statement reporting on how it applies the principles in the code. Secondly, the company has either to confirm that it complies with the code's provisions or, where it does not, to provide an explanation. The Combined Code further states that small listed companies may judge that some of the provisions are disproportionate or less relevant in their case, but such companies are encouraged to adopt the approach in the Code.

The provisions in both the King Code and the Combined Code give direction on the applicability of the corporate governance principles provided in the codes. The Uganda Code of Good Corporate Governance does not specifically state the enterprises to which it applies. Section 11 of the Uganda Companies Bill, states that a company may adopt any or all of the provisions of the code and incorporate them in its articles of association. This provision leaves companies in Uganda at liberty to choose either to apply the code or not. The enforcement of the code in this case becomes difficult since it is not meant to apply to specific enterprises. An approach as that adopted by the King Code is recommended for Uganda, which applies the code to a wide range of enterprises including; listed companies, banks, financial and insurance entities and public sector enterprises. This is particularly important because most companies in Uganda are not listed on the Securities Exchange.²⁰¹

The application of the Code on corporate governance in Uganda is different from the situations in both South Africa and UK in that under section 11 of the Companies Bill, once a company has chosen to include the Code in its articles, it will be bound by its

²⁰¹ At present, there are only six local and three cross border companies listed on the Uganda Securities Exchange, refer to the Uganda Securities Exchange website at <http://www.use.or.ug>.

provisions. Therefore application of the code is by choice since if a company does not include the Code in its articles, it will not be obliged to comply with its provisions. So, unlike in UK and South Africa, there is no option of comply or explain. It is important that the code is applied to specified business enterprises which should have the option to comply or explain non-compliance.

3.11.2 Consequences of breach of directors' duties

Weak enforcement of rules and regulations has been a perennial concern for investors in emerging markets. A precarious balance exists between sensible regulations and unreasonable enforcement.²⁰² Theoretically, the most effective internal monitors of corporate governance are the directors.²⁰³ The King Report establishes the board of directors as central to the South African corporate governance system, with ultimate accountability and responsibility for the performance of the dealings of the company. In view of the responsibility put on the directors of a company either by statute or common law, there is need to provide for consequences of breach of such responsibility.

Section 178 of the UK Companies Act provides for the preservation of existing civil remedies for breach or threatened breach of general duties. The remedies for breach of the general duties are the same as those available for breach of common law duties. Section 178(2) makes it clear that the duties are enforceable in the same way as any other fiduciary duty owed to a company by directors, except for the duty to exercise reasonable care, skill and diligence, which is not considered to be a fiduciary duty. It is stated in the Explanatory Notes to the UK Companies Act that in the case of fiduciary duties, the consequences of breach may include:

- damages or compensation where the company has suffered loss;
- restoration of the company's property;

²⁰² Melinda Vaughn and Lori Verstegen Ryan 'Corporate Governance in south Africa: a bellwether for the Continent?' (2006) *Corporate Governance: An International Review* 14 (5), 504-512. Available at <http://www.blackwell-synergy.com/doi/abs/10.1111/j.1467-8683.2006.00533.x> [Accessed on 20 May 2007].

²⁰³ Ibid

- an account of profits made by the director; and
- rescission of a contract where the director failed to disclose an interest.

The above is in addition to other remedies available to the shareholders of the company.

Section 93 of the South Africa draft Companies Bill makes a director liable to the company and any other person for any loss arising from that director's signing or agreeing to sign a false or misleading financial statement or prospectus, or be reckless in the conduct of a company's business. Subsection (6) of section 93 provides that the section applies in addition to any rule of common law that is consistent with the section. In addition to this provision, the Bill provides for the protection of whistle-blowers.²⁰⁴ This will go along way to encourage people to disclose information regarding breach of duty by the directors or other officers of the company without fear of liability for such disclosure.

In order to improve corporate accountability, the South African Companies Bill makes it an offence for a director to sign or agree to a financial statement or prospectus that is false, misleading or untrue, or be knowingly party to the reckless carrying on of a business.²⁰⁵ Section 217 of the Bill provides penalties in case of breach of the duties for a fine or imprisonment of a term not less than 10 years. It should be noted that the Companies Bill has several sections detailing directors' liabilities ranging from how to punish lies in a company prospectus to the real requirements on shareholder rights.

Given the new liabilities heaped on directors in the draft Companies Bill, it may be difficult for companies to find people willing to act as directors. It is rather harsh, since directors can be sued in their personal capacity for virtually any loss that is suffered due to a company's actions. On the other hand, Uganda has not dealt with the issue of consequences of breach of directors duties. Considering that Uganda has a limited source from which to choose directors, it is better not to heap a lot of liabilities on the

²⁰⁴ Companies Bill s 161.

²⁰⁵ Ibid s 215.

directors since this is likely to make it difficult for companies to find people willing to serve as directors.

3.11.3 Disqualification of directors

In South Africa, the policy document of Ministry of trade and industry,²⁰⁶ recommends that disqualification for directors should be clearly outlined in company law and should at least include un-rehabilitated insolvents and persons with certain categories of convictions. It suggests that the English Disqualification Act provides a framework for such disqualifications and may guide the drafters. The King Committee²⁰⁷ also recommends legislative changes to buttress the existing provisions of the Companies Act²⁰⁸ regarding directors' disqualification. The King committee²⁰⁹ particularly recommended the amendment of the Companies Act to provide for the disqualification of persons who have been delinquent in the management of a company from being appointed as directors. The Companies Bill²¹⁰ that has been published provides more adequately for the disqualification of directors and for a register of disqualified directors to be maintained by the registrar of companies.

Section 163 of the Bill provides for the application to declare a director delinquent or under probation and gives a wide range of people who are eligible to apply and states the grounds for such an application. Other relevant sections are section 88(3) which provides that the election of a director is a nullity if, at the time of the election that person is disqualified in terms of section 89. Section 89 prohibits a person who has been disqualified from acting as director and a disqualified person under this section includes a person who has been declared by court to be a delinquent director or placed under probation in terms of section 163.

²⁰⁶ DTI Policy document (note 62) at 41

²⁰⁷ King Report (note 88) at 67.

²⁰⁸ The South African Companies Act, 61 of 1973, sections 219, 219 and 421 provide for the disqualification of directors.

²⁰⁹ King report (note 88) at 147.

²¹⁰ The South African Draft Companies Bill, 2007 available at the website of the Department of Trade and Industry at <http://www.dti.gov.za>.

It has been argued that declaring directors delinquent would amount to blacklisting individuals and would discourage people from taking on directorship. However, it should be noted that declaring directors delinquent is a major innovation of the South African Companies draft Bill and is likely to act as check on the would be fraudulent directors. There is no provision in the Uganda Companies Bill on the disqualification of directors. A provision like that of South Africa is desirable in Uganda to check on fraudulent directors.

On the other hand, in view of the difficult of bringing a successful action for wrongful trading, the disqualification unit of the Insolvency Service (an agency of the DTI in UK) has in recent years enormously increased the number of successful actions for disqualification against directors of insolvent companies under the Company Directors (Disqualification) Act of 1986.²¹¹ The DTI applies to court to make a disqualification order of between two and fifteen years against a person who is found to be “an unfit director” of an insolvent company. Disqualification can apply to offences under the Companies Act as well as insolvency, and it is often those offences, of a relatively technical nature, which will be used as background technical evidence to mount a successful application for disqualification.²¹² Increasingly, failure to file accounts or annual returns on a persistent basis is giving rise to applications for disqualification.²¹³

3.11.4 Removal of directors

Section 185 of the Uganda Companies Act preserves the right of shareholders to remove directors. The section provides that a company may by ordinary resolution remove a director anytime during his term of office regardless of provisions to the contrary in the memorandum or articles of association of the company. Special notice is required of any resolution to remove a director or to appoint someone else in his place. This provision has been retained in the Companies Bill as section 193. While

²¹¹ Richard Smerdon, (note 186) at 41.

²¹² Ibid

²¹³ Ibid

this provision is crucial, the law does not safeguard against capricious removals of directors by significant shareholders.

In South Africa, section 88(5) of the Companies Bill provides that despite anything to the contrary in a company's memorandum of incorporation, or any agreement between a company and a director, or between any shareholders and a director, a director may be removed by a special resolution at a meeting of holders of the shares entitled to be voted in an election of directors. The section further provides that such a director must have received notice of the meeting and the resolution, a statement setting out reasons for the resolution, with sufficient specificity to reasonably permit the director to prepare and present a response. Therefore, unlike in Uganda, the South Africa Companies Bill requires a special resolution for the removal of directors.

4. CONCLUSION AND RECOMMENDATIONS

Corporate governance involves the balance of power with which the organization is directed, managed, supervised and held accountable. The basic theme of my study was to analyze the corporate governance reforms in Uganda in relation to developments in other jurisdictions with specific reference to the United Kingdom and South Africa.

The Uganda corporate law and governance strategy aims to promote an effective framework for corporate governance in the country, giving confidence to investors, business, and other stakeholders to underpin the relationship between an organization and those who hold future financial claims against that organization. Since 1994, Uganda has undertaken corporate governance reforms that include a number of codes, review of the Companies Act and new regulations. The provisions as contained in the Companies Bill, 2004 and various codes and guidelines on corporate governance are commendable achievements and a base for future improvement and modification. Corporate law review is a continuous process that ensures that laws are reflective of market practices and societal needs. Therefore, Uganda should put in place

mechanisms to ensure constant review of corporate laws to keep up-to-date with trends taking place else-where in the world.

It should be noted that a lot of time has passed since 2004 when the Companies Bill was drafted, more than a decade down the road; the Bill is just before cabinet. The delay in tabling the Bill before Parliament for debate and enactment into law means that however good the provisions are, they cannot be implemented. There is therefore need to speed up the process of putting in place the regulatory and institutional framework to ensure good corporate governance in the country. There is also need to establish a specialized body to co-ordinate the enforcement of various regulations on corporate governance.

The inclusion of the Code on corporate governance as a Schedule to the Companies Bill is likely to make its implementation very difficult. Section 11 of the Bill makes the Code applicable to only those companies which choose to include it, or part of it, in their articles. The companies that will not include the Code in their articles will not be obliged to comply with its provisions. It is important to separate the Code from the Companies Bill, and spell out the companies to which it applies following the examples in South Africa and the United Kingdom. Those companies would be encouraged to comply with the provisions of the Code, or explain no-compliance. Such a move would make the Code applicable to a wide range of companies and the enforcement would not be very difficult.

In addition to the nature of the laws and regulations on corporate governance, one must also consider the quality of the law enforcement in the country. The effectiveness of corporate governance legislation and regulations depends on the competence, integrity and forcefulness of the courts and regulatory agencies. The rules and decisions of certain private bodies, such as stock exchanges, professional accounting institutions and industry organizations, also influence corporate governance. There is need to equip the office of the Registrar of Companies to investigate alleged breach of the provisions of the Companies Act. A specialized institution should also be established

to monitor the progress of enforcement of corporate governance regulations and guidelines, in addition to role of criminal and civil courts in company law enforcement.

The basic principles of corporate governance fairness, transparency, accountability and responsibility are relevant all over the world. Corporate governance is an effective policy instrument in many areas of the operation of the national economy. While it should certainly not be perceived as some sort of panacea, the wide spread practice of good corporate governance can help to achieve multiple objectives in both developed and developing countries. The principles, structure, and systems of corporate governance can and should be applied in a wide range of organizations – not just publicly listed joint stock companies, but also throughout the banking sector, in state enterprises, in cooperatives, and in the ever-growing and increasingly important NGO sector. To survive in the global market and to increase economic growth, Uganda must address the inherent challenges and meet international corporate governance standards while maintaining allegiance to the needs of the country.

Clearly market economies require certain legislative and regulatory controls and Uganda is trying to put in place such regulatory framework. However, such controls are no substitute for corporate character, and ultimately the efficient exchange of goods and services will never occur in any market if the character of a contracting partner is in doubt. The government cannot legislate ethics and while regulatory systems and enforcement schemes may encourage people to follow the law, ultimately the decision to act responsibly must come from within.

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