# CORPORATE GOVERNANCE AND FINANCIAL PERFORMANCE OF REGIONAL DEVELOPMENT AUTHORITIES IN KENYA

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# DECLARATION

I declare that this is my original work and has not been presented for a degree in any other university.

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God bless you all.

# DEDICATION

I dedicate this research project to my parents for their encouragement and prayers during my study period.

## ABSTRACT

The economic development of a country has been argued to be dependent on the performance of individual organizations in the country. In the same context, the low growth level of developing nations can be attributed to the sub-optimal growth of its organization, especially government owned, which can by extension be linked to the low level of sound Corporate Governance practices. Effective corporate governance is said to affect the performance of an organization though the direction of its influence has been a contentious issue. Adherence of good corporate governance principles has been reinforced by regulatory authorities in different sectors due to its perceived benefits and effect on performance of entities. This study aimed at establishing the effect of corporate governance on the financial performance of Regional Development Authorities in Kenya. The principles of corporate governance to which their effect on performance was determined include board size, board composition, disclosure information and audit committee. The control variables will be firm size and leverage. Secondary data was obtained from annual reports and financial statements of the organizations and the analysis was performed through descriptive and inferential statistics. The results were that board size and composition depends on an effective selection process for new directors, which in turn rests on a clear definition of what the duties of a directors are and a situation be avoided where one director is in more than one committee. The study also established that board (measured by the presence of either gender in the board) had a positive outcome on the financial performance of the firm. In the case of disclosure of information as one of the corporate governance principles, the research found a weak correlation with the financial performance of the regional development authorities. Further, it was established that there is a positive association between the composition of audit committee and financial performance of the Regional Development Authorities in Kenya. The study recommends that; special attention should be taken upon when dealing with the board members' number. The board's size should match with the organization's size to avoid scenarios of having too small boards which will be overburdened with the firm's work which will lead to underperforming, and at the same time boards should not be too large as the inefficiency of large boards will also lead to underperforming of the board members.

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# Abbreviations and Acronyms

| | | |
|---|---|---|
| CG | - | Corporate Governance |
| CEO | - | Chief Executive Officer |
| BSC | - | Balanced Scorecard |
| CMA | - | Capital Markets Authority |
| RDAs | - | Regional Development Authorities |
| ROA | - | Return on Assets |
| ROI | - | Return on Investments |
| ROE | - | Return on Equity |
| EPS | - | Earnings Per Share |
| SPSS | - | Statistical Package for the Social Sciences |

# CHAPTER ONE: INTRODUCTION

## 1.1 Background of the Study

In the present-day globalized business environment that is characterized by integration of economies of the world and large corporations' growth, corporate governance has become a key crucial issue for managers, shareholders and regulatory authorities (Rajagopalan and Zhang, 2008). Corporate Governance has gained currency as a result of its perceived input to the growth of the organization and the development of nations. In cases where there has been absence of good Corporate Governance, many well performing companies have been known to collapse and indeed through the existing literature, the claim that sound Corporate Governance has a positive effect on the performance of an organization has been supported (OECD, 2009). On the part of shareholders, observance of CG is expected to improve free cash flow of a firm which will in turn earn dividends to them rather than being used by the management who have control on the firm. Indeed, empirical studies has supported the believe that improvement in the practices of corporate governance results in better corporate financial performance (MacAvoy & Millstein, 2012).

In Kenya, Corporate Governance has gained popularity like in other countries (Ekadah & Mboya, 2011). This is because sound corporate governance practice is crucial for the development of economy that is market based and consequently, a prosperous society. This has come into being because of the increased failure of business units that have been identified not to have practiced good corporate governance tenets. The Private Sector Corporate Governance Trust (PSCGT) has for quite some time been the leading proponent of Corporate Governance in Kenya. CG build up in Kenya began in 1999 when the Center for Corporate Governance Kenya came up with a framework that firms chose to either adopt or not. The framework was then embraced by the Capital Markets Authority (CMA) in 2000 in the draft Corporate Governance

practices to be adopted by the public quoted firms in Kenya. In the subsequent years, it was made a necessity by the CMA for the quoted firms to adopt the CG practices. The CG practices majorly highlighted issues of the board for example separating the role played by the CEO and the Chair, role of audit committee and composition of the board.

This study was anchored on resource dependency theory as advocated by Hillman (2000) which posits that the function of an organization's board of directors is increasing the access of resources needed by the firm. This will be actualized if there is an effective selection of directors to guide the entity since the performance of the firm is dependent upon those in leadership. To add on this, the agency theory which this study also is anchored on points to the presence of agency relations between the shareholders' representatives (board) and the representatives of the board and other stakeholders (management). From this relationship, the theory notes that corporate governance more so focusing the on the directors as the assessment and monitoring device; that works out to make sure that problems that may arise from principal-agent relationship are kept low (Fama & Jensen, 1983).

### 1.1.1 Corporate Governance

Mayer (1997) opine that corporate governance deals with means of aligning the interest stakeholders and management and ensure organizations are operated to benefit the stakeholders. On their part, Deakin and Hughes (1997) point that corporate governance focuses on the association between the internal governance practices of organizations and the concept of firm's accountability as viewed by the society. Adams and Mehran, (2003) gives the definition of corporate governance as "the mechanism through which stakeholders (shareholders, creditors, employees, clients, suppliers, the government and the society, in general) monitor the management and insiders to safeguard their own interests." Hence, corporate governance can be said to be a system that gives corporations direction and control. Corporate governance can be

viewed as comprising measures that are taken socially to encourage the actors in the economy to participate in the production process, so as to create surplus for the organization, and to bring about a distribution that is fair amongst the partners, with the consideration of what they have brought to the organization (Maati, 2009).

Sir Adrian Cadbury defined Corporate Governance as: "Corporate Governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The corporate governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society" (Cadbury, 2000). As reinforced by Mulili and Wong (2010), that countries which practiced civil law for example Holland, Italy, Germany and France were able to developed corporate frameworks that focused more on stakeholders. However, those nations that followed of common law for example New Zealand, Canada, USA, United Kingdom and Australia developed frameworks that looked more on the shareholders returns.

The increase in corporate governance practices is majorly seen as one of the key ingredients in enhancing the foundation for the long-term economic growth of nations and organizations. Currently, investors are more enlightened and as a result demand high standards of corporate governance in the corporations in which they invest. The need for corporate governance is becoming more pronounced as a way of protecting the interests of the varied number of stakeholders. The need for corporate governance for success in corporate as well as for social welfare cannot therefore be under estimated (Musaali, 2007). That notwithstanding, Kocourek (2003) asserts that in order to counter the leadership, accounting, and scandals in governance, companies rush to make corporate governance an institution and this may result in counterproductive. This is because with the tightly regulated membership and the functions of

corporate boards, corporations, such as commercial firms are tempted to see governance as a legal hurdle rather than as a way of improving performance. He therefore argues that corporation directors and senior managers are dealing with the signs and not what causes the governance crisis by demeaning the issue of corporate governance to small issue.

### 1.1.2 Organizational Financial Performance

Financial performance is a function of its profitability. A firm's profitability is determined by factors both within and outside the corporation. The internal factors of a firm that influence its level of profitability include for example the management decisions of the firm and policy objectives for example the provisioning policy, level of liquidity, expense management, size and capital adequacy (Duttweiler, 2009). Again, the external factors influencing the firm's profitability include concentration of the market, the development of stock market, ownership, and other factors of macroeconomic. Green et al, (2010) pointed out that growth in sales and market, return on investment and profit are crucial factors which can be used to assess the performance of an organization. Thus, as per these researchers, the measures of performance of a firm like financial performance, market shares, human resource management, and efficiency and effectiveness of an organization performance represents good ways of measuring the performance.

Different organizations have varying organizational goals that will need to be achieved. Consequently, there is need for the management to come up with a clear-cut operation plan to realising the stated organizational objectives. Because of the wide spectrum of goals that an organization can adopt, performance management has attracted the interest of scholars from varied disciplines since this topic is not specific and a monopoly to manangers in accounts, operations, human resource, marketing and strategists in business.business strategists (Magutu, 2013). A firms' performance measurement is done against expectations set earlier and is

monitored, evaluated and recorded over time. From the feedbacks generated from time to time, the firm will be able to undertake corrective action and continuous improvement on the set targets. The performance of business units and functional areas in any business will affect the overall firm performance. Indeed, the allocation of resources in order to achieve business objectives in an organization is based on the expected results from the business units which will cumulatively determine overall performance of the firm (Chen and Paulraj, 2014).

Some authors (Kaplan & Norton, 2001) have put forth appropriate performance measurement frameworks to the operations to be applied in a firm. They include the performance measurement matrix and the balanced scorecard (BSC). The BSC is a tool that gives a balanced view on how the performance of an organization is arrived at by cascading firm performance perspectives down from the strategic (top) to operational (down) level of business at four levels of: customer service; financial stewardship; internal business processes; and service delivery innovations. (Gunasekaran et al., 2001). The BSC has simplified the measurement of firm performance, especially for a multiple goal firm where the metrics are shared by all units in the organization (Kaplan and Norton, 2001).

### 1.1.3 Corporate Governance and Financial Performance

Different scholars have pointed out the advantages of different tenets of CG. Bhagat and Black, (2012) posit that a sound CG protects an organization from being vulnerable to financial distress in the future. There is an argument that that the corporate governance structure of any corporate body has an influence on the firm's ability to react to outside factors that may affect its performance financially. therefore, it has been observed that the firms that are well governed in most cases perform better and good corporate governance is key in their financial performance.

When good corporate governance is present in a firm and in all areas of an economy, it gives a sense of confidence that is vital for the economy to properly function. Consequently, lowered cost of capital is and corporations get encouragement to more efficiently apply resources, hence underpinning their growth (OECD, 2004). In the case of emerging economies, good corporate governance practices help to reinforce property rights, reduce cost of transaction and the cost of capital, reduce vulnerability to financial crisis and leads to capital market development. Corporate governance framework that are weaker brings about a reduction in investor confidence and discourage outside investor. Different principles of corporate governance have an effect on the performance of a firm financially.

The association between good corporate governance and profitability of a firm has been the main focus in the studies of corporate governance but earlier literature gives varied results. According to Jensen and Meckling (1976) the well governed firms have a tendency to have more efficient operations that results in a high expected future cash inflows. However, Gompers *et al.* (2003) proved that there is no significant relation between the corporate governance of a firm and its financial performance. Becht et al. (2002) demonstrates how practices of corporate governance affects the profitability of the corporation positively while MacAvoy and Millstein (2003) established that the board's composition does not have an effect on financial performance. The office term of a Chief Executive Officer is key in determining the performance of a firm. Executives are hired on short-term basis and give attention the performance of the organization during the time they are in charge which give rise to fgiving attention to short and medium-term achievements. This has a limitation on the importance of stock price which is a proxy for performance by organization (Bhagat and Jefferis, 2002). Managers of an organization do away with this hurdle by attaching rewards of the Chief Executive Officer with the long-term success of the corporation (Heinrich, 2002).

### 1.1.4 Regional Development Authorities in Kenya

Regional development refers to efforts put in place to reduce regional disparities by creating employment related and economic activities that generates wealth in the regions hence assisting lagging regions to catch up. In the 20th Century, regional development was more multidisciplinary in integrating public policy, politics, sociology with economics while focusing on how various factors helped to develop regional development.

During the 21st century, other disciplines were joined by economic geography in shifting the focus of regional development to be centred on the spatial dynamics of a region as places to live, work and invest. During this era, the achievement of the objectives of equitable economic development and social inclusion was primarily by way of large-scale infrastructure development and by attracting inward investment. This era also emphasized the notion that people are important as drivers of regional development. People with their knowledge and where and how they use that knowledge became a key focus for research in regional development.

Regions that are competitive dynamic are necessary for countries to achieve their economic, social and environmental objectives. New theories of regional development focus on innovation, the spatial dynamics and human and social capital presenting the solution to the pressure of global economies of competition and establishment of comparative advantage. The pressure of globalization is therefore the central driving force for the development of regional development policy. Regional development policies complement national macroeconomic and structural policies to ensure equitable socio-economic development and sustainable utilization of resources. To achieve this end, the Government of Kenya established 6 Regional Development Authorities (RDAs) through various Acts of Parliament.

The areas of jurisdiction covered by the RDAs were developed based on the river basin boundaries in the country. They include: Kerio Valley Development Authority (KVDA)

established under Cap 441 of 1979, Lake Basin Development Authority (LBDA) under Cap 442 of 1979, Ewaso Nyiro South Development Authority (ENSDA) under Cap 447 of 1989, Ewaso Nyiro North Development Authority (ENNDA) under Cap 448 of 1989, Tana and Athi Rivers Development Authority (TARDA) under Cap 443 of 1974, and Coast Development Authority (CDA) under Cap 449 of 1990. (MORDA, 2008).

The mandate of these agencies was to map the resources in the area for proper planning and coordination of their use, integrated basin based development, protection of river basins, water bodies and catchments and finally to empower and support communities in the various areas of jurisdiction. The RDAs were very instrumental in ensuring rapid economic growth after their inception contributing to the country's GDP growth. However, challenges emerged such as limited funding that raised questions on the sustainability of the RDAs. With limited resources in terms of funding coupled with the need for the organizations to be self-sustaining, RDAs have not been left out. There is need for them to optimize the resources allocated to them and this means that they must have sound corporate governance practices in place.

## 1.2 Research Problem

The economic development of a country has been argued to be a mirror of the overall performance of its organizations. Hence the lower degree of development in countries that are still developing can be linked to the sub-optimal growth of its firms which can by extension be linked to the lower level of good Corporate Governance practices. This led to the emphasis on good Corporate Governance in the available literature as the key component determining the growth of nations (Peng, 2012). Corporate governance is key effort that ensures responsibility and accountability is a set of principles, that should be included in every part of the organization. The fundamental goal contained in the tenets of corporate governance is making sure that the firm's directors and managers accounts by ensuring good and effective protection to all

stakeholders. Mulili and Wong (2010), point that corporate governance is portrayed as the means and structure that is used to run the operations of an organization as it tries to enhance business prosperity and corporate accountability with the end goal of achieving long-term shareholder value, while taking into consideration the interest of other stakeholders. Claessens et al. (2008) asserts that better corporate frameworks makes an organization to benefit from greater access to financing, lower cost of capital, improved performance and a fairer treatment of all stakeholders.

The need for business units to observe the tenets of corporate governance is more crucial for emerging economies, which may not have the institutions required to ensure efficient management within firm governance (Peng, 2008). It has been put down that many emerging economies, like Kenya, lack good established external control mechanisms, like merger and acquisition laws, market control and efficient law enforcement. This has not only made it more difficult to govern the organizations, but it has also made standard corporate governance practices less legitimate. In Kenya for example, Regional Authorities has an important role to play in spurring the growth of the economy because of the vast areas of the country both in terms of land mass land mass and population that live in these regions. A study of corporate governance aspects amongst Kenyan Regional Authorities and how they affect their organizational performance is hence a relevant research area. A recent case in point is the putting into receivership three commercial firms due to issue that relate to a lack effective adherence corporate governance by the management of the firms.

Locally, Kasoo (2008) researched the impact of corporate governance on the financial performance of quoted companies at the NSE. Companies that are not quoted were left out though an inclusion would have provided a more conclusive result. More recently Areba (2012)

used the case of commercial state corporations leaving out the regulatory and the non-commercial corporations. Abdi (2015) researched on the impact of corporate governance on State Corporations in Kenya. On the basis of the above studies, it is evident that there have not been studies done to establish how corporate governance affects the financial performance of Regional Development Authorities in Kenya. This study therefore sought to fill this gap by finding an answer to the question what is the effect of Corporate Governance on the Financial Performance of Regional Development Authorities?

## 1.3 Research Objectives

The key objective of this study was to find out the effect of Corporate Governance on the financial performance of the Regional Development Authorities in Kenya.

## 1.4 Value of the Study

This study will assist the policy makers that is government and any other key stakeholders to come up with relevant policies and projects that will help positively in stimulating the growth and sustainability of the regional bodies in Kenya, and again help those makes policies to encourage, assist, and enable the creation of the right and relevant corporate governance policies to guide and help the bodies. Regulatory bodies can at the same time adopt the study findings to help in improving the framework for regulation.

The findings from this study will also benefit the managers and key staff of the development authorities who will be able to understand gain how their organizations can effectively embrace corporate governance for effective management of the development institutions. This study will provide an insight on the need of adopting CG and thus offer increased level of efficiency. CG practices and their impact will be discussed for the benefit of the managers.

This study will assist the existing knowledge since it recommends how to improve the adherence of corporate governance principles through observance of the various regulatory requirements.

# CHAPTER TWO: LITERATURE REVIEW

## 2.1 Introduction

This chapter discusses literature relating to corporate governance and its effect on the financial performance of organizations. The organization of literature review is; the first section looks at the theoretical framework relevant to the study, then the corporate governance principles and finally factors affecting financial performance of a firm. Finally, the chapter looks at the empirical studies on the research matter at hand.

## 2.2 Theoretical Review

Theory refers to a collection of statements which have evidence to support them and gives an explanation of some phenomena. A theory gives a generalized explanation to an occurrence. The relevant theories discussed are the Resource Dependence theory, Agency theory and Stakeholders theory.

### 2.2.1 Resource Dependency Theory

The theory was advocated by Hillman (2000) and is concentrated on responsibility of the board of directors who provides access to the resources that is required by the firm. Resource Dependency theory looks at the duties of directors in either securing or providing key resources to a company by linking them with the outside environment. Johnson et al. (2006) agrees that proponents of this theory put more attention on the appointment of representative from those organizations that are independent as a means of acquiring resources that are crucial to the firm's success.

This Resource-Dependency based view of the corporation is used to explain how competitive advantage is reached in firms by using resources and the way that advantage can be maintained for quite some time (Pearce et al., 2012). This theory postulates that various types of resources available to a firm may pose a greater influence to performance of the firm. Having different

levels of resources across firms will result in discrepancies in performance. Hence, having resources that are unique is an indicator of good performance. As long ago as 1959, Penrose indicated that organizational resources are the s most important source of organizational performance thus leading to competitive advantage.

This is similar to the earlier views of Wernefelt (1984) who opined that organizations can be seen as bundles of resources and that these resources are distributed equally amongst firms and that there will be differences over time. However, scholars have been frustrated by not being able to back the relation between the structure of the industry and the performance of the firm. (Tokuda, 2005) looked at the internal features of the firm. Despite the lack of a clear link, from the mid-1980s, the RDT has gained currency as a key theory in strategic management (Pearce et al., 2012) although it may be argued by others that there is no empirical evidence for a theoretical system.

### 2.2.2 Agency Theory

This theory emanated from the economic theory as advanced by Alchian and Demsetz (1972) that further was advanced by Jensen and Meckling (1976). This theory refers to the relationship between the principals who are the shareholders and agents who are company executives and managers. The relationship comes about when the principals who owns the company, hires the agents to work on their behalf (Clarke, 2011). Agency theory has its base on the ownership separation and control of an organization. As Daily et al. (2008) argued, there are two important factors influencing the popularity of agency theory. Firstly, this theory is much simple and reduces the number of participants in the firm to the management and the shareholders only. Secondly, the theory provides a suggestion that that managers or employees in firm may be self-centered.

This theory advocates that failure to check managers they will focus on individual interest at instead of the interests of the organization. Agency theorist proposes that the board that should be drawn from people from outside the organization who are not directors that are not have interests and not participate in running the daily operations of the corporation. Agency cost may become more if the duties of the CEO are not distinguished from those of the chairperson of the board more so when the chairperson is influenced by the CEO. This makes the organization suffer from financial loss and control of the market (Balta, 2013). The limitations of this theory to corporate governance is that the corporation is benchmarked using the owners only. The other stakeholders do not participate in the daily operations of the organization. This may lead to pursuing goals that maximizes the owner's wealth therefore sacrificing the customers, workers, the environment and community. Performance measure and reporting of organizations that use this model will be limited to indicators such as profit or surplus, return on investment and earnings per share(Clarke,2011)

### 2.2.3 Stakeholder Theory

This theory was introduced to management in 1970's and was further developed by Freeman (1984). This theory advocates for accountability in corporate amongst many the stakeholders. Wheeler et al. (2012) said that the theory resulted from combining sociological and organizational disciplines. This is because, as he argues, this theory is not a unified and is more of a broad research tradition, ethics, incorporating philosophy, economics, political theory, law and organizational science. This theory advances the notion that no organization operate in a vacuum or alone but rather are part of a system where other interested stakeholders are present (Gibson, 2010). The varied members of stakeholders that include customers, employees, suppliers, the government, the community and shareholders are assumed to also have a stake in the affairs of an organization. The advocates of this theory hence advance for representation of

all the members of the stakeholders who are on board in order to achieve corporate governance that is effective. This theory stresses role played in non-market mechanism, for example need to establish an optimum board size, the requirement to design a committee structure which supports coming up with committees that are specialized. These structures would enable the setting up of committeees which are full of monitoring and are productive in their operations. (John and Senbet, 1998).

### 2.3 Aspects of Corporate Governance

This section discusses aspects of corporate governance, where previous studies on the board's size, board's independence, board's composition and firm size are highlighted.

Panasian (2003) defined board size to be the total number of directors in a board that has been vied as a crucial determinant of effective corporate governance. While Goshi (2002) stated board size includes both the directors who are executive and those who are non-executive. Leblanc & Gillies (2003) stated that a board consists of 8-11 members. In a recent study by Epstein (2004) also argued that a board comprises of 9-13 members is ideal for most firms but too small for those firms which are large. On other hand, Goshi (2002) noted that a board comprises of 16 directors (3 within and 13 outside directors) to be ideal for larger companies. Yermack (2000) argues that companies with smaller boards, that consists of less than ten directors, are seen to be better performers. In contrast, Chaganti (2001) believe that boards that are large are of value because of their knowledge and the kind of services that they can provide to the firm.

Lipton and Lorsch (2002) suggested that boards that are large are less effective and it is easy for a Chief Executive Officer to control. This indicates that the board's size gives an increase in the pool of experts, information and quality advice that cannot be obtained from another corporate

staff. The inherent difficulty in coordinating the contributions from the various members can be complex, which hinders them from using their knowledge and skills effectively (Epstein, 2004).

The board of directors performs a key role in corporate governance practice. The importance of boards and the feeling that they need to engage more in the affairs if the firm, and have an influence on the strategic management of their firms came to public prominence after the failures of Enron and WorldCom in early 2000s (Johnson and Scholes, 2008). There was considerable discussion as to whether the boards of companies were really exercising their stewardship role. The board of directors has the duty of monitoring and disciplining the senior management, and this helps to assure the stakeholders that the quality of financial reporting is above board (Anderson 2004). For a service providing corporation the board ensures that the shareholders get valuable service commensurate with their investment. Board composition is the size of the board and the demographic mix of the directors. It incorporates the idea of board's independence. The characteristics of the board includes the background of the directors and their skills in terms of training and experience. Board's structure includes the organization of the board, board committees and the role that is played by the smaller board committees. Board process is the arrangement for boards' operations, which comprises the frequency and duration of meetings, succession planning and the performance evaluation of directors (Moodie, 2001).

Mak and Kusnadi (2005) stated that the board's independence is a key condition for evaluation and monitoring of managers' performance. In effect, the independence of the board is the interest in considering attention in current coding of best practice. That notwithstanding, there is mixed evidence of a good effect on performance, probably resulting from the difficulties in identifying those directors who are truly independent. Bhagat and Black (2002) discovered that there is no

association between the ratio of the directors who are independent and the indicators of a corporation's performance.

The board may delegate some oversight responsibility to the audit committee and any of its committees. Audit committee is charged with the responsibility for recommending the external auditor to be selected, to ensure that the internal accounting and control practices are of sound and are of high quality and to monitor the independence of the external auditor from the senior management interference (Anderson, 2004). The audit committee's effectiveness in oversight role is determined by such features like literacy in finance and expertise, the independence of audit committee members, and frequency of activities in given year.

### 2.4 Determinants of Firm Financial Performance

Koch (1995) points out that the different performance amongst firms is an indication of the differences in the philosophy of management and also discrepancies in the market served.

Capital adequacy means that there is sufficient quantity of equity to take care of any risks that an organization may find itself in (Kosmidou, 2009). In most countries, the structure of capital of organizations is more regulated because capital is important in minimizing the failures by the firm. Those firms that have more leverage are prone to taking more risk for them to maximize shareholders value at the cost of those who provide the finance (Kamau, 2009). Even though statutory capital requirements are a necessity to bring down the lack of information disclosure, the debate is on how much capital is enough to run an organization smoothly.

Regulatory bodies would prefer the presence of higher basic necessities to minimize cases of failure by firms, while the firm on the other hand believe that getting more equity is difficult, it is expensive and more conditions limits its competitiveness in the market. Beckmann (2007) says that presence of high capital tends to result in low profits because firms with a high capital are

more likely to avoid risks therefore they ignore potential investment opportunities which leads investors to request for low return on their invested capital at the expense of lower risk.

Another important decision determinant of financial performance is liquidity. Management should be careful in measuring their demands relation to the task of making deposits and requesting for loans. Liquidity needs goes above the firm because failure to meet the target in liquidity at a single firm may have far reaching consequences (CBK, 2009). When firms have high liquidity, it is being done at the expense of certain investment, that may have generated higher returns to them (Kamau, 2009). The exchange present between return and liquidity risk are best seen by looking at the movement of short term securities those of long term or loans raising a firm's return and increasing its liquidity risks. Therefore, a high liquidity ratio is an indicator of a less risky and less profitable firm (Hempel et al, 1994). Managers will therefore be in a dilemma between liquidity and profitability.

Large firms that possesses market power have been seen to be possessing incentives that help them reduce the behavior of taking risk associated with them and hence improving their assets quality. Keeley (1990) as quoted by Northoctt (2004 argued that the reason for the increase failures by firms in the US in the 1980s was as because of the increase in industry competition. Flamini *et al* (2009) argued that in case of high returns brought out by the market power, this is an indicator of presence of some level of inefficiency in providing financial services. This can raise an alarm to the policymakers for them to come up with measures that will lower the risk and clear barriers that limits firms from entry if it exists and any other obstacles that limits competition and lastly re-evaluate the regulatory costs.

## 2.5 Review of Empirical Evidences

There are studies done to establish the relation between corporate governance and the financial performance of firms. An empirical study conducted by Gompers *et al*. (2003) found that

between 1991–1999, the investors that went on well governed corporations, as described by an index that combined 24 various aspects of corporate governance, whereas short listing those firms that are poorly governed, had an unusually higher annual return of 8.5%. likewise, strong returns were established for a trading strategy that was based on a narrow list of what was considered the six core elements of good corporate governance by reformers including carrying out board's election each year, and not blocking or being against takeovers. Nevertheless, a study by Bebchuk*et al*. (2010) disputed the results of the research by Gompers *et al*., and repeats the study for 2000–2008.Bebchuk*et al*. find that, in contrast with the 1990s, neither the 24-factor index nor the 6-factor index would have helped investors beat the market.

Adjaoud et al. (2007) did a research to observe the effect of board's quality on the performance of the firm with the terms of indicators being composition of the board, how the is compensated and disclosure issues. The quality of the board was arrived at by awarding a mark to each and every characteristic of the board given and after that adding the total marks from the variables. The study established that there the relationship between characteristics of the board and performance when traditional performance measures like Earnings Per Share (EPS) Return on Assets (ROA) and Return on Investments (ROI), were used had no significant relationship. A significant relationship was established between the characteristics of the board and performance, when the performance was evaluated by considering the terms of economic value that is added or the market value.

## 2.6 Conceptual Framework

The conceptual framework helps to create an understanding of the problem being considered and communication of it effectively. Mugenda and Mugenda, (2003) argued that conceptual framework involves forming ideas on relationships between variables in a study and showing this relationship in a diagram. This study will adopt the conceptual framework shown in figure 1

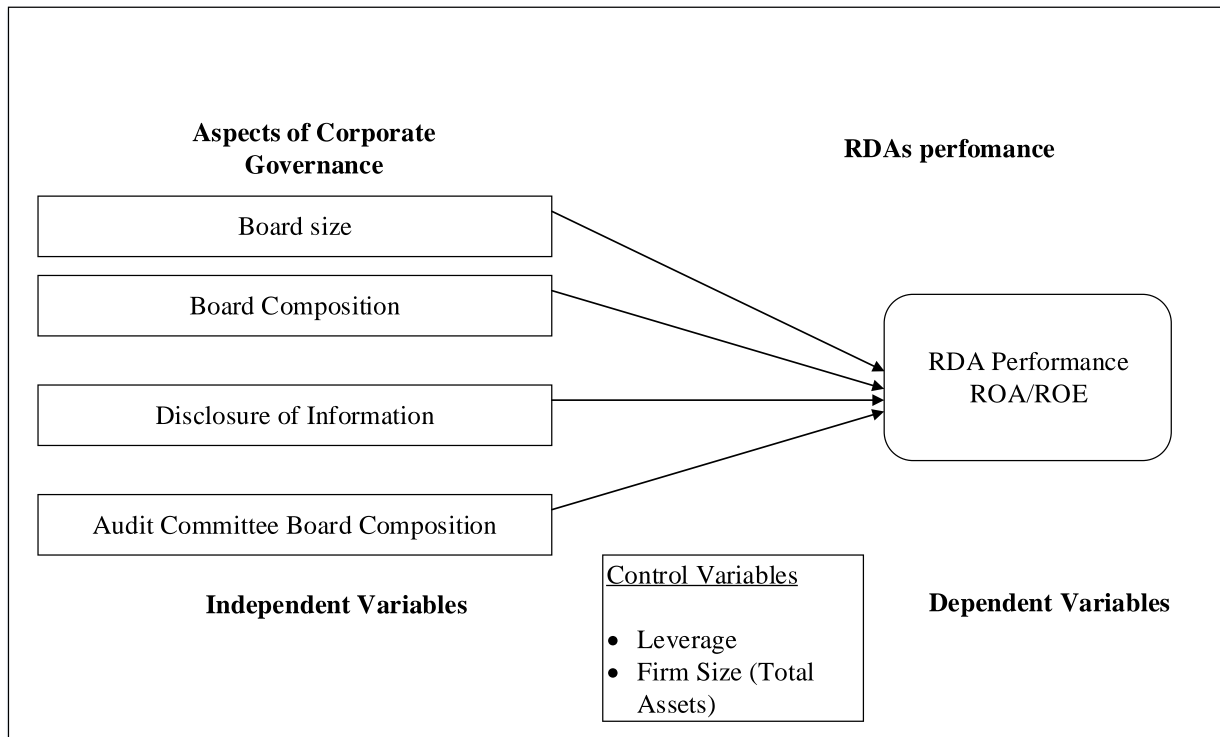


**Fig 2. 1 : Conceptual Framework**

**Source: Researcher, 2016**

## 2.7 Summary of the Literature

The practices of corporate governance and its effects on the financial performance of a firm has been discussed in the literature and from the studies that have been done on this subject area. It was established empirically that there is a relationship between the performance of an organization and its management. The studies have also come up with the conclusion that performance of the past can affect the degree of disclosure. Like more profitable corporations are more ready to reveal information to investors as compared to those firms that are less profitable. However, the findings reached so far do not provide an indication of the causal relationship between the disclosure by the firm and level of performance of the firm and therefore the studies

are not clear on what could be causing what, whether it is the level performance of the firm or disclosure.

Studies on corporate disclosures gives a lot supports the believe that a linkage between corporate governance disclosure and the level of performance by a firm is present. Nonetheless, literature on the relationship between characteristics of the board and performance of a firm provides results that are not conclusive. Likewise, in the case of ownership as per the literature above, it can be concluded that the relationship between managerial ownership and the performance of a firm is still unclear. The relationship could either be existing or not. This means that there has to be more research in this area. Locally, although different studies have been done knowledge gap still exists because no study has looked at the impact of corporate governance practices on the financial performance of Regional Development Authorities in Kenya.

# CHAPTER THREE: RESEARCH METHODOLOGY

## 3.1 Introduction

This chapter discusses the method of data collection, processing and analysis methods that were used. The target population, data collection instruments are also discussed.

### 3.2 Research Design

A descriptive census was adopted by the study. A descriptive study refers to collection of information without changing or manipulating the environment. The reason for using this design is because descriptive research is able to determine and report the exact way in which variables are (Cooper & Schindler, 2007). Furthermore, this design is more relevant to this study because it made it possible for the researcher to draw conclusions about the variables under the study without manipulating the respondent and hence allowed the measurements to be fully controlled. Since all the Regional Development Corporation were studied, the research adopted census survey.

### 3.3 Target Population

As defined by Lavrakas (2008) a population refers to collection of individual elements which may be finite or infinite. Hyndman (2008) defines a population as collecting 'things' which are of interest to the researcher.

The target population was the 6 Regional Development Authorities in Kenya (Appendix I). This was a census survey.

### 3.4 Data Collection Instruments

The study used secondary data only. Data was obtained from the state corporations annual reports and financial statements from 2011-2015. Data on their corporate governance practices was obtained from the annual reports.

The study looked at Corporate Governance characteristics which included board composition, disclosure information, board size, audit committee, leverage level and firm size. The dependent variable was evaluated by the the Return on Assets (ROA).

### 3.5 Data Analysis and Presentation

Analysis of the data was by use of SPSS Version 22. Descriptive statistics like mean and standard deviation were calculated to delineate variable characteristics. Correlation analysis was also performed to determine the association between variables. Regression analysis was conducted to find out the association between the independent and dependent variables.

The various variables were measured as shown in Appendix II.

The following is the model of analysis that was used:

$$\mathbf{Y = \alpha + \beta 1X1 + \beta 2X2 + \beta 3X3 + \beta 4X4 + \beta 5X5 + \beta 6X6 + \varepsilon}$$

Where:

Y = Represents the performance of the regional corporation as brought out by Return on Assets (ROA) β1, β2, β3, β4 and β5 are representation of the coefficients of corporate governance

X1 = BODSIZE - Board Size

X2 = BODCOMP - Board Composition

X3 = DISCINF - Disclosure of Information

X4 = AUDC - Audit Committee Board composition

Controls Variables:

X5= LEV - Leverage

$X6$ = Firm Size = Log (Total Assets)

$\alpha$ = Refers to the constant term that indicates the height of performance in case the Independent Variable i.e. corporate governance practices are absent

**$\varepsilon$** = This is the Error term: that represents, other factors apart from the corporate governance aspects above which are not taken care of in the model

# CHAPTER FOUR: DATA ANALYSIS, PRESENTATION AND INTERPRETATION

## 4.1 Introduction

This chapter presents a detailed analysis of the findings from the research. The aim of this study was to find out the impact of Corporate Governance on the financial performance of Regional Development Authorities in Kenya. The study targeted six Regional Authorities of which five responded.

## 4.2 Descriptive statistics

The descriptive analysis shown below gives the average and standard deviation of the various variables that were key for the study. It again shows the percentile values of the variables that guides in finding out both the maximum and minimum values that a variable can get.

### 4.2.1 Descriptive Statistics on Board Size

This section of data sought to establish the total number of board members over the 2011-2015 period. The results are shown in Table 4.1.

**Table 4. 1: Board Size**

| Year | Median | Minimum | Maximum | Mean | Std deviation |
|---|---|---|---|---|---|
| 2011 | 18.91 | 17.34 | 20.43 | 19.6 | 0.30 |
| 2012 | 18.91 | 17.34 | 20.43 | 19.2 | 0.12 |
| 2013 | 15.62 | 15.03 | 16.23 | 15.8 | 0.31 |
| 2014 | 15.65 | 15.03 | 16.23 | 15.8 | 0.47 |
| 2015 | 15.71 | 15.03 | 16.23 | 15.8 | 0.46 |

**Source; Research Data, 2016**

From the findings, it can be noted that the year 2013 - 2015 recorded the lowest value as shown by a mean of value of 15.8 while the year 2011 recorded the highest value for board size at 19.6. The values for standard deviation depicts variability in percentage ownership structure during the five-year period with the highest deviation of 0.47 in the year 2014 and the lowest 0.12 in the year 2012.

### 4.2.2 Descriptive Statistics on Board Composition

The measure of board composition was determined by the ratio of women against total number of the members of the board. The results are shown in Table 4.2.

**Table 4.1: Descriptive Statistics on Board Composition**

| Year | Mean | Std deviation |
|---|---|---|
| 2011 | 0.126 | 0.054 |
| 2012 | 0.141 | 0.016 |
| 2013 | 0.135 | 0.092 |
| 2014 | 0.151 | 0.112 |
| 2015 | 0.204 | 0.104 |

**Source; Research Data, 2016**

From the findings, it can be noted that the year 2015 recorded the highest ratio of female board members as shown by a mean of value 0.204 of all the board members while the year 2011 recorded the lowest ratio of female board members as represented by 0.126 of the total board memebers in the regional authorities. In addition, values for stardard deviation depicts variability in board composition during the five – year period with the highest deviation of 0.112 in the year 2014 and the lowest 0.016 in the year 2012. The findings implies that there has been a general rise in the number of female board members among the Regional Authorities.

### 4.2.3 Disclosure of Information

The disclosure of information that was sought relates to the Regional Development Authorities' disclosure of corporate social responsibility activities and the total budget set aside in a particular financial year under consideration. The results are presented in Table 4.3.

**Table 4.2: Descriptive Statistics on Disclosure of Information**

| Year | Median | Minimum | Maximum | Mean | Std deviation |
|---|---|---|---|---|---|
| 2011 | 0.32 | 0.13 | 0.34 | 0.26 | 0.17 |
| 2012 | 0.40 | 0.80 | 0.41 | 0.39 | 0.13 |
| 2013 | 0.29 | 0.01 | 0.48 | 0.34 | 0.11 |
| 2014 | 0.62 | 0.61 | 0.41 | 0.78 | 0.12 |
| 2015 | 0.91 | 0.61 | 0.51 | 0.89 | 0.11 |

**Source: Research Data, 2016**

From the findings, it is evident that the year 2015 recorded the highest value in disclosure of corporate social responsibility information as shown by a mean of value 0.89 implying that most of the Regional Authorities had conformed to disclosure of the activities relating to the organizations engagement on CSR activities. This trend improved over the subsequent years with the highest disclosure occurring in 2015. In terms of the stardard deviation of the disclosure results, it was found that the highest deviation was recorded in the year 2011 and this explain the lower mean in the reults on disclosere of information by the Regional Development Authorities.

### 4.2.4 Audit Committee Board Composition

The audit committee was determined by the proportion of female directors in relation to the total number of committee members. The results are presented in Table 4.5.

**Table 4.4: Descriptive Statistics on Audit Committee Board Composition**

| Year | Mean | Std deviation |
|---|---|---|
| 2011 | 0.12 | 0.07 |
| 2012 | 0.13 | 0.06 |
| 2013 | 0.14 | 0.09 |
| 2014 | 0.15 | 0.07 |
| 2015 | 0.21 | 0.10 |

**Source; Research fidings, 2016**

From the findings, it can be noted that the year 2015 recorded the highest mean in audit committee board compositions as shown by a ratio of 0.21 which translate to around 2 women on the average of 6 members of Audit committee while the year 2011 recorded the lowest value for audit committee female compositions at 0.12 in addition, values for stardard deviation depicts variability in audit committee board compositions during the five – year period with the highest deviation of 0.10 in the year 2015 and the lowest 0.06 in the year 2012. the findings revealed that there have been increase female audit committee members over the five-year period in the Regional Development Authorities in Kenya.

### 4.2.5 Descriptive Statistics on Leverage

The leverage measure as a control variable that impacts also on the financial performance of the Regional Development Authorities. This measure was found by determining the ratio of total liabilities to the organizations' total assets. The results are presented in Table 4.5.

**Table 4.2: Leverage**

| Year | Median | Minimum | Maximum | Mean | Std deviation |
|---|---|---|---|---|---|
| 2011 | 0.024 | 0.04 | 0.146 | 0.090 | .016 |
| 2012 | 0.134 | 0.102 | 0.196 | 0.136 | 0.08 |
| 2013 | 0.138 | 0.116 | 0.151 | 0.130 | 0.16 |
| 2014 | 0.188 | 0.163 | 0.284 | 0.206 | 0.22 |
| 2015 | 0.166 | 0.132 | 0.253 | 0.236 | 0.51 |

From the findings, it can be noted that the year 2015 recorded the highest value for percentage leverage as shown by a mean of value of 0.236 while the year 2011 recorded the lowest value for leverage at 0.09. The increased level of leverage could be attributed to the increased investments being undertaken by the regional authorities that are financed by the foreign countries and therefore the liability side of the balance sheet has increased, and thus the leverage level. The values of the standard deviation depict variability in percentage leverage during the five-year period with the highest deviation of 0.51in the year 2015 and the lowest 0.016 in the year 2011.

#### 4.2.6 Firm size

The firm's size was determined by the logarithm of the total assets. The financial performance of a firm is influenced, ceteris paribus, by the investment level which is affected by the total assets that the firm has. In this context, it is expected that a Regional Development Authority that has invested in different income generating activities will receive proportionate amount of income. The results are presented in Table 4.6.

**Table 4.3: Descriptive Statistics on Firm size**

| Year | Median | Minimum | Maximum | Mean | Std deviation |
|---|---|---|---|---|---|
| 2011 | 9.261 | 8.297 | 10.065 | 9.314 | 3.4 |
| 2012 | 8.735 | 7.933 | 10.137 | 9.170 | 3.8 |
| 2013 | 9.029 | 8.020 | 10.104 | 9.192 | 3.5 |
| 2014 | 9.182 | 8.450 | 10.083 | 8.891 | 3..1 |
| 2015 | 8.971 | 8.297 | 10.065 | 9.322 | 2.9 |

**Source; Research Data, 2016**

From the summary 2014 recorded the lowest value for firm size at 8.891 while 2015 recorded the highest value for Firm size at 9.322 while the stardard deviation values depicts variability in value for firm size during the five –year period with the highest deviation of 3.8 in the year 2012

and the lowest at 2.9 in the year 2015. The findings revealed that there have been a significant increase in firm size during the five-year period among the Regional Development Authorities.

### 4.2.7 Financial Performance

The financial performance was determined by the Return on Assets (ROA) determined by the logarithm of the total assets. The ROA is obtained as follows.

$$ROA = \frac{Surplus/(deficit)}{Total\ Assets}$$

The results are presented in Table 4.7.

**Table 4.4: Descriptive Statistics on Financial Performance**

| Year | Mean | Std deviation |
|---|---|---|
| 2011 | 1.590 | 0.160 |
| 2012 | 1.820 | 0.400 |
| 2013 | 2.240 | 0.350 |
| 2014 | 2.660 | 0.510 |
| 2015 | 2.750 | 0.290 |

**Source; Research Data, 2016**

From the summary 2011 recorded the lowest value for financial performance at 1.590 while 2015 recorded the highest value for financial performance at 2.750 while the stardard deviation values depicts variability in value for financial performance during the five –year period with the highest deviation of 0.510 in the year 2014 and the lowest at 0.160 in the year 2012. The findings revealed that there have been a significant increase in financial performance during the five-year period among the Regional Development Authorities.

## 4.3 Inferential statistics

For the inferential statistics, the research undertook correlation analysis and regression analysis. Firstly, correlation was performed to find out the degree of association amongst the different variables that were in consideration. As a result of multiple variables having an influence on the problem, the study noted the important factors of corporate governance linked with financial performance. Pearson and Spearman correlations are performed for all variables that are under consideration in the study by beginning with the Pearson's correlation results. Secondly, regression analysis is similarly used.

### 4.3.1 Correlations Analysis

Pearson correlation analysis was conducted to bring out a linear association between the predicted and explanatory variables and vice versa. It therefore helps in establishing the strengths of association in the model. In consistency with Shin and Soenen (1998), the spearman's rank correlation coefficients are found to be on the upper right triangle whereas the Pearson product moment correlation coefficients are found to be at the lower left triangle. Pearson's Correlation analysis is applied to find out the relationship between variables such as those between working capital management and profitability.

**Table 4.3 : Correlations**

| | | Financial performance | Board composition | Disclosure of Information | Disclosure of Information | Audit Committee Board Composition | Leverage |
|---|---|---|---|---|---|---|---|
| Financial Performance | Pearson Correlation | 1 | .567 | .418** | .298* | .618** | .067** |
| | Sig. (2-tailed) | | .001 | .000 | .014 | .000 | .003 |
| Board size | Pearson Correlation | .567 | 1 | .016 | .005 | .103 | .293* |
| | Sig. (2-tailed) | .001 | | .898 | .965 | .406 | .016 |
| Board composition | Pearson Correlation | .418** | .016 | 1 | .746** | .021 | .168 |
| | Sig. (2-tailed) | .000 | .898 | | .000 | .863 | .173 |
| Disclosure Of Information | Pearson Correlation | .298* | .005 | .746** | 1 | .052 | .058 |
| | Sig. (2-tailed) | .014 | .965 | .000 | | .676 | .641 |
| Audit Committee Board Composition | Pearson Correlation | .618** | .103 | .021 | .052 | 1 | -.580** |
| | Sig. (2-tailed) | .000 | .406 | .863 | .676 | | .000 |
| Leverage | Pearson Correlation | .067** | .293* | .168 | .058 | -.580** | 1 |
| | Sig. (2-tailed) | .003 | .016 | .173 | .641 | .000 | |

**Source: Research findings (2016)**

The study carried out a Pearson moment correlation on the correlation of the study variable. As per the finding in the Table 4.7, it was established by the study that a positive correlation coefficient exists between Board size and financial performance of the Regional Development Authorities in Kenya evidenced by correlation factor of 0.567, the association was established to be significant statistically because the significant value was 0.001 which is less than 0.05, the study established a strong positive correlation between quality board composition and financial performance of Regional Development Authorities, as shown by correlation coefficient of 0.418, the significant value was 0.000 which is less than 0.05. In addition, the study established a positive correlation between disclosure of information and financial performance of Regional

Development Authorities as shown by correlation coefficient of 0.298. The study established that there was positive correlation coefficient between audit committee board composition and financial performance of Regional Development Authorities , as shown by correlation factor of 0.418, this relationship was found to be statistically significant as the significant value was 0.000 which is less than 0.05 and finally the study found positive correlation between leverage and financial performance of Regional Development Authorities as shown by correlation coefficient of 0.067, the significant value was 0.003 which is less than 0.05. The findings concur with Franks and Curswoth, (2003) who found out that strong positive correlation between financial performances of the firms listed. The findings further agree with Ayodele (2011) who found out that strong positive correlation between audit committee board composition and financial performance.

## 4.4 Regression Analysis

Multiple regression analysis was undertaken to test the influence amongst predictor variables. SPSS V 22.0 was used to code, input and perform computation on the measurements of the multiple regressions. The summary of the model is laid out in table 4.8.

**Table 4.8: Coefficients**

| Model | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|---|---|---|---|---|---|
| | B | Std. Error | Beta | | |
| (Constant) | -2.284 | 0.236 | | -5.436 | 0.001 |
| Board Size, X1 | 2.546 | 0.151 | 0.527 | 3.616 | 0.000 |
| Board Composition, X2 | 0.450 | 0.119 | 0.410 | 3.790 | 0.015 |
| Disclosure of Information X3 | 0.351 | 0.094 | 0.326 | 3.734 | 0.021 |
| Audit Committee Board composition X4 | 0.613 | 0.065 | 0.408 | 6.815 | 0.007 |
| Leverage X5 | -0.012 | 0.002 | 0.016 | -6.681 | 0.001 |
| Firm Size, X6 | 1.628 | 0.125 | 0.428 | 3.951 | 0.023 |

**Source: Research data, 2016**

From the output generated which is given in Table 4.8, the equation ($\mathbf{Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \beta_5X_5 + \beta_6X6 + \varepsilon}$) comes to:

$Y = -2.284 + 2.546X_1 + 0.450X_2 + 0.351X_3 + 0.613X_4 + 0.012X_5 + 1.628X_6$

From the regression model obtained above. The study revealed that a unit Board size while other factors being held constant would change the financial performance of the Regional Development Authorities by a factor of 2.546, a unit change in board composition while other factors being held constant would change the Regional Development Authorities by a factor of 0.450, a unit change in disclosure of information while other factors being held constant would

change the Regional development authorities by a factor of 0.351, a unit change in audit committee board composition while other factors being held constant would change Regional Development Authorities by a factor of 0.613 and that a unit change in leverage while other factors are held constant would lead to an increase in Regional Development Authorities by a factor of 0.012.

The significance level undertaken by the study was 5%. The method used to compare if the predictor variables were either significant or not in the model was by comparing the obtained probability value and α=0.05. If the probability value was found out to be less than α, then the predictor variable was significant otherwise it was not. All the predictor variables were found to be significant in the model because their probability values were less than α=0.05.

**Table 4. 4 : Model Summary**

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|---|---|---|---|---|
| 1 | 0.729 | 0.532 | .512 | .37489 |

**Source: Research data, 2016**

Coefficient of determination was used in the study to establish the model fit. The coefficient of multiple determinations (adjusted $R^{2,}$), represents the percent of the variance in the dependent variable that is uniquely explained by or jointly by the independent variables. The model had an average adjusted coefficient of determination ($R^2$) of 0.512 and which implied that 53.2% on the variations financial performance is explained by the independent variables understudy (ownership structure, board composition, disclosure of information audit committee board composition and leverage).

## 4.5 Discussion on the Findings

Corporate governance practices of an organization provide specific distribution of duties and responsibilities amongst various parties in the company which include, board, shareholders, management and other stakeholders stipulating the guidelines and procedures when deciding on corporate issues. The common tenets that define the corporate governance practices are the board size, composition of the board, disclosure of information and audit committee composition. These principles have been found to influence, among others, firm's financial performance (Uche, 2004).

From the descriptive statistics result obtained, the board size was established to be one of the important variables that affects the financial performance of the Regional Development Authorities. An optimum number board members will be in a position monitor the management's actions and also the resources that organization has in its disposal. Effective governance also depends on an effective selection process for new directors, which in turn rests on defining the duties of a directors and a situation be avoided where one director is in more than committee. The findings are in line with the research by Yesuf and Mesut (2014) that board size is a crucial component of corporate governance among government entities similarly. Consistent with Lipton and Lorsch (2002) findings, the study suggest that a large board will, however, lack effectiveness and are easily controlled by the chief executive officer. This indicates that the board's enables an increased pool of expertise, quality advice that is not obtained from other corporate staff and information.

The research further established a positive relation between board composition and financial performance of the Regional Development Authorities (Beta coefficient value = 0.450, P- value =0.015). The study also established that board (measured by the presence of either gender in the

board) had a positive effect on the financial performance of the firm. A more gender sensitive board is likely to bring more wealth of knowledge to the board and consistent with Erakovik and Goel (2008) investigation on the relationship between the board and management and how the relationship can help to bring a competitive advantage to the firm, by comparing with other firms, the others find that more inclusive, open and collaborative relationship between board and the management will give rise to unique corporate governance structure which will acts as a resource to the firm. This is in line with the Resource Based Theory as advanced by Barney (1991).

In the case of disclosure of information as one of the corporate governance principles, the research found a weak correlation with the financial performance of the regional development authorities. The research established that a positive link between disclosure of information and the performance of regional bodies is present (Beta coefficient value = 0.351 P- value =0.001). The weak correlation between disclosure of information and financial performance maybe be due to the fact that this are government entities and not listed firms where the information disclosed as far as corporate social responsibility might not be accessed by many users. Hence the information is not considered important. By viewing the disclosure of information from the agency theory, the connection between them requires that the agent discloses relevant information which will enable the principal who in this case is the government to watch on their agreement with the laid down agreements with the contracts (Healy and Palepu, 2001). However, these findings contradict that of Lang and Lundholm (1993) who said that corporate's disclosure ratings by analysts are positively related to earnings performance.

The research established a positive relation between audit committee compositions and financial performance of the Regional Development Authorities in Kenya (Beta coefficient value =.0.613, P- value =0.001). The results obtained from descriptive analysis show that composition of audit

committee members is subjected to review at least annually and more often as necessary., and hence policies should be in place to enable prompt identification of changing relationships or events that may affect the composition and audit committee members' independence.

In order to promote quality in compositions of audit committee, the management should ensure that audit committees have a composition of members who are independent and non-executive directors who possesses recent and relevant experience in finance. Cognizance should be taken of the position of shareholders as potential audit committee members. These findings are consistent with the findings by Cadbury Committee Report (2002) that audit committee as a whole to have competence relevant to the sector in which the company operates.

# CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

## 5.1 Introduction

The chapter provides a summary of the findings and the conclusion from the study's findings and recommendations that were laid out. The recommendations and conclusions arrived at by focusing on achieving the study's objectives. The researcher had sought to determine the association between corporate governance and the financial performance of Regional Development Authorities in Kenya.

## 5.2 Summary of the Study

In line with the first corporate governance principle, the study showed that the board size of the Regional Development Authorities influences the financial performance of the organizations. The results were that an optimal number of board members will be in position to monitor the actions of the management and also the resources that the organization has in its disposal. Effective governance also depends on an effective selection process for new directors, which in turn rests on defining the duties of directors and avoid a situation where one director is in more than one committee. Therefore, the size of the board is a crucial component of corporate governance among government entities similarly.

The board's composition being measured by ratio of female directors in the board was also found to positively influence financial performance of the Regional Development Authorities. The study found that a more gender sensitive board is likely to bring more wealth of knowledge to the board and consistent with and consequently create necessary competitive advantage to the

organization. This is because with incorporation of all genders in a board, it is envisaged that the board will be more inclusive, open and collaborative leading to a more un imitable resource and therefore creating necessary competitive advantage to the firm.

The disclosure of information as one of the corporate governance principles, was found to a small extent affect the financial performance of the regional authorities. The weak correlation between disclosure of information and financial performance could have been due to the fact that the government entities and not listed firms where the information disclosed as far as corporate social responsibility might not be accessed by many users. By viewing the disclosure of information from the agency theory, the relationship between the principal and the agent requires that agent discloses relevant information to the principal to enable the principal to monitor compliance by the agent.

The research found negative relation between firm leverage and financial performance of the Regional Development authorities in Kenya. This was because over reliance on financial leverage might lead to poor performance of firms due to excessive costs of financing debt that might override the returns obtained from investing in projects.

## 5.3 Conclusion

Resulting from the findings and discussions above, a conclusion can be made that there exists no conclusive answer to the question of if there is a relationship between the corporate governance aspects and performance of the Regional Development Authorities. There is a lot of literature on corporate disclosures that has an assumption that there exists a link between corporate governance disclosure and performance level of an organization, this was not found in the present study. However, literature on the association between the characteristics of the board and performance of the firm does not give any conclusive result.

In regards to the effects of composition of the board on the performance of Regional Development Authorities, this study found out that different aspects of board's composition have an impact on the performance to a large extent. This study concludes that the composition of the board has a positive impact on the performance of Regional Authorities to a large extent.

The study findings from the effects of Leverage on the performance of Regional Development Authorities, the study found out that the leverage of a firm negatively influences the performance of the organization. This study hence concluded that the firm's leverage negatively influences the performance of organizations.

## 5.4 Recommendations

From this study findings, the research recommends that the management (government) of the Regional Development Authorities should strike a balance between their choices of board composition in a manner that both genders are incorporated in the directorship of the organization because both the board size and composition significantly affected the performance of the organizations.

Based on this study research findings, it recommends that; special attention should be taken upon when dealing with the board members' number. The board's size should match with the size of the organization to avoid scenarios of having too small boards which will be overburdened with the firm's work which will lead to underperforming, and at the same time boards should not be too large as the inefficiency of large boards will also lead to underperforming of the board members

The management of Regional Development Authorities should ensure that the audit committee consists of both genders for effective oversight.

## 5.5 Limitations of the study

Given that financial performance of the Regional Authorities could be attributable to other factors that were not taken into by this study; the study's findings would not necessarily be generalizable to the entire population of government owned institutions. The study results are subject to the validity of the data used, the study used the ordinary least square regression method of analysis which may have a weakness as compared to other methods that will limit the application of the study.

## 5.6 Recommendations for Further Studies

In future, a research should be carried out with a much higher population size and the corporate governance aspects, like the inclusion of ownership characteristics. The relationship between corporate governance practices and the financial performance of a firm when the board's remuneration is factored in should be found out.

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# APPENDICES

## Appendix i: Introduction Letter

UNIVERSITY OF NAIROBI
SCHOOL OF BUSINESS
KISUMU CAMPUS

Telephone: 732160 Ext. 208
Telegrams: "Varsity", Nairobi
Telex: 22095 Varsity

P.O. Box 19134-40123
Kisumu, Kenya
0202659307 / 0720348080

**Ref: CHSS-SOB D61/73195/2014** **October 3, 2016**

**TO WHOM IT MAY CONCERN**

The bearer of this letter **Kutto George**

**REGISTRATION NO: D61/73195/2014**

The above named student is in the Master of Business Administration Degree Program. As part of requirements for the course, he is expected to carry out a study on "**Corporate Governance and Financial Performance of Regional Development Authorities**". He has identified your organization for that purpose. This is to kindly request your assistance to enable him complete the study.

The exercise is strictly for academic purposes and a copy of the final paper will be availed to your organization on request.

Your assistance will be greatly appreciated, thanking you in advance.

Sincerely,

**DR. NIXON OMORO**
**ASST. COORDINATOR, SOB, KISUMU CAMPUS**

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## Appendix ii: List of Regional Development Authorities in Kenya

| NO. | Name |
|---|---|
| 1 | Kerio Valley Development Authority (KVDA) |
| 2 | Lake Basin Development Authority (LBDA) |
| 3 | Tana and Athi Rivers Development Authority (TARDA) |
| 4 | Ewaso Nyiro South Development Authority (ENSDA) |
| 5 | Ewaso Nyiro North Development Authority (ENNDA) |
| 6 | Coast Development Authority (CDA) |
| | |

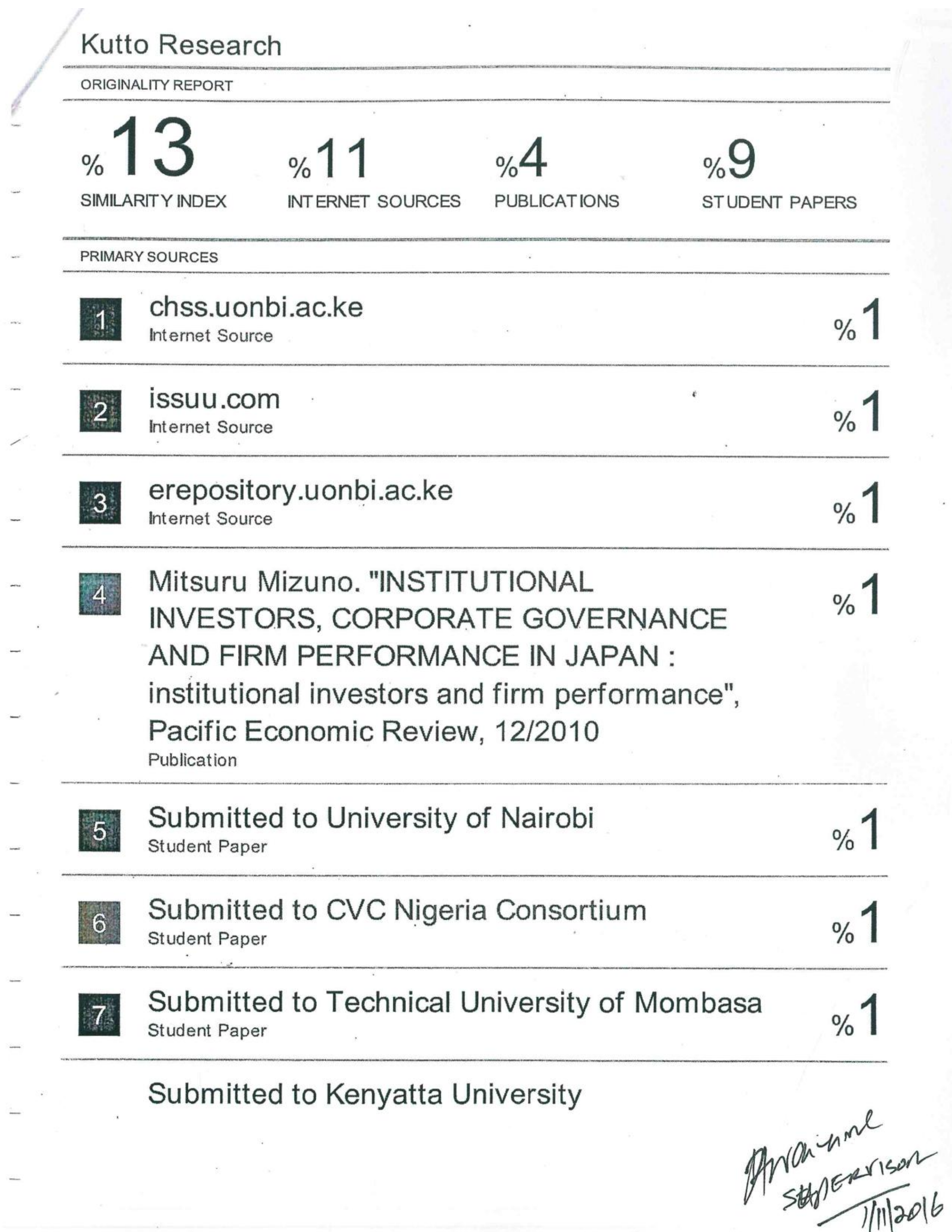
**Source: Researcher, 2016**

## Appendix iii: Data Capture Form

| Items | Survey items | Variables | 2010/ 2011 | 2011/ 2012 | 2012/ 2013 | 2013/ 2014 | 2014/ 2015 |
|---|---|---|---|---|---|---|---|
| **Board size** | Total number of directors | Number | | | | | |
| **Board composition** | Ratio of either gender to the total number of board members | Female | | | | | |
| | | Total number of directors | | | | | |
| | | Ratio | | | | | |
| **Disclosure of information** | Disclosure of Corporate Social Responsibility Activities. | yes | | | | | |
| | | No | | | | | |
| **Audit committee** | Ratio of female directors to total audit committee members | Female | | | | | |
| | | Total audit committee members | | | | | |
| | | Ratio | | | | | |
| **Leverage** | Ratio of total liabilities to total assets | Total liabilities | | | | | |
| | | Total assets | | | | | |
| | | Ratio | | | | | |
| **Firm Size** | Log of total assets | Total asset | | | | | |
| | | Log | | | | | |

| | | (assets) | | | | | |
|---|---|---|---|---|---|---|---|
| **ROA** | Return on Asset (ROA) | Surplus/ (Deficit) | | | | | |
| | | % ROA | | | | | |

## Appendix iv: Originality Report



Kutto Research

ORIGINALITY REPORT

| %13 | %11 | %4 | %9 |
|---|---|---|---|
| SIMILARITY INDEX | INTERNET SOURCES | PUBLICATIONS | STUDENT PAPERS |

PRIMARY SOURCES

| # | Source | % |
|---|---|---|
| 1 | chss.uonbi.ac.ke<br>Internet Source | %1 |
| 2 | issuu.com<br>Internet Source | %1 |
| 3 | erepository.uonbi.ac.ke<br>Internet Source | %1 |
| 4 | Mitsuru Mizuno. "INSTITUTIONAL INVESTORS, CORPORATE GOVERNANCE AND FIRM PERFORMANCE IN JAPAN : institutional investors and firm performance", Pacific Economic Review, 12/2010<br>Publication | %1 |
| 5 | Submitted to University of Nairobi<br>Student Paper | %1 |
| 6 | Submitted to CVC Nigeria Consortium<br>Student Paper | %1 |
| 7 | Submitted to Technical University of Mombasa<br>Student Paper | %1 |
|  | Submitted to Kenyatta University |  |