

**THE RELATIONSHIP BETWEEN CORPORATE GOVERNANCE
PRACTICES AND THE FINANCIAL PERFORMANCE OF TOP 100
SMALL AND MEDIUM ENTERPRISES IN KENYA**

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DECLARATION

This is to declare that this research project is my original work and has not been presented to any other University or Institution of Higher Learning for examination.

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This Research proposal has been submitted for examination with my approval as the university supervisor

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DEDICATION

To the Almighty for his Great plans for my life, my parents for their support and strength and the University of Nairobi.

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I wish to acknowledge the support of my parents who continually encouraged me to do better. The unwavering guidance of my supervisor Professor Josiah Aduda and the University of Nairobi for providing the platform to continue my studies. Thank you all.

ABSTRACT

The Capital Markets Authority published “code of corporate Governance Practices “for public listed companies in Kenya which was Gazetted on 4th March,2016.The new code of governance is based on apply or explain principle which requires companies to follow set out corporate governance codes. The country having experienced corporate malpractices like the CMC ,Imperial Bank, Uchumi, Mumias, Kenya Airways, Transcentury which were very costly to public investors needed to take immediate action to prevent a corporate crises.

The study investigates the relationship between corporate governance and the performance of Top 100 SMES in Kenya. It adopts descriptive research methodological framework through which the secondary data collected were analyzed using both Regression analysis and Karl Pearson’s correlation techniques to find the relationship between corporate governance and organizational performance on one hand and the degree of relationship between corporate governance and organizational performance. The findings shows that the Number of board of directors, percentage of inside ownership, number of board meetings are positively correlated to improved organizational performance while Number of board committees percentage of outside directors CEO duality was negatively correlated to organizational performance . Organizations are encouraged to adopt good corporate governance practices to improve their performance and also to protect the interest of the shareholders. Most importantly the regulatory authorities must ensure compliance with good governance and apply appropriate sanctions for non-compliance to help the growth and development of industries in the country. The main contribution of the study to knowledge lies in its effort in strengthening corporate governance beyond the rights and responsibilities of different stakeholders in the management of an organization into areas involving the relationship between finance providers and an organization, compliance with legal, ethical and environmental needs of the society, among others. This contribution has in no small measure enhanced our understanding about the interpretations which have shaped corporate governance in relation to organizational performance both in theory and practice.

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LIST OF ABBREVIATIONS

CACG	Commonwealth Assessment for Corporate Governance
GDP	Gross Domestic Product
KPMG	A leading audit, tax and advisory services firm operating in Kenya
NMG	Nation Media Group
NSE	Nairobi Securities exchange
OECD	Organization for Economic Co-operation and Development
ROA	Return on Asset
ROE	Return on Equity
ROK	Republic of Kenya
SME	Small and Medium enterprises
SPSS	Statistical Package for Social Sciences

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

The concept of corporate governance has become of great contributor to development of nations like Kenya because it is the internal system which serves the needs of shareholders and other stakeholders by directing and controlling management activities with good business savvy, objectivity, accountability and integrity (Mang'unnyi, 2011). Directors, owners & corporate managers have started to realize that there are benefits that can accrue from having a good corporate governance structure (McGee, 2008).

SMEs in developing countries face a number of challenges including access to finance both domestically and internationally. The main underlying constraint to their growth is lack of good corporate governance practices which deal with the ways in which supplies of finance to corporations assures themselves of getting a return on their investment. (Shlefer and Vishny, 1997). There is generally a lack of awareness among these enterprises regarding significance of corporate governance practices as a competitive tool and if there is awareness, there is a general aversion to adopting these practices because of the high cost of implementation (Mahmood, 2008).

1.1.1 Corporate Governance

Corporate governance is the relationship among shareholders, management, members of board of directors, employees, customers, suppliers and other interest groups in determining the direction and performance of corporations (Monks & Minow, 2004). Corporate governance refers to that blend of law, regulation and appropriate voluntary private sector practices which enable the corporation to attract financial and human capital, perform efficiently, and thereby perpetuate itself by generating long-term economic value for its shareholders, while respecting the interests of stakeholders and society as a whole (Hart & Milstein, 2003).

The principal characteristics of effective corporate governance are transparency (disclosure of relevant financial and operational information) and internal processes of management oversight and control. Protection and enforceability of the rights and

prerogatives of all shareholders; and directors capable of independently approving the corporation's strategy and major business plans & decisions, and of independently hiring management, monitoring management's performance and integrity, and replacing management when necessary (World Bank, 1999). Effective corporate governance structures encourage companies to create value (through entrepreneurship, innovation, development and exploration) and provide accountability and control systems commensurate with the risks involved (ASX Corporate Governance Council, 2003).

The role of corporate governance is also an essential factor for SMEs because it is about the individual roles of the shareholders as owners and the managers. Furthermore, it is about establishing and following rules and procedures to manage and run the enterprise, setting up a system of checks and balances to stop abuses of authority and to ensure the integrity of financial statements (Mahmood, 2008).

1.1.4 Small and Medium Enterprises

The term "SME" encompasses a broad spectrum of definitions. The definition varies from country to country. Generally, these guidelines are based upon either headcount or sales or assets. For example the Inter-American Development Bank defines SMEs as having a maximum of 100 employees and less than \$3 million in revenue. In Europe, they are defined as having manpower fewer than 250 employees and United States define them with employees less than 500 (Natarajan & Wyrick, 2011). As general guidelines, the World Bank defines SMEs as those enterprises with a maximum of 300 employees, \$15 million in annual revenue, and \$15 million in assets. In Kenya, there are different definitions of SMEs which are yet to be consolidated. For example, a national baseline survey of MSEs carried out in 1999 defines a small enterprise as one which employs 6-10 people while a medium one is expected to have 11-100 employees (CBS et al., 1999).

Sessional Paper No. 2 of 1992 and national baseline survey (1999), cluster enterprises in the following order; micro enterprises- 1-9 employees, small enterprises 10-49 employees; medium enterprises 50-99 employees, large enterprises -100 and above (RoK, 1992). SMEs are playing pivotal role in promoting grassroots economic growth and equitable sustainable development (Kachembere, 2011).

Recent studies have shown that there is a robust relationship between the relative size of the SME sector and economic growth (Beck,2005).In recent years scholars in the entrepreneurship discipline have been attracted to the SMEs because of their contribution to achieving macroeconomic goals of nations, especially in developing nations. (Shelley, 2004). A complex global environment in which SMEs survive, grow and thrive is, therefore, considered an important objective of policy makers in both developed and emerging economies around the world. SMEs are generally characterized by their informality in organizational structure, corporate governance, financial management practices and business planning - crucial requirements when it comes to qualifications to financing.

1.1.3 Corporate Governance practices and Financial Performance of SMEs.

Corporate governance has been identified in previous studies to influence firms financing or capital structures decisions which affect the performance (Friend and Lang, 1988;Berger et al.,1997).Weak corporate governance practices not only lead to poor financial performance and risky patterns ,but is also conducive to macroeconomic crises(Claessens et al.,2002).

The concept of corporate governance is key issue for the improvement of economic growth and efficiency because top level management can consider it as a tool to reduce mismanagement or misconduct in the organizational processes (Gomper et al., 2003). Good corporate practices lead to reduced agency costs in firms, and there is a reduction in inefficiencies caused by conflict of interest between managers, owners and stakeholders, firms have improved competitive advantage over other firms, and there is fulfillment of their social responsibilities towards the communities that they operate in (OECD, 2004).

1.1.4 Small and Medium Enterprises in Kenya

SMEs are the main source of employment in developed and developing countries alike, comprising over 90% of African business operations and contributing to over 50% of African employment and GDP (Okafor, 2006). Estimates are that there were about 900,000 small and microenterprises establishments employing 2

million Kenyans and generating about 14 per cent of the country's GDP (Dolman, 1994). It is also stated that in Kenya this sector accounted for 20% of the GDP in 1999 (CBS et al, 1999) and 64% of the urban employment by 2002 (Karekezi and Majoro, 2002). According to the Economic Survey (2006), the sector contributed over 50 percent of new jobs created in the year 2005.

In addition to its importance in creating jobs, the small enterprise sector contributes 33% of the value-added in manufacturing and the retail trade in Kenya (Onyango and Tomecko, 1995). Despite their significance, past statistics indicate that three out of five businesses fail within the first few months of operation (Kenya National Bureau of Statistics, 2007). This can be attributed to governance because Corporate governance is about ensuring accountability of management in order to minimize downside risks to shareholders and about enabling management to manage enterprise in order to enable shareholders to benefit from upside potential of firms (Keasey & Wright, 1993). In Kenya, they create employment at low levels of investment per job, lead to increased participation of indigenous people in the economy, use mainly local resources, promote the creation and use of local technologies, and provide skills training at a low cost to society (ILO, 1989).

SMEs are playing pivotal role in promoting grassroots economic growth and equitable sustainable development. High rates of economic growth contribute to economic and social development and poverty reduction. (Kachembere, 2011). Recent studies show that economic growth of any country is closely linked with SME development. For example, as noted by Beck (2005) there is a robust, positive relationship between the relative size of the SME sector and economic growth. The contribution of formal SMEs in high – income countries amount to almost 50 percent of GDP on an average (Ayyagari, 2007). It is also important to note that the majority of employment generation is through the growth of SME sector only (Ardic, et al, 2011). Though it is observed that the role of SMEs is increasing significantly in respective national economies, SMEs are generally underrepresented in world trade (OECD, 2005).

1.2 Research Problem

The corporate governance subject has often been acknowledged as a major issue affecting all types of enterprises particularly the SME in Kenya. As a matter of fact, the SME might apply similar governance codes to those pertaining to large

businesses, yet, several elements which have a remarkable impact on affecting their structures and systems of governance must be taken into account (OCDE, 2006). The SMEs have some specific characteristics distinguishing them from large enterprises namely, the strategies of planning and the survey of the practices of management (Kerr, 2006). Economists underline the essential role these enterprises play in creating employment, enhancing growth, innovation, and exports in underdeveloped economies. According to the Department of Micro- and Small-Enterprise Development (DMSSED) in the Ministry of Labor and Human Resource Development, in 2002 there were about 2.8 million SMEs employing 5.1 million people (Stevenson and St-Onge, 2005).

There is a school of thought which claims that corporate governance problems may not exist within SMEs as ownership control is considered to be strong in these firms and the agency problems are therefore less likely to exist. The owner is the proprietor and the manager. And thus no need for corporate governance in their operations (Hart, 1995). Abor & Adjasi (2007) argue that there is a global concern for the application of corporate governance practices in small and medium sized firms. They maintain that good corporate governance practices helps Small and Medium Sized firms to obtain funds from investors and financial institutions. They further argue that: "Entrepreneurial firms need access to resources for growth. They need inputs on business operations". Mead (1998) observes that the health of the economy as a whole has a strong relationship with the health and nature of SMEs.

There is a basic condition to share sufficient information with banks to assess loan applications; many SMEs in the EU have problems doing so according to the Observatory of European SMEs. The main managerial functions along with the capital are most frequently concentrated in the hands of the controlling owner and/ or his family (Hamad, 2004). The separation between the propriety and the decision making does not exist (Charreaux, 1998). A study done by Lishenga & Mbaka, (2012) found that there is a positive link between compliance of corporate governance disclosure code and firm performance of Kenyan firms. Kavulya ,(2011) studied the relationship of corporate governance and financial performance of deposit taking Microfinance SACCOs and concluded that board size and board composition did not

affect their financial performance. Muturi, (2013) on his study on the effects of corporate governance on financial performance on large manufacturing companies firms established that there is a positive relationship between independent directors, board committee and CEO dual role as chairman and financial performance of the company. (Aduda et al, 2013) studied the agency theory and stewardship theory on the NSE listed companies for four years, the study found that the outside directors, inside directors, and CEO duality are important predictors of firm performance.

There has been a heightened search to understand the indicators, drivers and mitigating instruments of corporate governance because of the recent failure of top organizations:

Enron, Worldcom, Tyco, Adelphia, Arthur Anderson, Lehman Brothers, Freddy Mac, Fanny Mae, Goldman Sachs, Marconi, Northern Rock, Parmalat and Yukos. (Duke & Kankpang, 2011).

In Kenya, cases of corruption has attracted lively debates in many legal and business sectors which have in result shaken both local and foreign investor confidence (Munyuru, 2005). For example, the recently published huge losses and numerous unresolved court cases of Kenya Airways and Kenol Kobil has thrust corporate governance practices into the limelight Mboka, (2014). Scandals where managers and directors have been accused of poor corporate governance like Euro Bank, Uchumi supermarkets, the near collapse of unga group, the National Bank of Kenya, and the discovery of secret accounts by some directors at CMC Motors (Madiavale, 2011). Kenyan companies need to focus on corporate governance which would mitigate against some of the risks of doing business. This has made corporations to rethink how they are directed and controlled (Cadbury committee, 1991).

Very often smaller companies do not have the financial administrative skills, the understanding, the time or collateral requirements based on real estate or other assets to produce the financial information or required by banks. Banks normally charge them higher interest rates as compared to larger companies. Furthermore, It has been observed that Research on corporate governance of SMEs is limited compared to research on large firms (Dyer, 2003; Smith, 2007) even though the role of SMEs is increasing significantly in respective national economies they are generally

underrepresented in world trade (OECD, 2005). However, this research is important as we will be able to know how Corporate Governance affects the financial performance of SMEs in Kenya especially the companies that make it to the KPMG & Nation group Top 100 mid-sized companies. There is substantial literature and empirical studies that look at the phenomenon and state of corporate governance in Kenya. From the above research gap, this study aims to address the following research question: What is the relationship between top management characteristics and the financial performance of SMEs in Kenya? Establish whether the number of board meetings and sub-committee meeting held per year SMEs affects the financial performance of the SME. Determine how board composition affects the SMEs financial performance

1.3 Objective of the study

To establish the relationship between corporate governance practices and financial performance of Top 100 SMEs in Kenya.

1.3.2 Specific objective

The study will be guided by the following specific research objectives:

- i. To determine the relationship between top management characteristics and the financial performance of SMEs in Kenya.
- ii. To establish whether there is a link between the number of board meetings and sub-committee meeting held per year and financial performance of the SME.
- iii. To determine the whether there is a relationship between Board composition and performance of firms.

1.4 Value of the Study

The output and benefits accrued from this study will be of great importance to a number of stakeholders,

From the findings, the management of SMEs in Kenya facing declining performance will be able to understand how certain corporate governance practices have an influence on the general performance of the SME in terms of profitability. The

research will therefore equip the management with better information when making decisions with regard to the choice of whether or not to use specific strategies to influence their operations and profitability. Investors will also be informed of the value of investing in companies which hold sound corporate governance practices.

Government of Kenya, The study will aid the regulatory authorities of the republic of Kenya to be able to know the impact that corporate governance have on SMEs and the accrued benefits to the society as a whole. The corporate governance practices employed by SMEs will also have an impact on the SMEs' tax status and thus the tax authority may want to know how the choice of practices will impact on the tax levels. The study will also aid the government of Kenya when making policy decisions with regard to the SME sector of the economy.

Students of finance, academicians and researchers will be able to understand the impact of corporate governance practices on SMEs in Kenya and in similar economies in the world.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter summarizes the information from other researchers who have carried out their research in the same field of study. The chapter presents theoretical background, corporate governance models, the empirical review, conceptualization, operationalization and the research gap.

2.2 Theoretical Review

The main purpose of this literature review is to identify and examine what has been done by other scholars and researchers in relation to the Relationship between Corporate Governance and the financial performance of SMEs in Kenya. The following section will describe and discuss different theories such as Agency theory, Stewardship Theory, Resource Dependency Theory and Stakeholder Theory.

2.2.1 Agency Theory

Jensen & Meckling (1976) put forward the theory of the agency explaining that the interest of management and shareholders interest often conflict because managers try to give priority to their interest at the expense of shareholders. In turn shareholders who are owners have to incur costs to monitor and direct the managers.

Agency theory is defined as “the relationship between the principals, such as shareholders and agents such as the company executives and managers”. In this theory, shareholders who are the owners or principals of the company, hires the agents to perform work. Principals delegate the running of business to the directors or managers, who are the agents to the shareholder (Clarke, 2004) .Daily et al. (2003), argued that two factors can influence the prominence of agency theory. First, the theory is a simple theory that reduces the corporation to two participants of managers and shareholders. Second, agency theory suggests that employees or managers in organizations can be self-interested.

The agency theory shareholders expect the agents to act and make decisions in the principal's interest. On the contrary, the agent may not necessarily make decisions in the best interests of the principals (Padilla, 2000). Such a problem was first highlighted by Adam Smith in the 18th century and subsequently explored by Ross (1973) and the first detailed description of agency theory was presented by Jensen and Meckling (1976). Indeed, the notion of problems arising from the separation of ownership and control in agency theory has been confirmed by (Schoorman & Donaldson, 1997). In agency theory, the agent may be succumbed to self-interest, opportunistic behavior and falling short of congruence between the aspirations of the principal and the agent's pursuits.

Although with such setbacks, agency theory was introduced basically as a separation of ownership and control (Bhimani, 2008). (Holmstrom & Milgrom, 1994) argued that instead of providing fluctuating incentive payments, the agents will only focus on projects that have a high return and have a fixed wage without any incentive component. Although this will provide a fair assessment, but it does not eradicate or even minimize corporate misconduct. Here, the positivist approach is used where the agents are controlled by principal-made rules, with the aim of maximizing shareholders value. Hence, a more individualistic view is applied in this theory (Clarke, 2004).

Indeed, agency theory can be employed to explore the relationship between the ownership and management structure. However, where there is a separation, the agency model can be applied to align the goals of the management with that of the owners. Due to the fact that in a family firm, the management comprises of family members, hence the agency cost would be minimal as any firm's performance does not really affect the firm performance (Eisenhardt, 1989).

The model of an employee portrayed in the agency theory is more of a self-interested, individualistic and are bounded rationality where rewards and punishments seem to take priority (Jensen & Meckling, 1976). According to this model, people or employees are held accountable in their tasks and responsibilities. Employees must

constitute a good governance structure rather than just providing the need of shareholders, which maybe challenging the governance structure.

2.2.2. Stewardship Theory

A steward is a person who essentially wants to do a good job, to be a good steward of the corporate assets (Donaldson & Davis, 1991). Stewardship theory is defined by (Schoorman& Donaldson, 1997) as “a steward protects and maximizes shareholders wealth through firm performance, because by so doing, the steward’s utility functions are maximized”. This theory assumes that managers are basically trustworthy and attach significant value to their own personal reputation (Fernando, 2009).

In contrast to agency theory, stewardship theory suggests that executives tend to be more motivated to act in the best interest of the corporation than in their own self-interest. Whereas agency theory focuses on extrinsic rewards that serve such lower-level needs as pay and security, stewardship theory focuses on the higher-order needs, such as achievement and self-actualization. Stewardship theory argues that, over time, senior executives tend to view the corporation as an extension of themselves (Clarke, 2004). Rather than the use of firm for their own ends, the executives are more interested in guaranteeing the continued life and success of the corporation(Mallin,2004).

The relationship between the board and top management is thus one of principle and steward, not principle and agent (“hired hand”). Stewardship theory notes that in a widely held corporation, the shareholder is free to sell his/her stock at any time. A diversified investor may care little about risk at the company level, preferring that management assume extraordinary risk so long as the return is adequate. Because executives in a firm cannot easily leave their jobs when in difficulty, they are more interested in a merely satisfactory return and put heavy emphasis on the firm’s continued survival. Thus, stewardship theory would argue that in many instances, top management may care more about a company’s long-term success than do more short-term oriented shareholders (Monks &Minow, 2004).

Stewardship theory recognizes the importance of structures that empower the steward and offers maximum autonomy built on trust (Donaldson and Davis, 1991).On the other end, Agyris(1973) argues agency theory looks at an employee or people as an

economic being, which suppresses an individual's own aspirations. It stresses on the position of employees or executives to act more autonomously so that the shareholders' returns are maximized.

Moreover, stewardship theory suggests unifying the role of the CEO and the chairman so as to reduce agency costs and to have greater role as stewards in the organization. It was evident that there would be better safeguarding of the interest of the shareholders. It was empirically found that the returns have improved by having both these theories combined rather than separated (Donaldson and Davis, 1991).

2.2.3 Resource Dependency Theory

There is an additional theory used in corporate governance research, namely, resource dependency theory. According to this theory, organizations attempt to exert control over their environment by co-opting the resources needed to survive. The concept of co-optation has important implications for the role of the board and its structure. Boards are important boundary spanners. Boards can be used as a mechanism to form links with the external environment. Inter-organizational linkages, such as the appointment of outside directors and board interlocks, can be used to manage environmental contingencies. Directors who are prestigious in their professions and communities can be a source of timely information for executives (Pfeffer and Salancik, 1978).

According to Pfeffer and Salancik (1978), when an organization appoints an individual to a board, it expects that the individual will come to support the organization, will concern himself with its problems, will favorably present it to others, and will try to aid it. This assistance is believed to raise organizational performance, and increase returns to shareholders. Pfeffer (1972) has made the case that the board's co-optation role, in which he includes establishing contacts and raising funds, best explains board composition. His evidence shows that board size and type of outside director are related to an organization's needs for capital and the degree of regulation in its environment.

2.2.4 The Stakeholder Theory

Stakeholder theory was embedded in the management discipline in 1970 and gradually developed by Freeman (1984) incorporating corporate accountability to a broad range of stakeholders. In essence, stakeholder theory considers the firm as an input-output model by explicitly adding all interest groups: Employees, customers, dealers, government and the society at large- to the component mix. Stakeholder theory can be defined as “any group or individual who can affect or is affected by the achievement of the organization’s objectives” (Fernando, 2009).

Unlike agency theory in which the managers are working and serving for the stakeholders, stakeholder theorists suggest that managers in organizations have a network of relationships to serve – this include the suppliers, employees and business partners. And it was argued that this group of network is important other than owner-manager employee relationship as in agency theory (Freeman, 1999).

Furthermore, the stakeholder theory attempts to address the group of stakeholder deserving and requiring management’s attention (Sundaram&Inkpen,2004). Whereas, Donaldson & Preston (1995) claimed that all groups participate in a business to obtain benefits. Nevertheless, (Clarkson, 1995) suggested that the firm is a system, where there are stakeholders and the purpose of the organization is to create wealth for its stakeholders. (Freeman, 1984) contends that the network of relationships with many groups can affect decision making processes as stakeholder theory is concerned with the nature of these relationships in terms of both processes and outcomes for the firm and its stakeholders.

2.3 Determinants of financial performance of SMEs

Firm performance can be looked at as the results of an organization measured against its intended goals and objectives (Druckman,2000).There are various ways to measure financial performance such as profits ,Return on Assets and return on investment(Arthur et al,2003).Assessment of business performance should include not only financial measures but incorporate other measures such as employee satisfaction, Social contribution, goal achievement and effectiveness(Brush,1992).

2.3.1 Corporate Governance Principles

Corporate Governance is considered to be one of the institutional means that aims to align decision making in financial institutions with that of the best interest of their stakeholders (Arun & Turner, 2009).

2.3.1 Board Size

Among the duties of a director is the fiduciary duty to protect shareholders interest(Ongore and K'Obonyo,2011).Although there is no ideal board size so as to avoid a stale mate it should be an odd number(Haniffa and Hudaib,2006)while Eisenberg,Sundgren and Wells(1998)suggest that large boards offer relevant networking and are more diverse, experienced,better exposed and execute more objectivity in decision making. Lipton and Lorsch(1992)argue that larger boards are more likely to be dysfunction, greater productivity losses resulting from greater coordination problems, slower decision making and more director free riding. The benefit of encouraging team development through a widen board has been argued to be an important step in improved corporate governance in SMEs(Cadbury,2000).Eistenberg et al (19918)found a negative correlation between board size and profitability when using a sample of small and mid-size Finnish firms.

2.3.2 Board Committees

The CMA proposes that the board should establish relevant committees and delegate specific mandate to them. (CMA guidelines on corporate governance (2002 p.124 clause 2.1.1).

2.3.3 Inside Ownership

Inside ownership refers to the proportion of equity held by insiders.Randoy and Goel(2003)found that a high level of board and inside ownership had a positive impact on firm performance in founder led firms but negative effect on non-founder firm. High level of inside ownership is said to create conditions conducive for managerial entrenchment and self-aggrandizing behavior which leads to the firm incurring high agency costs for the lack of transparency(Randoy &Goel,2003).

2.3.4 Outside Directors

The CMA guidelines (2002) propose that a balanced board constitutes an effective board it is therefore requires the independent and nonexistence directors should form one third of the members of the board to ensure that no individual or small group of individuals can dominate decision making process (CMA guidelines on corporate governance (2002 p.124, 125)).John and Senbet(1998)argue that board of directors are seen to be more independent as the proportion of their non-executive directors. A number of empirical studies support the beneficial monitoring and advisory functions to firm shareholders (Byrd and Hickman, (1912); Baysinger and Butler (1985) and Rosenstein and Wyatt(1990)showed that the market rewards firms that appoint non-executive directors.

2.3.5 CEO Duality

Fama and Jensen (1983) suggest that concentration of decision management and decision control in one individual reduces board effectiveness in monitoring to management. It has also been supported by (Brickley et al., 1997) who noted that where a CEO also acts as board chairman leads to leadership conflicts of interest and agency problems. Yermack (1996) argues that firms are more valuable when the CEO and board chairman positions are separate. On the issue of performance Daily and Dalton(19192)found no relationship. Sanda et al found a positive relationship between firm performance and separating the CEO and the chairman. Rechner and Dalton(1991)however reported that companies with CEO duality had strong financial relative to others.

2.4 Empirical Review

Various researchers have investigated the relationship between corporate governance and the performance of firms in various dimensions.

2.4.1 International Evidence

Aksoys & Bozkus (2008) studied the impact of corporate governance on Accounting measures of financial performance, Credit usage and trade openness in Turkish SMEs

firms. They used a sample of 47,053 SMEs data taken from Turkish SME development organization. Based on the empirical findings there is a positive relationship between corporate governance principles implementation and firm performance. Corporate governance was recommended as a critical success factor for firms to be more profitable and efficient to be able to survive especially in deep financial crises that were experienced in the world economy.

Bhogat and Borton(2008) studied the relationship between corporate governance and performance of 11,736 firms in the United States stock exchange. The study took place between 1990 to 2004. The data was collected and they found that stock ownership of board members and co-chair separation is significantly positively related with subsequent operating performance.

Drobotz et al (2003) in a study done in 91 German firms sought to explore the relationship between firm-level corporate governance and firm performance. They found out that good corporate governance leads to higher firm valuation (performance), hence, investors are willing to pay a premium, and bad corporate governance is punished in terms of valuation discounts.

(Klapper & Love ,2003),in a study conducted in the US, use the CLSA governance index and find a positive correlation between market value and corporate governance for 374 firms in 14 countries. They document a positive relationship between governance and operating performance as well measured by ROA.

Sanda et al (2003), Conducted a study in Nigeria. Using pooled ordinary least squares regression analysis for a sample of 93 firms quoted on the Nigerian Stock Exchange for the period 1996–1999, they found a positive relationship between firm performance and separating the functions of the CEO and Chairman. Sanda et al (2003) found that, firm performance is positively related with small, as opposed to large boards.

Shehzad et al. (2010) conducted a study in the Netherlands and Germany. Using data of 800 banks from more than 50 countries averaged over 2005-2007, report that concentrated ownership significantly reduces a bank's non-performing loans ratio, conditional on supervisory control and shareholders protection rights. Furthermore,

ownership concentration improves the capital adequacy ratio conditional on the extent of shareholder protection.

Ujunwa (2012) in Nigeria, investigated the relationship between the board characteristics represented by board size, gender, ethnicity, skills, duality and nationality and financial performance depicted by accounting measure i.e. Return on Assets. Panel data collected from the annual reports of 122 Nigerian firms between 1991 and 2008 revealed no significant association between board characteristics and firm performance in particular. Between different variables of board characteristics CEO duality was positively associated with the Nigerian firm's performance.

In a study done in the United States, Yermack, (1996) tested the effect of board size on the performance and management efficiency. The main hypothesis here is that the board size of the firm presents an important determinant of its performance, and that the firm value depends on the quality of monitoring and decision making by board of directors. He estimated a regression relationship using the ratio of (market value of assets over the replacement cost of assets) as the dependent variable and board size as the most important of the explanatory variables.

Other measures of firm value and profitability used by Yermack (1996) include the return on assets and return on sales ratios. All three dependent variable have negative and significant associations with the board size, and the main result is that there is an inverse relationship between board size and firm value. Companies with large boards appear to use assets less efficiently and earn less profit. He did a study of 452US firms and found that market would be gaining value to firms where CEO duality did not exist.

2.4.2 Local Empirical Studies

Afande, (2015), sought to examine the financial performance and extent of adoption of corporate governance practices of SMEs in Kenya. The population of study was the registered SMEs in the manufacturing sector in Kariobangi Light Industries that have adopted corporate governance practices. The study utilized a combination of both quantitative and qualitative techniques in the collection of data. The study targeted 30

SMEs in Kariobangi Light Industries. The primary data was collected by administering semi-structured structured questionnaires to the sampled respondents. Data pertaining to the extent of adoption of corporate governance by SMEs in Kenya was conducted using descriptive statistics, which includes measures of central tendency, measures of variability and measures of frequency among others.

The findings show a positive relationship between the following corporate governance practices and profitability of the SMEs that participated in the study: availability of board of directors; existence of a system of evaluating board and individual directors; existence of Bylaws to govern board meetings; and use of cumulative voting for elections of directors. The findings also show that adoption of the following corporate governance practices did not have a direct influence on profitability of the SMEs that participated in the study: holding four or more regular board meetings per year; the choice of shareholder date or location to encourage attendance; and board approval requirement for related party transactions. In Kenya corporate governance can greatly assist the SME sector by infusing better management practices, stronger internal auditing and greater opportunities for growth since it enhances firms' corporate entrepreneurship and competitiveness.

Aduda et al. (2013), investigated from the point of two Governance Theories (Agency Theory and Stewardship Theory), whether there is relationship between Board attributes and performance. This was an analytical study of the relationship between Board composition and Firm performance of companies listed at the NSE and covers a period of four years from 2004 to 2007. It involved the use of descriptive statistics and testing of hypothesis in order to answer the research question.

The study found that the outside directors, inside directors, and CEO duality are important predictors of firm performance. The study also found that the significance of the individual variables in the overall specification models have differing significant variables on the basis of the measure of performance selected for the firm. The study identified that value creation for the shareholders is paramount and the basis for this is value decision making processes which discriminates and settles on projects with positive net present values.

Barako & Brown (May, 2008) examined the influence of gender and board representation on communication of corporate social reporting by Kenyan banks. The descriptive statistical analysis reveals that the level of corporate social disclosure by Kenyan banks is low with a mean of 15%, indicating that disclosure of corporate governance information is not a primary concern to Kenyan banks. In particular, there is a complete lack of disclosure on the categories of Recruitments, Employment of special groups, Assistance to Retiring Employees and Employees Productivity and Turnover. The results of multiple regression analysis indicate that board representation can fundamentally improve corporate communication. A higher level of women representation and independent directors greatly improves disclosure.

Maranga, (2014), did a study on the effect of corporate governance on financial performance of SMEs in Kenya as of December 2013 in Nairobi County. She looked at CEO duality, size of board, Number of boards, size of sub-committees and age of the SME. Performance was measured using Return on Assets (ROA) and using descriptive research design. The findings were that there is a positive relationship between corporate governance and financial performance of SMEs and recommended that the government provide incentives to help implement corporate governance and financial monitoring of managers and boards subcommittees.

Mang'anyi (2011) explored ownership structure and corporate governance and its effects on performance of firms in Kenya with reference to banks. The study revealed that there was no significant difference between type of ownership and financial performance, and between banks ownership structure and corporate governance practices. Further results revealed that there was significant difference between corporate governance and financial performance of banks. However, foreign-owned banks had slightly better performance than domestically-owned banks.

This study recommends that corporate entities should promote corporate governance to send a positive signal to potential investors. The Central Bank of Kenya (CBK) should continue enforcing and encouraging firms to adhere to good corporate governance for financial institutions for efficiency and effectiveness. Finally, regulatory agencies including the government should promote and socialize corporate governance and its relationship to firm performance across industries.

Murithii (2004) conducted a study in Nairobi on 44 Firms listed at the NSE between 1999 and 2003, used a number of governance variables which included, block ownership, family ownership, foreign ownership, Board size and Board composition. Board composition variable under consideration in his study was the proportion of non-executive directors. In this study, the researcher found out that there was no significant relationship, in case of non-executive Board of directors. Murithii (2004) went further to conclude that, “No measure of Firm performance has a significant relationship with the percentage of non-executive Board members. Though the importance of independent directors should not be put to doubt, the outcomes of this study conflict with the conventional wisdom that suggests that a Board’s principle task is to monitor management and only independent directors’ can be effective monitors.” The study by Murithii (2004) is largely skewed to the position of Agency Theory on the monitoring role of the Board which roots for outside director representation.

Ongore& K’Obonyo (2011), examined the interrelations among ownership, board and manager characteristics and firm performance in a sample of 54 firms listed at the Nairobi Stock Exchange (NSE). A census approach was used, and thus the sampling frame consisted of all listed firms in Kenya. By using the Nairobi Stock Exchange Handbooks (2006, 2008) the final sample consisted of forty-two firms, representing about 78 percent response rate. The study findings were that in Kenya, managers work better in an environment where they are afforded an opportunity to own shares of the firm, then allowed freehand to exercise their professional judgment without undue influence from shareholders

2.5 Summary of Literature Review

The theories discussed in this chapter explained how Corporate Governance mechanisms such as Board composition, CEO duality and Executive compensation affects Shareholders’ wealth maximization through firm performance. According to the different studies, Corporate Governance is vital to the performance of SMEs. For instance, (Muriithi,2004) studied the relationship between corporate governance and firms listed in the NSE. Afande(2015) studied the adoption of corporate governance

practices on financial performance of SMEs. However, they have not exhausted to research on the relationship between corporate governance practices and how SMEs can use it as unutilized strategy to gain more competitiveness and survival in this global market. Tsamenyi et al, (2007) observes that corporate governance studies in developing countries are limited and available only on an individual country basis. There is little or no research conducted to provide empirical evidence particularly on the impact of corporate governance mechanisms on financial performance of SMEs in Kenya. And most of the literature related to corporate governance and firm performance talks about ownership structures and boards into consideration as governance dimensions. It was found that SMEs sector was of lesser concern for researchers. Taking into account these gaps in the literature, the aim of the paper is to find out the relationship between corporate governance of SMEs and their financial performance in Kenya especially those ranked in the KPMG and NMG survey of Top 100 SMEs in Kenya.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter provides information on the type of research design, the population and sample that was selected for the study. In this section, we will also discuss the data collection, data analysis and presentation techniques that have been used in this study.

3.2 Research Design

A research design constitutes of variables, the sample selection, data collection, hypothesis testing as well as analysis of results (Kumar, 2011).It is a plan of action aimed at obtaining answers to researcher's questions through laid out methods and procedures

The researcher adopted a descriptive research design as it provides a significantly accurate picture, locates new data, clarifies a sequence of steps or stages and documents a causal process.(Neuman,2010).The choice of the descriptive research design was based on the fact that the researcher was interested in carrying out an in-depth study on the relationship between corporate governance practices and the financial performance of SMEs in Kenya. The researcher used mostly quantitative approaches in this study in order to gain a better understanding and enable a better and more insightful interpretation of the results from the quantitative study.

3.3 Population

A population refers to an entire group of individuals, events or objects having common observable characteristics (Mugenda & Mugenda, 2003).The target population for this study consisted of Top 100 SMEs of the top 100 SMEs survey, an initiative of KPMG Kenya and Nation Media Group. Of 2014 and covers financial analysis for period 2012 to 2014 in Kenya.

3.4 Sample

Cooper and Schindler (2000) assert that the researcher must clearly define the characteristics of the population, determine the required sample size and choose the best method for selecting members of the sample from the larger population in order to ensure that the sample accurately represents the population. Purposive sampling was used to select SMEs that have adopted corporate governance practices. A sample size of 20 SMEs was then selected using systematic random sampling.

3.5 Data Collection

Yin (2003), points to six possible sources of data for case studies; documents, archived records, interviews, direct observations, participant-observation and physical artifacts.

The study used a secondary data source which was obtained from financial statements as at 31st December 2014 of the SMEs that made it to the Top 100.

3.6 Data Analysis

Data Analysis is the process of systematically applying statistical and/or logical techniques to describe and illustrate, condense and recap, and evaluate data (Shamoo & Resnik, 2003). Data analysis is developed to deal with manipulation of the information that has been gathered so as to present the evidence.

Quantitative data was analyzed by using tools such as Statistical Package for Social Sciences (SPSS). Qualitative data was analyzed descriptively and inferential statistical methods were used to show the relationship between variables. The results were presented by use of tables and Charts for easy understanding and analysis of the data.

3.6.1 Analytical Model

The researcher used a multiple regression analysis to establish the relationship between Corporate Governance and Financial Performance of SMEs in Kenya. The Dependent variable is Financial Performance of SMEs while the independent variable is Corporate Governance. The control variables were the size and industry to which the SME operates as suggested by Mc Williams & Siegel (2000) to be factors that affect firm performance. The analytical model used in analyzing the relationship between the dependent and independent variables was:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + e$$

Where;

Y= is the financial performance of SME measured by ROA

α = Constant Term.

β = Beta Coefficient

X₁ = is the size of the Board measured by the number of directors

x₂= is the number of sub-committees available measured by the number of sub-committees

x₃= is the number of board meetings measured by the number of board meetings held per year by the board

x₄=is the CEO duality measured as 1 if CEO and Chairman are the same person and 0 if otherwise

e=Error term

3.6.2 Test of Significance

To test the significance of the analytical model, the researcher used the Analysis of Variance (ANOVA). According to Larson (2008), Analysis of variance (ANOVA) is a statistical technique to analyze variation in a response variable (continuous random variable) measured under conditions defined by discrete factors (classification variables, often with nominal levels). Frequently, we use ANOVA to test equality among several means by comparing variance among groups relative to variance within groups (random error).

3.7 Data Validity and reliability

Validity and reliability was used to test for soundness of the research instruments. Validity indicates the degree to which an instrument measures what it is supposed to measure while reliability is a measure of the degree to which a measuring instrument provides consistent results (Kothari, 2004). Pilot testing of data collection instrument was carried out to test for validity by using objective questions while reliability was done by pre-testing with a selected sample of three SMEs.

CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter discusses the interpretation and presentation of the research findings drawn from the research instrument by way of data analysis. This chapter presents the analysis and findings of the study as set out in the research methodology. The research data was gathered exclusively through secondary data.

4.2 Descriptive Statistics

The study sought to establish the effect of corporate governance practices on the financial performance of Top 100 SMES in Kenya. This was measured through correlation analysis between the study independent variables of corporate governance principles which include board size, Number of board committees, percentage of inside ownership, percentage of outside directors ,number of board room meetings and CEO duality as compared to financial performance indicators of profitability, sales turnover and liquidity .consequently descriptive statistics of the collected data was analyzed using excel analysis tool Pack and the summary of the findings is presented in the in table 4.1 below

Table 4.1 Summary of study variables

	Board size	board committees	inside ownership	outside directors	No. Of Board meetings	CEO Duality	ROA
Mean	11.30	3.80	54.58	10.92	43.66	0.40	0.48
StandardError	0.42	0.14	3.52	0.70	0.38	0.11	0.02
Median	11.00	4.00	56.81	11.36	43.39	0.00	0.43
S. Deviation	1.87	0.63	15.74	3.15	1.69	0.50	0.10

S.Variance	3.48	0.40	247.77	9.91	2.86	0.25	0.01
Kurtosis	-0.39	-0.38	-0.84	-0.84	-0.73	-2.02	-1.97
Skewness	-0.76	-0.85	-0.24	-0.24	0.50	0.44	0.19
Range	6.00	2.00	54.18	10.84	5.70	1.00	0.25
Minimum	7.00	2.33	26.15	5.23	41.30	0.00	0.37
Maximum	13.00	4.33	80.33	16.07	47.00	1.00	0.62

According to the findings in Table 4.1 Top 100 SMES in Kenya on average have 11 board members and approximately 4 board committees. On average the percentage of inside ownership was 55% an indication that in majority of SMES major shareholders happen to be company directors/employees. On average outside directors comprised only 11% of the company directors an indication that majority of SMES are managed by the owners. The number of annual board room meetings was 44 and CEO duality was zero meaning in most cases the CEO did not act the board chairman. On average ROA is 0.48 or 48%

4.2.1 Effect of Corporate Governance Practices on Financial Performance

In order to determine the relationship between adoption of corporate governance practices by SMEs in Kenya and financial performance, correlation analysis was undertaken. The independent variable (corporate governance practice adopted) was correlated against the dependent variables ROA. The findings and summarized and presented in the tables below.

Table 4.2 Correlation analysis

	Size	Commit	inside owner	outside directors	Meet	Duality	ROA
Size	1						
commit	0.972	1.000					
inside owner	-0.802	-0.758	1.000				
Outsidedirectors	0.839	0.799	-0.984	1.000			
Meet	-0.855	-0.816	0.971	-0.995	1.000		
Duality	0.651	0.594	-0.850	0.791	-0.788	1.000	
ROA	-0.597	-0.518	0.665	-0.701	0.716	-0.642	1.000

Findings in table 4.2 above indicate that there was a negative correlation between

Number of board of directors and ROA of the organization. There is also a Negative correlation between Number of board committees and ROA of the organization. There is a strong positive correlation between percentage of inside ownership and ROA of the organization. There is a strong negative correlation between percentage of outside directors and ROA of the organization. There is a strong positive correlation between number of board meetings and ROA of the organization. There is a negative correlation between CEO duality and ROA of the organization.

4.3 Regression Analysis

A regression model was applied to determine the relationship between Corporate Governance and Financial Performance of SMEs in Kenya. The Dependent variable is Financial Performance of SMEs while the independent variable is Corporate Governance. The analytical model used in analyzing the relationship between the dependent and independent variables is:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \beta_6 X_6 + e$$

Where;

Y= is the financial performance of SME measured by ROA

α = Constant Term.

β = Beta Coefficient

X₁ = is the size of the Board measured by the number of directors

x₂= is the number of sub-committees available measured by the number of sub-committees

x₃= is the number of board meetings measured by the number of board meetings held per year by the board

x₄=percentage of inside ownership

x₅=Percentage of outside Directors

x₆=is the CEO duality measured as 1 if CEO and Chairman are the same person and 0 if otherwise

e=Error term

Coefficient of determination explains the extent to which changes in the dependent variable can be explained by the change in the independent variables or the

percentage of variation in the dependent variable (financial performance) that is explained by all the two independent variables (corporate governance). The research used statistical package for social sciences (SPSS V 21.0) to code, enter and compute the measurements of the multiple regressions.

Table 4.3: Model Summary
Relation between corporate governance and profitability

<i>Regression Statistics</i>	
Multiple R	0.802525843
R Square	0.644047728
Adjusted R Square	0.479762065
Standard Error	0.069327558
Observations	20

R-Squared is a commonly used statistic to evaluate model fit. R-square is 1 minus the ratio of residual variability. The adjusted R², also called the coefficient of multiple determinations, is the percent of the variance in the dependent explained uniquely or jointly by the independent variables. 48% of the financial performance in SMES could be attributed to the combined effect of the predictor variables.

ANOVA

	df	SS	MS	F	Significance F
Regression	6	0.113053	0.018842	3.920292	0.018563
Residual	13	0.062482	0.004806		
Total	19	0.175535			

The study used One-way ANOVA to establish the significance of the regression model from which a probability value of 0.018563 was established. This indicates that

the regression relationship was highly significant in predicting adoption of corporate governance practices affect financial performance of Top 100 SMES in Kenya. The F calculated at 5% level of significance was 3.920292 .since F calculated is greater than the F critical (value = 3.87), this shows that the overall model was significant.

Table 4.4 Regression Coefficients results

	<i>Coefficients</i>	<i>Standard Error</i>	<i>t Stat</i>	<i>P-value</i>	<i>Lower 95%</i>	<i>Upper 95%</i>
Intercept	-0.35	6.48	-0.05	0.96	-14.36	13.66
Size	-0.04	0.04	-0.85	0.41	-0.12	0.05
Commit	0.13	0.11	1.14	0.28	-0.11	0.36
inside owner	-0.01	0.01	-1.36	0.20	-0.03	0.01
Outsidedirector	-0.05	0.09	-0.52	0.61	-0.24	0.15
Meet	0.05	0.12	0.38	0.71	-0.21	0.30
Duality	-0.11	0.08	-1.41	0.18	-0.27	0.06

The established regression equation was;

$$Y = -0.35 - 0.04X_1 + 0.13X_2 - 0.01X_3 - 0.05X_4 + 0.05X_5 - 0.11X_6 + e$$

The regression equation above has established that holding all other factors constant (no implementation of corporate governance practices) financial performance of Top 100 SMES in Kenya would be -0.35. The findings presented also show that taking all other independent variables at zero, a unit increase in the Board size would lead to a -0.04 decrease in financial performance of Top 100 SMES in Kenya, a unit increase in the number of board committees would lead to a 0.13 increase in financial performance of Top 100 SMES in Kenya. A unit increase in the percentage of inside ownership would lead to a -0.01 decrease in financial performance of Top 100 SMES in Kenya. A unit increase in the percentage of outside directors would lead to -0.05 decreases in financial performance of Top 100 SMES in Kenya. A unit increase in the number of board meetings would lead to a 0.05 increase in financial performance of

Top 100 SMES in Kenya. A unit increase in CEO Duality would lead to -0.11 decreases in financial performance of Top 100 SMES in Kenya

4.4 Interpretation of the Findings

From the above regression model, the study found out that adoption of corporate governance practices enhances the Financial performance of Top 100 SMES in Kenya .The independent variables that were studied explain a substantial 48% of financial performance of Top 100 SMES in Kenya as represented by adjusted R² (0.479). This therefore means that the independent variables contributes 48 % of the financial performance of Top 100 SMES in Kenya while other factors and random variations not studied in this research contributes 52% of the financial performance of Top 100 SMES in Kenya.

The findings indicate that the relationship between the financial performance of SMEs and board size, percentage of inside ownership, number of Outside director and duality indicated a negative correlation. This was seen from their correlation coefficients which indicated that a unit change in the variables causes a negative change in the financial performance. This was consistent with the studies reviewed earlier. The findings agree with Belkhir (2006) in literature review who conducted a research on board composition and bank performance. The result showed that the larger the board size the lesser the performance of the organization. The study suggested that as board size increased beyond a certain point, inefficiencies outweighed the advantages of having more directors.

Accordingly, Oyoga (2010) in his findings concluded that good corporate governance practices will lead to higher financial performance in Kenya in his study of corporate governance and firm performance. There was no significant relationship between board size and financial performance of SMEs in Kenya. This implied that the financial performance in SMEs was not affected by the size of the board. This was inverse to the study done by Robbinson and Dechant, (1997).

CHAPTER FIVE: SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.0 Introduction

This chapter presents a summary, conclusions and recommendations of the study. Section 5.2 summarizes the key results found, while section 5.3 draws the conclusions. Section 5.4 notes the recommendations from the findings of the study. Section 5.5 outlines the limitations of the study while section 5.6 gives suggestions for further research.

5.1 Summary of the Findings

The main objective of the study aimed at establishing the influence of corporate governance principles on performance of organization. The findings on the demographic information of the respondent's greatly enhanced the reliability of the research findings. The study findings indicate that the majority of the respondents had good experience in the sector and had the prerequisite education level and technical competence needed to enhance the reliability of the information that they provided. The research findings indicate that the corporate governance principles influence organizational performance positively. This may be explained by the fact that the supply chain management practices provides a platform in supply chain inefficiencies and focusing on objectives, activities ,outputs and roles which eventually lead to improved organizational performance One of the main findings of this study is that Board size impacts on the financial performance of SMEs. It was seen that as the board size increased beyond 7, the financial performance reduced since the board became less effective. The medium negative correlation implied that as the board size reduced below optimal level, taken to be 7 in this study, and then the financial performance would reduce. The number of non-executive directors also depicted a similar trend and thus an optimal number of both the board size and NEDs needed to be observed in order to have the financial performance of SMEs at a higher level.

The findings on number of management committees showed that as the number of management committees increased the financial performance of SMEs improved significantly. The reduction in NPLs meant a stronger asset base for the SMEs and thus improved profitability. Number of board meetings also drew positive relationship

in that the operating efficiency of SMEs improved over the years (2011-2013) thus leading to higher financial performance. These findings were in line with the objective of establishing the effect of corporate governance practices on the financial performance of SME

5.2 Conclusions

The study examined the relationship between corporate governance and the performance of organizations it was discovered that the adoption of good corporate governance practices enhances transparency of company's operations, ensures accountability and improves firm's profitability. It also helps to protect the interest of the shareholders by aligning their interest with that of the managers. The results show SMEs in Kenya should embrace corporate governance practices for them to enhance shareholder wealth maximization and corporate profitability. CBK through their prudential regulations should ensure that SMEs follow these regulations which ensure adequate risk management measures are followed not only in writing but in day to day operations in the SMEs. It is also recommended that the Institute of Certified Public Secretaries in conjunction with Kenya Bankers Association come up with awards to those SMEs that practices best corporate governance to encourage and root the culture of corporate governance in SMEs in Kenya.

. The regulators should also improve on the mechanisms of ensuring that the corporate governance disclosures in the annual reports are not simply statement of good intentions but are actually implemented at firm level. This will greatly improve the level of corporate governance and by extension firm performance.

That generally corporate governance has positive impact on all the performance indicators of an organization. The factors of board size, board and management skill, CEO tenure, size, foreign and institutional ownership and annual meeting, all have positive correlation with the performance of organizations.

Findings of the study indicate that some SMEs that participated in the study had adopted the following corporate governance practices: Formation of board of

directors; development and institutionalization of a system for evaluating board and individual directors; development of Bylaws to govern board meetings; holding four or more regular board meetings per year; use of cumulative voting for election of directors; choosing shareholder meeting dates and locations to encourage attendance; and ensuring board approval for related party transactions.

The findings further show a positive relationship between the following corporate governance practices and performance of the SMEs that participated in the study: availability of board of directors; existence of a system of evaluating board and individual directors; existence of Bylaws to govern board meetings; and use of cumulative voting for elections of directors. The findings also show that adoption of the following corporate governance practices has a direct influence on profitability of the SMEs that participated in the study: holding four or more regular board meetings per year; the choice of shareholder date or location to encourage attendance; and board approval requirement for related party transactions.

The annual reports and the financial statements of the companies are the main means of communication between the company and the stakeholders. Therefore the sensitive role of the board of directors by ensuring that the financial statements show the true position of the company's performance cannot be over emphasized. The board of directors must be well constituted to increase its independence and with the right size. Furthermore, the result is an indication that the companies are well positioned to support the economic growth and development of the country. With good corporate governance record, the companies would be able to generate more resources to create more employment opportunities, pay dividend to shareholders and generate more tax revenue to government. .

The relevance of corporate governance cannot be over emphasized since it constitutes the organizational climate for the internal activities of a company. In Kenya corporate governance can greatly assist the SME sector by infusing better management practices, stronger internal auditing and greater opportunities for growth. Corporate governance brings new strategic outlook through external independent directors; it enhances firms' corporate entrepreneurship and competitiveness. It is not a threat to value creation in entrepreneurial firms if the guidelines on corporate

governance are properly applied.

5.3 Recommendations of the study

Based on findings of the study, it is expected that the stakeholders, who include the Government, the SME owners and the agencies offering various support mechanisms to the SMEs will gain a better understanding of the impact of corporate governance on their performance. The following measures are recommended in order to enhance adoption of corporate governance practices among SMEs in Kenya: Good governance mechanisms among SMEs are likely to result in boards exerting much needed pressure for improved performance by ensuring that the interests of the firms are served. In the case of an SME, board members bring into the firm expertise and knowledge on financing options available and strategies to source such finances thus dealing with the credit constraint problem of SMEs as well.

This study identifies that the research, management, and policy development of training in the SME sector needs to be more open and flexible in order to address corporate governance issues. Research, management and policy instruments of training support will need to interact with, and be responsive to, the subtle distinctions of context that will moderate what is more appropriate, and more likely to be welcomed, in the small business sector.

5.4 Limitations of the study

Since it was a survey study involving a large sample size and collection data was extremely tedious and time consuming. The duration that the study was to be conducted was limited hence exhaustive and extremely comprehensive research could not be carried out. The study, however, minimized these by conducting in-depth analysis that significantly covers the shortcomings of the study. Further, the data was tedious to collect and compute as it was in very raw form. Further the presentation of the data in the different SMES was varied which made the data computation even harder. The limitation of this study was time constraints, limited financial resources and geographic distance between SMES in Kenya.

In addition, the researcher did not overlook the major limitation of descriptive research design which is that the design makes it difficult to explain phenomena that occur over time, hence the study's findings are only applicable to the study's time frame. This makes it difficult to explain phenomena that occur over time, hence the study's findings are only applicable to the study's time frame. It was difficult to access secondary data due to strict confidentiality exhibited by most SMES. The annual financial statements are also prepared under the fundamental assumptions and concepts which are subjective and therefore not be uniformly applied especially in terms of provisions and estimates

Limitations include the study's restricted focus on SME businesses within one geographical area. The study focused on SMEs and considering the diversity of the country, the findings may not be representative of the whole population of SMEs in Kenya. However, the sampling technique used ensured that each respondent had a non-zero chance of being selected to participate in the study. Though the researcher was determined to undertake the study to completion within the given time frame, various constraints were encountered as earlier envisaged. The time allocated for data collection may not have been sufficient.

5.5 Recommended areas of further research

The findings of this study, it is hoped, will contribute to the existing body of knowledge and form basis for future researchers. The following areas of further research are thus suggested: (i) Whereas the current study focused on corporate governance practices and their impact on their performance, future studies should focus on the various organizations that support SMEs, with a view to establishing any variances; (ii) the present study did not allow for the exploration of employees perspectives of corporate governance activities, considered to be crucial in the development of effective corporate governance intervention strategies. Neither did it allow for strategists nor do training institutions' perspectives of the difficulties they face in engaging with SME managers nor in encouraging them to undertake does corporate governance practice activities.

The social, legal, economic and the political environment are equally important. It is therefore suggested that future research should consider some of these factors in exploring the impact of corporate governance on firm performance. However, the above mentioned constraint will not invalidate the findings of the study but rather pave way for future research on the concept and any related topic Corporate governance is about building credibility, ensuring transparency and accountability as well as maintaining an effective channel of information disclosure that would foster good corporate performance

Given the importance of the views of employees, strategists and practitioners, an exploration of their experiences should be undertaken through further research studies, using the same conceptual framework, so that a more holistic understanding of corporate governance can be established and a fully coordinated approach can be taken to policy, practice, education and training; and (iii) there is need to adjust the survey instruments to capture the much more basic and limited range of training present in SMEs; extending the survey to SMEs outside of urban centers, and conducting longitudinal and qualitative studies to explore how and why investment in corporate governance practices increases with SMEs growth over time and how it contributes to enterprise development.

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