EFFECT OF CORPORATE GOVERNANCE PRACTICES ON THE FINANCIAL PERFORMANCE OF SMALL AND MEDIUM MANUFACTURING ENTERPRISES IN NAIROBI COUNTY

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DECLARATION

I declare that this project is my original work and has not been submitted for an award of a degree in any other university or institution of higher learning for examination/academic purposes.

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DEDICATION

A special dedication to my family and friends for their unwavering support throughout this entire process.

ABBREVIATIONS AND ACRONYMS

AMFI- Association of Micro Finance Institution

ANOVA- Analysis of Variance

CCG- Centre for Corporate Governance

CEO- Chief Executive Officer

CMA- Capital Markets Authority

CSR- Corporate Social Responsibility

FSD- Financial Sector Development

GDP- Gross Domestic Product

IRA- Insurance Regulatory Authority

IFC- International Finance Corporation

KAM- Kenya Association of Manufacturers

KBA- Kenya Bankers Association

KCC- Kenya Cooperative Creameries

KMC- Kenya Meat Commission

MFI- Micro Finance Institution

MSEA- Micro and Small Enterprises Authority

MSE- Micro and Small Enterprises

MSMEs- Micro Small and Medium Enterprises

NSE- Nairobi Stock Exchange

ROA- Return on Assets

ROCE- Return on Capital Employed

SACCO- Savings and Credit Cooperatives

SASRA- SACCO Societies Regulatory Authority

SMEs- Small and Medium Enterprises

SMMEs-Small and Medium Manufacturing Enterprises

SPSS- Statistical Package for Social Sciences

UNDP- United Nations Development Program

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ABSTRACT

The main purpose of this study was to establish the effect of corporate governance practices on financial performance of small and medium manufacturing enterprises (SMMES) in Nairobi County. The theories underpinning this study were agency theory, stewardship theory, stakeholder's theory and resource-dependency theory. The study was undertaken using a descriptive research, employing both secondary and primary quantitative data. The data was obtained from annual reports of the Kenya Association of Manufacturers. The population for this study constituted of 279 SMMEs registered by Kenya Association of Manufacturers (KAM). The study sample was 162 obtained by the Krejcie and Morgan formulae. All the data was brought together by examination of documents, annual reports and a questionnaire. The chosen interval was year 2012 to year 2016 (5 years). The study employed frequencies, averages and percentages to present the findings. Statistical Package for Social Sciences (SPSS) aided in generating the descriptive statistics as well as the inferential results. Regression analysis was used to demonstrate effect of corporate governance practices on performance of small and medium manufacturing enterprises (SMMES) in Nairobi County. The conclusions were depicted by employing tables and figures to give a representative of the research findings at a peek. Regression results showed that CEO Duality had a significant and adverse impact on financial performance. Board Size, Board Independence, Frequency of Board Meetings, Size of the Firm had a positive and significant impact on financial performance of SMMEs. However, regressions results showed that the Age of the firm and Board Diversity were positively and insignificantly related to the financial performance of SMMEs. Based on the findings, the study resolved that CEO Duality, Board Size, Board Independence, Frequency of Board Meetings, Size of the Firm affect financial performance of small and medium manufacturing enterprises (SMMEs). The study recommended for adoption of corporate governance practices as they have a positive influence on performance of small and medium manufacturing enterprises (SMMEs) in Nairobi County. From this study, SMMEs are left with no option but to adopt better governance practices that impact positively on their financial performance in order for them to remain afloat and even grow. In conclusion, area for further studies could consider effect of individual corporate governance such as board composition and CEO duality on financial performance of SMMEs.

CHAPTER ONE: INTRODUCTION

1.1 Background

In order to determine the corporate governance practices in place, various facets are considered. These include the CEO duality, board diversity, board independence, board size, frequency of board meetings, and the number of sub-committees and so on. All these will act as a guide in determining whether a firm has adopted proper governance mechanisms. Moreover, financial performance can be measured through different means but most commonly the Return on Sales, Return on Assets, Return on Investment, Earnings per Share and Return on Equity have been adopted. It has been noted that organizations that have adopted proper governance mechanisms are likely to perform better financially unlike those that shy away. According to Wiley et al (2005), in order to strengthen the foundations of long term economic performance of firms and countries, enhancement of corporate governance practices should be adopted as one of the indispensable elements.

Different theories that underpin the corporate governance practices have been formulated by various scholars. The most common one being the agency theory by Berle and Means (1932) which mainly advocated for the separation of the Chairman and CEO position. This is attributed to the fact that the principal and the agent interests may not agree thereby resulting into the agency problem, which usually manifests as a cost to the firm. Secondly, we have the stewardship theory by Donaldson and David (1991) that supports CEO duality whereby it is believed that the managers act as stewards and will operate in the best interest of the shareholders. This theory emphasizes on executive directors being in charge thereby reducing agency costs and does not embrace the role played by non-executive directors. The stakeholder theory by Freeman (1984) emphasizes on the different persons that relate to the firm. It is informed by the fact that such persons are able to influence the firm positively by giving their input and ensuring all interested parties are contented. Finally, the resource-dependency theory by Pfeffer and Salanick (1978) advocates for the role of non-executive directors who are

envisaged to bring their expertise in different fields that would result in the success of the firm's operation.

Corporate governance has been an issue that has taken great shape in the economy of Kenya. This has been attributed to the fact that many firms that have undergone financial failure are mainly battling matters related to poor corporate governance mechanisms in their firms. Some of these organizations include the Kenya Meat Commission (KMC), Rift Valley Textiles, Kenya Cooperative Creameries (KCC), Uchumi Supermarkets, Imperial Bank and most recently the Nakumatt chain of stores. Seeing that this matter has seized many large organizations then the small and medium firms have been left with little or no choice but to embrace the practices so as to survive in a very cutthroat environment. Organizations such as the Nairobi Stock Exchange (NSE), Capital Markets Authority (CMA) and The Centre for Corporate Governance (CCG) have been tasked with the responsibility of ensuring that firms adopt such practices in order to safeguard the interests of all stakeholders. Regulatory bodies such as the Insurance Regulatory Authority (IRA), Kenya Bankers Association (KBA) and the SACCO Societies Regulatory Authority (SASRA) have assisted in ensuring proper governance structures are in place for their members. However, when it comes to SMEs, it is just barely taking off with recent set up of the Micro and Small Enterprise Authority (MSEA). Thus we shall delve into how corporate governance practices have affected the financial performance of SMEs in the manufacturing sector.

1.1.1 Corporate Governance

As stated by the Cadbury Committee Report on Financial Aspects of Corporate Governance, 1992, "Corporate Governance is the approach by which companies are directed and controlled.'' According to Keasey et al, (1997), it is the course which is used to direct and manage the dealings of an organization to boost its success and ensure it remains accountable so that the stockholders can achieve their worth even as their interests are taken into consideration. The Cadbury Report (1992) and CMA (2002) recommend the principles that should be adopted for good corporate governance practices. Many SMEs fail in their early stages due to financial complications. This is attributed to restricted access to capital due to high assessment of risk and information hindrances and costs associated with it (Kayanula and Quartey, 2000). This makes

it difficult for SMEs to obtain long term financing. Moreover, the inadequate managerial competencies and lack of proper governance systems are seen as a major obstacle to obtaining finance and SME development (Gockel and Akoena, 2002).

Of significance is to note that corporate governance is focused with the external outlook of an entity. It is usually strategy-oriented and is mainly concerned with where the entity is going; the vision. Fundamentally, the corporate governance mechanisms adopted are mainly concerned with persons accorded with the responsibility of running organizations especially those in management positions. In accordance with Kahan and Rock (2003) and Bhagat and Black (1998), the governance structures include the diversity of the directors, the size of the board, the sub-division into committees, the percentage of independent members, the proportion of executive to non-executive members and the segregation and or unification of the position of the chairman and the CEO. Others include the recruitment process, internal control systems, ethics and the corporate social responsibilities.

Board size is the sum of executive and non-executive members. It is encompassed by both the agency cost and the expertise obtained by a firm. The agency cost increases amounts paid out to board members. Having a big board may be good in terms of experience and expert advice. However, there is no specific preference to the size of the board but a balance should be obtained (Shirdasani, 1993). The committees of the board are the working systems which are headed by persons with specific skills and knowledge especially from trained professionals. In order for them to perform their oversight role appropriately, they should have non-executive members (Lishenga and Mbaka, 2010). Board independence involves the ability of persons to make decisions without being externally influenced and is mainly affected by the ownership of the firm or overbearing executives. CEO duality comes about when the CEO doubles up as the chairperson of the board and is unable to separate these two roles while performing his duties. An element of bias is likely to creep in decision making. However, the stewardship theory advocates for it as it argues that agency costs will be adversely reduced (Abdullah and Valentine, 2009).

Generally, in SMEs, corporate governance is mostly about enhancing business competence and operations and less about scrutinizing the activities of management. It is imperative to note that the International Finance Corporation (IFC) has issued guidelines on corporate governance for family- owned businesses, many of which will be SMEs. These guidelines enable them to decrease conflict, enhance access to credit, rapid business advancement and greater resilience to fraud and other financial costs due to poor internal controls.

1.1.2 Financial Performance

Financial performance of any entity established with the main aim of making profit is of key importance. Wang & Huynh (2013) describe it as any mathematical indicator used to assess how effectively an organization employs its reserves to generate income over a particular period. This is because it enables an organization gauge its current performance and also its return on investment. This information is also very vital to the owners, investors and stakeholders. Good financial performance will result to a ripple effect whereby investors are able to get long term returns therefore willingness to put in more investment, stakeholders such as creditors are able to be paid on time thereby ensuring better quality and timely products and services. Employees also get remunerated well thus enhancing quality services to the customers and stakeholders hence more satisfaction for all involved parties and overall growth of the firm. A number of scholars have described it differently but it all boils down to the usage of resources in a corporation's possession.

So as to evaluate the performance, a number of ratio indicators have been used such as the Return on Assets, Return on Equity, Return on Investment, Return on Sales and Earnings per Share. Kaplan and Norton (1996) introduced the Balanced Scorecard which merges financial measures and non-financial measures in a distinct report so as to present managers with richer and more pertinent information in what they are managing save for the financial measures only. Accordingly, Kaplan (2001) also noted that financial measures independently are insufficient for evaluating and managing performance. This was attributed to the fact that financial reports communicate scarcely regarding long term value creation. Thus the introduction of the Balanced Scorecard which kept a hold on the financial measures but supplemented them with other measures from three perspectives namely the customer, the internal process and learning and

growth. This would therefore ensure accountability thereby making sure performance levels are aligned to the strategic goals of the firm.

Elly (2012) in his study on executive compensation and firm performance suggests that various stakeholders of any organization influence how its performance is measured and communicated. The study reiterates that despite the numerous performance measures in place, there has been no accord on a unanimously acceptable performance measure. It also noted that the various stakeholders have varying information and expectations depending on the measure adopted and therefore deep consideration is needed for the performance measure adopted. Therefore, the connection between executive compensation and financial performance is most likely influenced by the performance metric used. Emphasis is on the choice of a performance metric that is in line with the objective of shareholder wealth maximization.

1.1.3 Corporate Governance and Financial Performance

It is an open secret that there exists an affiliation between corporate governance and financial performance. Firms that are well governed are more prone to invest in money-making projects thereby resulting in effective operations and higher expected future cash flows (Shleifer and Vishny, 1997). Good governance structures encourage firms to create value and provide accountability. According to Brownbridge (2007), corporate governance encompasses procedures that necessitate the structuring of management and control of corporations. It also reflects the relations among persons and groups which provide resources to the company and contribute to its performance.

According to Policy Insights No 7, small enterprises in Africa hardly meet the stipulations set by financial establishments as they see SMEs as risky due to poor assurances and scarcity of information about their ability to repay loans. For one to achieve favor and confidence from investors, then quality governance must be in place while those that are poorly governed are expected to be less rewarding. Effective corporate governance is significant in increasing investor assurance and market liquidity (Donaldson, 2003). This would enable SMEs access finance more easily due to the security in terms of working internal controls hence goodwill and eventually collateral for credit.

According to the Kenya Economic Report 2013, effective governance advances answerability, candidness, adeptness and rule of law in public institutions in all stages. Additionally, it permits sound and professional management of resources including financial resources for equitable and sustainable development. It was contended that adopting return on assets as a gauge of financial performance provided confirmation that firms with superior governance have higher operating performance (Klapper and Love, 2002).

According to Mizra and Javed (2013), firms that have properly governed ownership structure, capital structure and risk management are inclined to have enhanced financial performance. Moreover, corporate governance practices ought to be amended so as to strengthen the value of the investors' fortune. Ansong (2015) in his study also resolved that the board size has a substantial optimistic association with financial performance of SMEs with the belief that large board size tend to be diverse in terms of experience, skill, gender and nationality thereby improving financial performance.

1.1.4 Small and Medium Manufacturing Enterprises in Kenya

In developing nations like Kenya, SMEs are one of the major contributors in the growth of the economy and job creation. It is commonly known as the "Jua- Kali'' sector as they operate under the sun. They are also referred to as micro, small and medium enterprises (MSMEs) or micro and small enterprises (MSEs). In the year 2014, 80% of the employment creation was dominated by SMEs. In the Micro and Small Enterprise Act of 2012, Small enterprises have between Kshs. 500,000 and 5 million annual turn-over and employ 10-49 people. Moreover, in the manufacturing sector, investment in plant and machinery should be between Kshs. 10 million and Kshs. 50 million. Medium enterprises are not contained in the act, but have been stated as encompassing enterprises that have a turnover of between Kshs. 5 million and Kshs.800 million and employing 50-99 employees.

In accordance to a UNDP report by Wairimu (2015), MSMEs' share of contribution has increased through time, from 13% in 1993 to as much as between 20-25% between 2011 and 2014. In 2013 only, they contributed to 84.3% of all new jobs. The Deloitte Kenya Economic Outlook 2016 notes that Kenyan SMEs are hampered by insufficient resources, restricted access to the market, deprived infrastructure, unsatisfactory knowledge and skills and swift changes in

technology. Corruption and an unfavourable regulatory environment are other impediments encountered. Government endeavours to tackle these drawbacks including compelling legislation on local content for public projects, establishing 'Buy Kenya, Build Kenya' policies in public procurement, research and development support and intensified donations to funds for instance, the Uwezo Fund.

According to the FSD report, Growth Cap- Financing SME Growth in Kenya (June 2016), most financial institutions should stream-line their products so as to have those specifically designed for SMEs and give them access to capital and credit. In Kenya, the Kenya Association of Manufacturers (KAM) is the representative organ for value- add industries in manufacturing sector therefore, the study shall include manufacturing SMEs registered by the KAM. Manufacturing is one of the largest sectors in Kenya contributing 10.5% to GDP in 2015. It comprises about 3,700 firms classified into 14 sub-sectors that include: food products, textiles and apparels, beverages and tobacco, fabricated metal, chemicals, rubber and plastic and so on. Manufacturing Priority Agenda 2017, notes that growth in the Kenyan manufacturing sector in the last one year has been on a downward trajectory, with the growth rate of 1.9% in the last quarter of 2016 being the sectors worst performance since 2015 when the country grew at 3.5%. However, manufacturing has grown over 50% since 2010 with employment in the sector rising from 287,400 in 2014 to 295,400 in 2015, a 2.7% increase with employee compensation doubling since 2010 and increasing by 30% from 2014 to 2015.

SMMEs in Kenya face great challenges when it comes to performance. That is mainly due to lack of finances required to enhance their operations and sustainability. Those that have been in existence for more than five years find it hard to access long term financing and are forced to take loans from informal sources at very high rates to gain collateral so that they get loans from organised financial institutions such as banks (Brethenoux and Mulder, 2015), so as to add value. Kauffman (2005) reiterates this fact by noting that access to formal finance is low due to high rate of default among SMEs and additionally owing to inadequate financing facilities. SMEs are hampered by the fact that existing framework and guidelines in place are developed with large and listed companies in mind (Mirkovic, 2015). As such, most SMEs are likely to shy away from adopting the corporate governance mechanisms. More so, they may also

consider it as a large business affair as they would find it costly to incorporate in their entities. Ongeri (2011) found that SMEs that had incorporated corporate governance practices including board availability as well as existence of by-laws to govern the board positively influenced financial performance. Moreover, its relevance cannot be over-emphasized as it signifies the organization environment for in-house activities of the business.

1.2 Research Problem

Despite the fact that corporate governance has been regarded as a preserve of the listed and large firms, there is no argument on its importance to business as it provides a framework for scrutinizing the actions and performance of the agent. It acts to protect both the future of the business and the interests of the owners and investors (Mirkovic, 2015). As such, the focus has been on the influence of corporate governance on financial performance. Studies done by Klapper and Love (2002), Brown and Taylor (2004), Moenga (2013) and Afande (2015) have shown that adoption of proper governance mechanisms has affirmatively impacted the performance of a firm. This is attributed to the fact that there will be less risky and higher guarantee of higher expected future cash-flows. Thus, we cannot only look at the financial performance of an entity without referring to the processes of corporate governance. In today's ever changing business environment, the two have come to be seen as two peas in a pod. As a matter of fact, it has become increasingly difficult for SMMEs to access finances without proper governance structures so as to protect the financiers. Therefore, the association between corporate governance and financial performance has been of great significance in many studies.

According to Kenya's vision 2030 plan, it is expected that the country will have achieved its dream of industrialization. Corresponding to that dream is the growth of the manufacturing sector. It is believed that the SMMEs which are a majority in the country employing most of the youth will be the driving force towards achieving an industrialized economy by 2030, (Manufacturing Priority Agenda, 2017). It therefore goes without saying that SMMEs play a crucial role in our economy. Of much interest is the contribution that SMMEs have in our economy, that is, job creation through employment, contribution to the GDP of the economy, increased standards of living and value creation. Ongeri (2011) highlighted on the direct connection between governance and profitability. In Kenya, SMMEs face many challenges in

their quest to stand out. They lack the proper regulation mechanism that is enjoyed by their colleagues in similar fields who have structured bodies to regulate them. They are also faced with the difficulty of obtaining finance due to poor governance structures as they lack collateral and are also deemed to be family-oriented firms without proper internal controls. However, adopting such practices will allow them to flourish in their field and be open to expansion in the future.

Globally, many studies have been done in regards to this topic. Baldo (2010) in his research concluded that CSR and corporate governance were closely related especially in small firms where governance and accountability were of significant importance. Maluzi (2013) in his study found that good governance structures were vital for growth and continuity. He encouraged further research on SMEs with a focus on external funding and case study on SMEs, Abor and Biekpe (2007) in their research established that corporate governance can immensely aid the SME segment by instilling improved management practices, studier internal auditing, superior prospects for progression and a modern strategic viewpoint through non-executive directors. They advocated for more studies in this area of SMEs and also to give further clarity on similar issues on corporate governance as well as policy formulation that is simplistic due to the nature of operations of SMEs. Anggadwita and Mustafid (2013) found that entrepreneurial aspect weighted more than the human personnel competence. Innovativeness and sustainability did not however alter the performance. Further research on external factors and large social system were also advocated for.

Locally, many studies have been carried out and have shown that corporate governance is seen to positively influence financial performance. Kamonjo (2012) in his study outlined the negative relationship between board size and internal audit function with financial performance. However, he found a positive relationship amid the frequency of board discussions and performance. Nonetheless, he urged for future studies on the regulator’s impact on financial performance and a similar study in the same field. Maranga (2014) emphasized on the importance of adopting such practices but was quick to note that most SMEs have not inculcated them in their business as they consider it a costly investment. She encouraged further research on CEO duality in comparison to performance, challenges SMEs face in adopting

corporate governance practices and similar study in different financial sectors. Marikio (2014) was also in favor of the positive effect of corporate governance on managerial and financial performance. He emphasized on the need for similar studies with the aim of establishing a code of conduct or governance framework and a study for entities outside Kenya and those with board complexities.

Regardless of the many studies done on corporate governance, there still exists a research gap. No specific study has been done to scrutinize the effect of corporate governance on the financial performance of Small and Medium Manufacturing Enterprises (SMMEs). This is in spite of the great importance the SMMEs offer towards achieving Kenya's vision 2030. The study will seek to fill this gap by addressing the issue of whether corporate governance is present in SMMEs and how it in turn affects their financial performance.

1.3 Research Objectives

This study sought to establish:

i) The corporate governance practices adopted by small and medium manufacturing enterprises (SMMEs) in Kenya.

ii) The effect of corporate governance practices on financial performance of small and medium manufacturing enterprises (SMMEs) in Kenya.

1.4 Value of the Study

This research will assist SMEs in the manufacturing sector to make better decisions as regards to management and operations. This will aid in better management, easier access to finance and also growth and sustainability of the business entities. The firms will be able to identify how corporate governance influences their operations and how it will enable them increase the firm value. Organizations will find out what obstacles are hindering their performance as regards to corporate governance mechanisms. Different boards will be able to bench- mark with their competitors in the industry. It will be helpful for shareholders to reduce conflicts between the board, management and themselves if the proper governance mechanisms are instituted. They

will gauge their performance against best practices in the industry. Investors will also device better mechanisms for monitoring and control of those in management.

The findings in this study will assist the government of Kenya to make policies that will benefit the manufacturing sector and facilitate the realization of vision 2030. This will aid in better regulation of SMMEs as the study will offer guidance to the Micro and Small Enterprises Authority. Other regulatory bodies including the Capital Markets Authority, Nairobi Securities Exchange and the Centre of Corporate Governance will also use this study to enhance their framework of regulation especially with regards to SMMEs. They can tailor-make structures and mechanisms that can be adopted by SMMEs which are crucial in enhancing sustainability, effectiveness, efficiency and improving productivity in their business operations. This will also promote growth of small business in the economy that are looking to transition into larger organizations as they will adopt better practices that will enhance their financial management. Moreover, it would lead to investor confidence and thus more investments in the economy. The regulators can also use it as a tool of performance appraisal for the SMMEs.

Furthermore, it will also assist other researchers and academicians in ascertaining the influence of corporate governance practices on the financial performance of SMEs in the manufacturing sector. It will add to the already existing research previously done by other scholars. This will be done by either critiquing various theories in existence or supporting them. Additionally, it may also be used as a foundation for future reference and further investigation in a similar field.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter will offer a brief insight into studies that have already been done by other researchers in the same discipline. As such, it will encompass the literature review with an emphasis on the agency theory, stewardship theory, stakeholders' theory and resource-dependency theory. Furthermore, it shall delve deeper into the empirical studies in order to give a better understanding and to avoid replication. Finally, it shall conclude with a summary of the literature review.

2.2 Theoretical Review

Amidst the changes in the business environment undergone all around the world in respect to corporate governance, the works of various scholars have been brought to the limelight. The section will delve into specific theories that underpin corporate governance practices. These include the agency theory, stewardship theory, stakeholders' theory and resource-dependency theory.

2.2.1 Agency Theory

This theory is derived from the works of Berle and Means (1932) who posited the separation of ownership and control which resulted to the advancement of the agency problem. This guided the development of the agency theory by Jensen and Meckling (1976). It is explained as the relationship between the principals (shareholders) and agents (company executives and managers). Clarke (2004) indicates that the principal delegates the operations of the organization to the executives or managers who are the shareholders' agents.

It is expected that the agent works for the well- being of the principal. However, this may not always occur and an agency problem arises where the desires of the two parties are conflicting and it may also be problematic or costly for the principal to corroborate what the agent is essentially undertaking (Eisenhardt, 1989). Thus, this theory is concerned with solving these problems.

The principal is thus shouldered with the burden of incurring costs, “agency costs” to monitor the actions of the agents so that they act in the wellbeing of the principal. These costs comprise of direct contracting or bonding costs, monitoring costs and loss of principal’s wealth due to outstanding unsettled agency troubles (Jensen and Meckling, 1976). In conclusion, this theory stipulates that agents are answerable for their duties and responsibilities. They are obliged to institute an effective governance structure instead of only fulfilling the necessities of the principal that may be contesting the governance structure (Abdullah and Valentine, 2009).With this in mind and being cognizant that the agent may short change the principal at times when there is lack of proper governance structures in place, then it is without a doubt that there exists a correlation between an entity’s corporate governance structure and its financial performance.

2.2.2 Stewardship Theory

It is believed to have its origins from both psychology and sociology. In this theory, managers are regarded as stewards that are expected to represent the owners’ interests (Donaldson & David, 1991). It is centered on the behavior of executives. Donaldson and Davis (1994) indicate that managers are predominantly driven by achievement and responsibility needs. According to Davis, Schoorman and Donaldson (1997), a steward safeguards and makes the most of shareholders wealth through firm performance for the reason that the steward’s utility functions are maximized.

It highlights the role of senior management being stewards and merging their objectives as an element of the firm thus they are more contented with the success of the establishment. It underscores on the position of executives to act independently so as to maximize shareholders returns as they in turn minimize costs of monitoring and controlling behavior. It concentrates on arrangements that expedite as well as inspire instead of scrutinizing and domineering (Davis, Schoorman & Donaldon 1997).

Executives are seen to also want to protect their reputation thus they work hard as stewards to ensure there is financial success for not only the owners but also for their advantage whereby they can get back into the market for prospective financing (Fama, 1980 & Shleifer and Vishny, 1997). According to McGregor’s (1960) motivation theory, stewardship portrays a “Theory Y” view of mangers while “Theory X” represents agency theory contending that prominence on

monitoring is needed for the board to influence corporate governance. This theory advocates for the amalgamation of the function of the CEO and Chairman in order to cut down agency costs and play a better part in safeguarding the shareholders' interests rather than non-executive directors (Clarke, 2004).

Principally, establishing whether or not CEO duality is beneficial for an entity should be integral to all concerned. This is due to the fact that one has to act as a steward and allow the entity's objectives to take precedence over their own personal desires. Wesley (2010) observes that managers are not driven by personal or individual ambitions but rather the interests of the firm. As most SMEs are established by family members or groups of friends, it would be important to find out how this affects their governance structure and how that in turn also influences the performance of the entity.

2.2.3 Stakeholders' Theory

This theory is believed to have been engrained in the management discipline in 1970 and was progressively advanced by Freeman (1984) and is said to encompass an extensive selection of stakeholders. A stakeholder by definition is any individual or alliance that can shape or is influenced by the attainment of the organization's objectives (Abdullah & Valentine, 2009).

It insinuates that managers have a network of relationships to fulfill. Some of the most notable ones include investors, government, suppliers, trade associations, employees, customers, communities and political groups. According to Freeman (1999), the group of network was considered more crucial than any other, such as owner- manager relationship in agency theory. Donaldson & Preston (1995) claimed that this theory centers on managerial decision making and all stakeholders' interests have fundamental value, and that no set of interests is said to outshine others. With the aim removing conflict of interests and agency costs, firm management is shared between investors and stakeholders.

With the ever changing times, organizations have fell under the scrutiny of a number of groups and associations who hold them to higher standards of accountability. This is because their operations are deemed to be extensive and may have a pervasive impact equally to the shareholders/owners as well as the stakeholders. Rodriguez et al (2002) classified stakeholders

in three broad categories: Consubstantial, Contractual and Contextual stakeholders. Consubstantial stakeholders are those essential for the existence of business and include shareholders, investors, strategic partners and employees. Contractual stakeholders have some kind of formal contract with the business and comprise of financial institutions, suppliers, sub-contractors and customers. Contextual stakeholders are representatives of the social and natural systems in which the business operates and they play a fundamental role in obtaining business credibility and ultimately the acceptance of their activities. For instance; public administration, local communities, countries and societies, knowledge and opinion makers.

The connotation of this theory is that financial performance is affected by the size of the board and composition of the board. According to Louma and Goodstein (1999), the success of an organization will likely depend on the proper representation of all stakeholders in the board as this will result in more harmony and easier conflict resolution. The board composition may vary in terms of age, gender and experience however a board that is bloated will also negatively impact the performance of the entity. Therefore, decision making will be slower and coordinating a large number of persons is quite difficult. As such, many great opportunities are likely to pass by due to indecisiveness caused by varying interests and opinions. However, smaller board size may seem to be more effective but may also lack in terms of expertise or even experience thereby poor financial decisions will be made (Datton and Dalton, 2005).

2.2.4 Resource Dependency Theory

In this theory, the board is seen as an indispensable connection between the organization and the crucial resources that it requires to capitalize on performance (Pfeffer and Salanick, 1978). Williamson (1985) presumed that environmental linkages or network governance could lessen transaction costs related to environmental interdependency. For instance, having an outsider director who is a partner in a law firm may in turn assist the organization not only in legal advice but also reduce transaction cost that would be incurred by hiring an independent lawyer.

Consistent with the resource dependency rule, the directors add value that includes knowledge, abilities, key constituents (suppliers, buyers, public policy decision makers, social groups) and legitimacy that will diminish uncertainty (Gales and Kesner, 1984). It encourages appointment of directors in varying boards as this allows them to collect information and network extensively. The directors can be grouped into four classes: the insiders- specifically the present and past executives that provide knowhow in particular areas such as firm law, finance, overall strategy and guidance. The business experts are inclusively all senior executives and directors of different large for profit organizations who offer proficiency in decision making, strategy of the business in addition to unravelling challenges. The support specialists are insurance company representatives, lawyers, public relations experts and bankers who provide support in their individual specialized field. Finally, we have the community influential that include the political leaders, clergy members, university lecturers and leaders of social or community organizations.

This theory brings out the influence of independent or non-executive directors when it comes to corporate governance. The directors are mainly appointed to bring more experience and expertise that may be lacking in a board. They are mainly handed the task of handling crucial teams such as the audit and remuneration committee. They are thus tasked with ensuring internal controls in place are functioning properly in order to avert financial crisis. They also ensure that stringent measures are in place when it comes to remuneration of directors. Podrug and Millic (2010) noted that they offered guidance on the market trends and challenged any abuse of office in terms of allowances that may affect financial performance.

2.3 Determinants of Financial Performance of SMME's

According to Pfeffer and Salanick (1978), performance of an organization is best described as its ability to create action and acceptable results. SMEs have been recognized as one of the major contributors in any thriving economy and thus their performance should be of critical significance. Crag and King (1988), Nwachukwu and Oseghale (2010), and Rutherford and Oswald (2000) have indicated that earlier studies on factors influencing the performance of small businesses are categorized in three groups: Individual Characteristics, Firm Characteristics and Environmental Characteristics.

2.3.1 Individual Characteristics

These are the traits that are professed by the owners and managers and earlier studies have investigated the relationship between these traits (individual characteristics) and performance. Nwachukwu and Osegahle (2010) enumerate the traits as age, education, managerial experience, industry experience, leadership practices, race, CEO personality and gender. Others categorized social skills gained through reputation, relevant experience and direct contacts as the major determining factor (Rutherford and Oswald, 2000). Such traits are seen to be interrelated with better management practices and also in ensuring the sustainability of the business due to better links with both internal and external knowledge.

2.3.2 Firm Characteristics

Studies done have analyzed various attributes including strategy/structure, competitive orientation, firm-specific policies, legal structure, geographic location, accurate record keeping, financial control, the top management team, operations management, culture, organizational growth, family control and stage of development (Nwachukwu and Osegahle, 2010). Firms with more than one founder are well poised to perform better due to more influx of capital and wealth of experience. These characteristics outline how the organization is run and managed and thus are able to influence the performance of SMEs. They determine what policies or practices are to be adopted in running the organization which in turn results to success or failure.

2.3.3 Environmental Characteristics

Nwachukwu & Osegahle (2010) and Sawyerr (2003) have itemized these as: competitors, creditors, contacts with customers, suppliers, regulatory organizations, consultants, stockholders, financial institutions and perceived uncertainty in the industry. For small businesses to prosper, they need to maintain good working relationship with their external stakeholders and should also be ready to adapt to the changing environment in order to stay afloat. Versatility in today's ever changing environment is an essential contributing factor in the performance of SMEs and is the only means by which they can ensure prosperity in their undertakings.

2.4 Empirical Review

This takes a look into other studies and researches done in the same field in regards to factors affecting the financial performance of SMEs. It basically gives a clearer understanding of the varied outcomes that one may expect to get. It explores studies done both locally and globally.

Abor and Biekpe (2007) studied corporate governance, ownership structure and performance of SMEs in Ghana. The outcome was that the size of the board, its composition, management skills, the duality of the CEO, inside, family and foreign ownership had a considerably optimistic impact on the prosperity of SMEs. It revealed that corporate governance for Ghanaian SMEs if adopted would infuse better management practice, stronger internal controls, better chances for growth and strategic stance by adopting non-executive directors. Once all these are taken under consideration, then it would be easier for them to access finance and investor attention. It would also assist the SMEs in preparations for listing in the Ghana Stock Exchange.

Angagdwita and Mustafid (2013) examined the factors influencing the performance of SMEs in Indonesia. Entrepreneurial aspect, competence of human resource, innovativeness and sustainability were the key variables under study. Entrepreneurial aspect for instance motivation, optimism, self-efficacy and self-management influenced SME performance more than the competence of human resource- skill, ability and knowledge. Nonetheless, innovativeness and sustainability don't alter the performance of SMEs due to the fact that they don't model the product themselves and they still run their business traditionally rather than using technology extensively. They had high regard to face to face negotiations and considered it a better way of doing business. They also had a lower desire to develop their business and were satisfied as long as they were not making losses. They believed in the ownership characteristic such that the entrepreneurial aspect was more highly regarded.

Kamonjo (2012) investigated corporate governance practices on financial performance in SACCOs and established that the larger board size lead to lower financial performance as

shown by the ROCE. Furthermore, the more the number of meetings in a year, the better the financial performance. Ultimately, it was also ascertained that there was a negative relationship between ROCE and the internal audit function such that it lead to a reduction in ROCE due to costs related to audit.

Karo (2012) analyzed factors affecting SMEs performance in Kenya and summarized them as accessibility to finance, informatics, regulatory framework, education and training, and management. Inability to access finance easily, poor marketing strategy, the complexities of the regulatory framework, inadequate training opportunities and poor management systems all negatively impacted the performance of SMEs.

Lema (2013) researched on factors affecting performance of SMEs. There were seven variables used including demographic characteristics, business characteristics, business capital structure, legal structure, marketing strategy, financial constraints and enterprise management. The results were that SMEs that had more income performed better in contrast to lower income. It also showed that those managed by younger people performed better and that most of them were owned by men though this did not have an impact on performance. In other words, education was a major player that positively influenced performance and older SMEs received more income than younger ones. Additionally, those SMEs who used personal savings for launching their businesses performed way better than those that got loans. Those that invested more initially performed better than those who made smaller investments. In regards to the legal structure, means of running operations hardly had any effect on performance. However, the marketing strategy used produced a greater impact on the firm.

Maranga (2014) investigated corporate governance on the financial performance of SMEs in Nairobi County. It was established that the SME leadership was key in appointment and monitoring of the CEO and that division of the role of the CEO and Chairman was key to ensure better financial performance. Nonetheless, in most SMEs, the case of duality of the two roles

prevailed predominantly. Moreover, most of them had board management with sub-committees that met frequently resulting to better financial performance as opposed to those with fewer meetings. In essence, most of the SMEs appreciated the need for corporate governance practices in their organizations but they are yet to fully embrace them as they still consider it a "large-firm" practice while those who had adopted them were yet to fully implement due to high costs involved and rigid government regulations.

Marikio (2014) researched on corporate governance practices and financial performance of manufacturing firms in Kenya. It was ascertained that corporate governance structures were practical as they influenced both managerial and financial performance. Additionally, observing good corporate governance practices contributed to stronger internal control mechanism, better management and opportunities for growth. Investors' confidence is also built and a better strategic outlook which would result in enhanced competitiveness for the firms.

Moenga (2015) investigated corporate governance on the financial performance of micro finance and found out that majority of the MFIs had small boards and though they were independent, board diversity was yet to be embraced. More so, setting up good structures was significant as it influenced financial performance.

Nakhaima (2016) reviewed factors affecting the performance of SMEs in Kenya whereby it was ascertained that corporate governance positively influenced financial performance. It emphasized the agreed separation of the role of the CEO and Chairman; focus on audit committee to improve performance and competitiveness, proper board composition and book keeping for enhanced audits. The human resource capacity was also imperative as they needed to be constantly trained and well-staffed in order to improve financial performance. Lastly, ease of accessibility to finance also positively influenced financial performance of the SMEs.

Sitharam and Hoque (2016) studied factors affecting SMEs in Kwa Zulu- Natal South Africa. Internal factors such as management competency and skills, access to finance and technological capabilities were considered with an outcome that had a positive correlation with performance. In the case of external environmental factors, competition was viewed as a major stumbling block with 74% picking it as a hindrance to performance. Globalization was seen to bring both opportunities and drawback of almost equal measure in the performance of SMEs. Government bureaucracy and tax laws were also seen to influence performance deleteriously especially due to the major hurdles they pose for business owners. Macro-economic factors such as the inflation rates, interest rates and strength of the rand all had an impact on business performance. For instance, weak rand and high inflation rates made it difficult for SMEs to run their businesses profitably. Power supply and telecommunication infrastructure also influenced SMEs performance. Lastly, crime and corruption had a huge impact especially because small organizations were an easy target as they did not have the requisite controls to detect and prevent fraud and theft in the small organization. 88.89% of the respondents viewed it as a major intimidating factor to the success of their firms.

2.5 Conceptual Framework

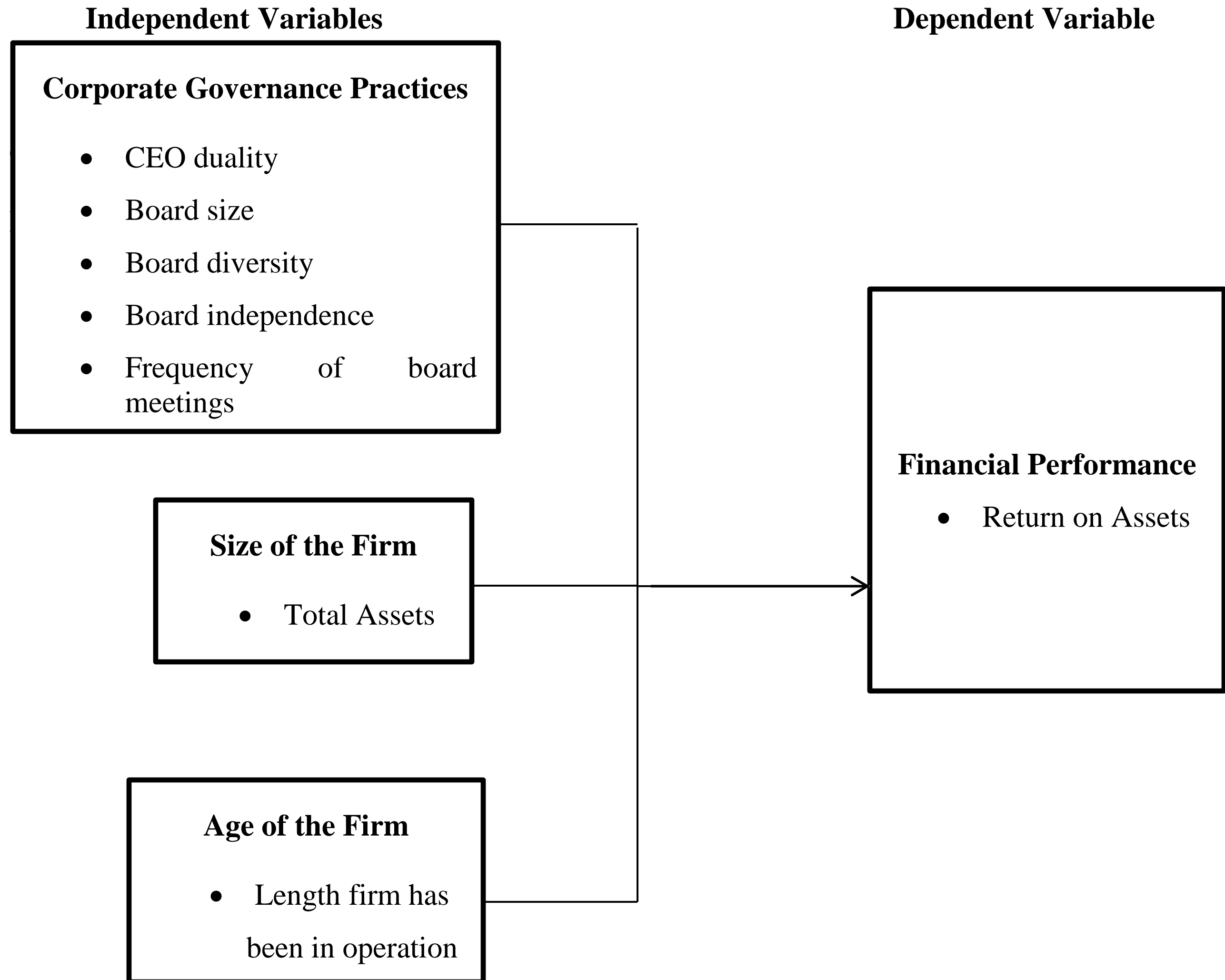

Figure 2.5: Conceptual Framework

The conceptual framework comprises of the independent and dependent variables:

CEO duality: This arises when the role of the CEO and the Chairman are shouldered by one person in an organization, (Rechner & Dalton, 1989). The agency theory advocates for the separation of this role, (Daily & Dalton, 1993) and thus it is important to keep an eye on the functioning of the CEO and board with the intention of safeguarding the interests of all

interested parties. This in essence will assist in avoiding the agency problem. However, the stewardship theory advocates for combining the two roles as it would result in better leadership and faster decision making.

Board size: It comprises of both the Executive and Non- executive members who make up the entire board. A board should essentially be large enough to include all necessary skills, expertise and knowledge. According to Pfeffer (1972), when the board size increases, the performance of the firm also multiples as the members provide greater monitoring, advice and linkages to the external environment. However, others prefer smaller board which they say would be easier to manage and allow for faster decision making.

Board diversity: The structure of the board ought to be a true reflection of the society in terms of gender, professional and ethnic background. This will ensure that varied viewpoints are brought forward. It supports the basis for moral obligation to shareholders, stakeholders and for commercial purposes as it encompasses widespread decisions (Daily & Dalton, 1993).

Board independence: This was mainly advanced in the agency theory. It advocated for the concept of independent or non-executive directors for the purpose of accountability. For effective boards, they should constitute of principally outside independent directors maintaining managerial positions in other firms (Fama and Jensen, 1983).

Frequency of board meetings: For effectiveness of the firm, directors should dedicate their time and resources by meeting regularly. It is recommended that board meetings should be frequent and those that convene regularly have a tendency to perform their duties in conformity to the stockholders’ expectations (Demb and Neubauer, 1992).

Return on Assets (ROA): This is computed by dividing the Total Assets by the Net Income. Total assets represent the ability of the firm to generate revenue and therefore profitability, (Sun and Tong, 2003). The ability of a firm to access finance leads to better financial performance. ROA shows how efficiently and effectively the management of a firm is able to generate income from the resources of the institution (Khrawish, 2011). According to Pandey (2010), a high ROA indicates that the assets contribution to sales and profitability is high while a smaller ROA indicates that profit generated is low compared to assets invested by the firm.

2.6 Summary of the Literature Review

Despite the number of studies carried out, there still remains a large research gap as seen in the table below. Most commonly is the need to carry out further research on SMEs with more emphasis on external variables, to investigate challenges faced by SMEs in accessing credit, to examine the SMEs impact on economic growth, to study challenges SMEs face in adopting corporate governance practices, studies on similar financial sectors, research to establish how CEO duality can contribute to better financial performance, exploring corporate governance with the aim of establishing a governance framework, a study on entities outside Kenya, exploring emerging board complexities and similar studies to find out if the outcomes in studies already carried out hold true.

Author	**Focus of Study**	**Methodology**	**Findings**	**Research Knowledge/ Gaps**
Abor and Biekpe (2007)	Corporate governance, ownership structure and performance of SMEs in Ghana.	Regression Analysis	Board size, board composition, management skill level, CEO duality, inside ownership, family business, and foreign ownership have significantly positive impacts on	Policy direction- coming up with a simple and systematic structure that provides best practice guidance on how corporate governance structures can be

			profitability. Corporate governance can greatly assist the SME sector by infusing better management practices, stronger internal auditing, greater opportunities for growth and new strategic outlook through non-executive directors.	effectively employed within a firm. Limited research done on SMEs as compared to large, public listed companies.
Angagdwita and Mustafid (2013)	Factors influencing performance of SMES in Indonesia.	Regression Analysis	Entrepreneurial aspects influenced SMEs performance more than the human resource expertise. Innovativeness and sustainability does not shape the performance of SMEs.	Entrepreneurial aspects have the higher influence because success of business was determined by owner characteristics. Study limited to only examine internal factors thus there is room to explore external variables and expand research to a larger social system for a varied sample.
Kamonjo	Corporate governance	Regression	There is a negative relationship between the	Study only covered SACCOs in one

(2012)	practices on financial performance of SACCOs.	Analysis	board size and financial performance (ROCE). There is a positive relationship between the frequency of board meetings and financial performance. There is also a negative relationship between the internal audit function and financial performance.	region thus should be expanded to encompass others. The effect of SASRA on the financial performance of SACCOS should also be a matter of concern.
Karo (2012)	Factors affecting SMEs performance in Kenya.	Inferential Analysis- Factor analysis and correlational analysis	Inability to access finance easily, poor marketing strategy, the complexities of the regulatory framework, inadequate training opportunities and poor management systems all negatively impacted the performance of SMEs.	Study to be done to investigate the challenges faced by SMEs in accessing credit.
Lema (2013)	Factors affecting SMEs performance in Kilimanjaro region.	Regression Analysis	SMEs that had more income performed better than those with lower income, those managed by younger people performed better. Education positively influenced performance and older SMEs received more	Further studies on net job creation to better determine the employment capacity of SMEs. Additionally, a further study on

			income than younger ones. Moreover, those that use personal savings to launch their businesses other than loans also performed better. Those that had higher initial investment also did well. The legal structure had no effect while marketing strategy used had a greater impact on the performance.	SMEs impact to economic growth.
Maranga (2014)	Corporate governance on financial performance of SMEs in Nairobi County	Regression Analysis	In most SMEs, CEO duality prevailed predominantly though separation would result in better financial performance. Moreover, those that had frequent board meetings ended up performing better financially. However, though most SMEs appreciated the need for corporate governance, they were yet to fully embrace it as they considered it a "large-firm" practice and the high cost involved plus rigid government regulations.	Establish how SMEs listed in the NSE have been able to come up with various strategies and policies to comply with a regulated business environment (adoption of corporate governance practices). Undertake study to establish how CEO duality can contribute to better financial

				performance. Finally, a study on the challenges SMEs face in adopting corporate governance practices. Similar study on other financial sectors.
Marikio (2014)	Corporate governance practices and financial performance of manufacturing firms in Kenya.	Regression Analysis	Corporate governance structures were practical as they influenced both managerial and financial performance. Additionally, it resulted in enhanced management, sounder internal control mechanisms, prospects for development as well as increased investor confidence thus enhancing firm's competitiveness.	Statutory bodies such as CMA and academia to research more on corporate governance with an aim of establish a code of conduct/ governance framework that is applicable across all industries. Further research on entities outside Kenya and other elements thereof. Include emerging organizations and board complexities

				such as block ownership, antitakeover mechanisms, financial leverage and executive compensation in study.
Moenga (2015)	Corporate governance on financial performance of MFI's.	Regression Analysis	Majority of MFIs had small boards and though they were independent, board diversity was yet to be embraced. Setting up of good structures was significant as it influenced financial performance.	Studies done on MFIs that fall outside AMFI and other sectors of the economy such as the agricultural sector.
Nakhaima (2016)	Factors affecting performance of SMEs in Kenya.	Regression Analysis	Corporate governance has an optimistic effect on financial performance. It emphasized of separation of the role of CEO and Chairman, focus on audit committee, human resource capacity and accessibility to finance all positively influenced financial performance of SMEs.	Further studies on SMEs in the informal sector. Similar study in different institution to determine if findings will hold true.
Sitharam	Factors	Regression	Internal factors such as	Further study on

and Hoque (2016)	affecting SMEs in Kwa Zulu-Natal, South Africa.	Analysis	management experience, expertise, access to finance, and technological proficiencies all positively influenced performance. External factors such as competition, globalization, government bureaucracy and tax laws, macro-economic factors, infrastructure and corruption negatively impacted performance of SMEs.	external factor competition and how it impacts performance of SMEs.

Table 2.6: Summary of Literature Review

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter provides an outline of the entire process that was used in carrying out the research in order to realize the specified objectives set out initially at the inception of the study. Therefore, it incorporated the research design, the population, the sample, the technique for data collection and conclusively the data analysis.

3.2 Research Design

As stated by Burns & Groove (2003), research design is described as the blueprint for carrying out an investigation with utmost domination of the factors that may restrict the validity of the conclusions. In this study, the descriptive research design was used. Burns & Groove (2013) points out that descriptive research is intended to naturally illustrate a condition as it ensues. Gill and Johnson (2002) indicate that descriptive survey is mainly involved in addressing specific features of a particular matter, one over a fixed point in time or the other at varying periods for comparative purposes. The choice to use this design was because it ensured that the sample chosen will be a good representation of the relevant target population. Subsequently, any other evaluations done on the population will result in precise outcomes and thus allow for generalization, what is referred to as population validity.

Additionally, it allows one to use both quantitative and qualitative data to ascertain the impact of corporate governance on SMMEs. This design made it easier for collection, analysis and interpretation of data collected. Descriptive research design involves collecting of information through administration of questionnaires and interviews to a sample of individuals (Orodho, 2013). In order to get up-to-date responses on the elements in the analysis then data collection process will come in very useful (Gay, 1999).

3.3 Population

Population is defined as the entire collection of persons and things from which a sample is picked (Greener, 2008). According to Cooper and Schindler (2003), population is defined as the subject that is measured hence it is the unit of observation. The population is usually very

important as it provides for equal opportunity of representation under the extent of study. Consequently, the population relevant in this study was small and medium manufacturing enterprises (SMMEs) that are members of the Kenya Association of Manufacturers (KAM). As such, the target population is 279 SMEs within the county of Nairobi obtained from the KAM website.

Table 3.3: KAM Sectors

KAM Sectors	Population
Building, Mining & Construction	13
Chemical & Allied	34
Energy, Electrical & Electronics	17
Food & Beverages	52
Fresh Produce	7
Leather & Footwear	1
Metal & Allied	36
Motor Vehicle Assemblers & Accessories	20
Paper & Board	31
Pharmaceutical & Medical Equipment	9
Plastics & Rubber	33
Textiles & Apparel	13
Timber, Wood & Furniture	13
Total	**279**

Source: KAM website

3.4 Sample

A sample size is described as the smaller size of a larger population, (Cooper and Schindler, 2003). Nonetheless, of importance is to note that a larger sample size should be the best choice as it would be a good representation of the population. Moreover, it would produce more accurate results. Nevertheless, it is also quite clear that using a sample is cost- effective but would also be limiting especially if it does not give a true representation of the population under study. Kothari (2004) emphasizes the fact that using a sample size that is too small would

hinder one from achieving the intended objective whereas one that is too large would lead to wastage of resources in addition to being very costly.

Kothari (2004) describes the sampling design as the method of selecting items to be observed for the given study. In this case, the use of probability sampling technique was adopted in the collection of data. Therefore, stratified random sampling technique was chosen to pick the sampling frame as it provided better representation from the heterogeneous data. According to Kothari (2004), this technique reduces biasness as it captures information that is unique to each stratum. The target population from KAM was divided into different sectors, which in our case will represent the various strata. From the different strata, a few elements were randomly selected to make up the sample for the study. . It is recommended that a population of 10 percent or more is a good representation of the population (Mugenda and Mugenda, 2003). Consequently, the sample size will be selected by employing the Krejcie and Morgan (1970) formulae:

$$S = \frac{X^2NP(1-P)}{d^2(N-1) + X^2P(1-P)}$$

Where:

S= Required sample size

X= Z value (e.g. 1.96 for 95% confidence level)

N= Population size

P= Population proportion (expressed as decimal, assumed to be 0.5/ 50%)

d= Degree of accuracy (expressed as a proportion, 5%). It is the margin of error.

Therefore, the appropriate sample size in this study will be:

$$\frac{1.96^2 \times 279 \times 0.5 \times (1-0.5)}{0.05^2 \times (279-1) + 1.96^2 \times 0.5 \times (1-0.5)} = 162$$

In this case, 162 respondents will be chosen as the study sample.

3.5 Data Collection

The data collected was both secondary and primary data. The use of self-administered questionnaires was picked as the main instrument for primary data collection. The questionnaires encompassed both open and closed ended questions. This was intended to capture both quantitative and qualitative characteristics of the data. Moreover, they were used as they focused on the matter at hand and also give more in-depth information. The questionnaire was split into three sections whereby section A comprised of general information about the correspondents such as sector of operation, size and age of the firm. Section B incorporated the corporate governance practices within the entities while section C encompassed the financial performance of the entities. All information was collected from persons in management positions as they were better placed to have an enhanced comprehension of the operations of the organization.

3.6 Data Analysis

The data collected was first analyzed for completeness and consistency. The data was then evaluated using both descriptive and inferential statistical analysis method. The data collected was recorded and coded then posted in a spreadsheet before in-depth analysis on the statistical software package. The descriptive statistical tools employed included both the Microsoft Excel and Statistical Package for Social Sciences (SPSS). The inferential statistics used was regression analysis. To determine the link between independent and dependent variables in this study, multiple regression analysis was explicitly used.

The corporate governance practices including the CEO duality, size of the board, board independence and board diversity were analyzed using descriptive statistical measures such as the measures of central tendencies. Multiple regression aided in ascertaining the relationship between corporate governance practices and financial performance. Once done, the outcomes and findings were presented using charts, tables, percentages and measure of central tendencies.

3.6.1 Analytical Model

The multiple linear regression model was used to determine the relationship between corporate governance and financial performance i.e. the link between the dependent and independent variable as there were more than one independent variables. Therefore, the model was as shown below:

$$Y=\alpha+\beta_1X_1+\beta_2X_2+\beta_3X_3+\beta_4X_4+\beta_5X_5+\beta_6X_6+\beta_7X_7+\mathcal{E}$$

Where:

Y is the SMEs financial performance as a dependent variable measured by ROA

α is the Constant representing financial performance explained by other factors other than those in the regression equation above.

X_1 is the CEO duality

X_2 is the Board size

X_3 is the Board diversity

X_4 is the Board independence

X_5 is the Frequency of Board meetings

X_6 is the Size of the firm

X_7 is the Age of the firm

$\mathcal{E}$ is the Error term (normally distributed about the mean of zero)

$\beta_{i's}$ is the coefficient for variables $X_{i's}$ that measure the responsiveness of Y to changes in X.

Table 3.6.1: Operationalization of study variables

Variable	Measure	Adapted from
ROA	Average Net Income/Average Total Assets	Langat (2013)
CEO duality	Yes=1, No= 0	Moenga (2015)
Board size	Log (Number of members in the board)	Okumu (2015)
Board diversity	Proportion of male directors to female directors	
Board independence	Number of non-executive members/ Total number of directors	Marikio (2014)
Frequency of board meetings	Log (Number of meetings in a year)	Lishenga (2015)
Size of the firm	Log (Total Assets)	Marikio (2014)
Age of the firm	Log (Length company has been in operation)	Marikio (2014)

3.6.2 Test of Significance

Regression analysis was used as the test of significance. Linear regression analysis was used to demonstrate the connection between the dependent (ROA) and independent variables (corporate governance practices). The t-test was used to determine the significance of the regression. The

coefficient of determination (R^2) showed the variations in the ROA as determined by the various changes in the various corporate governance practices.

The correlation coefficient (r) showed the relationship between the variables under study. Generalizations were then be made to the population under study. The ANOVA test was also used in finding out the variance of categorized data whereby the statistical significance aided in analyzing the impact of independent and dependent variables in the regression analysis

CHAPTER FOUR: ANALYSIS, RESULTS AND DISCUSSIONS

4.1 Introduction

This chapter describes the data analysis, findings and interpretation centered on the research methodology. Tables and figures were used to depict the outcome. Data that was evaluated was organized under themes that mirrored the objective of the research.

4.2 The Response Rate

The rate of response achieved was 64.8% (105 respondents out of possible 162). This was attributed to follow up calls made with an endeavor to boost the effective response rate. Mugenda and Mugenda (2003) and Kothari (2004) affirmed that a response rate of 50% is adequate for a descriptive study. Similarly, it was contended that return rates of 50% is conventional to examine and publish, 60% is good and 70% is very good, (Babbie, 2004). As founded by these assertions from distinguished scholars, the 64.8% response rate is ample for the analysis.

Table 4.2: Response Rate

	Response	**% Response**
Successful	105	64.8%
Unsuccessful	57	35.2%
Total	162	100%

4.3 Demographics

4.3.1. Sector of Operation of Organization

The study attempted to establish the sector of operation of the organization of small and medium manufacturing enterprises (SMMEs).Results indicated that Motor Vehicle Assemblers & Accessories accounted for 14.3%, Building, Leather & Footwear was 11.4% , Timber, Wood & Furniture was 10.5%, Food & Beverages was 9.5%, Plastics & Rubber was 8.6%, Pharmaceutical & Medical Equipment was 7.6 %, Energy, and Metal & Allied 7.6 %, Mining &

Construction was 6.7%, Electrical & Electronics was 6.7%, Fresh Produce was 6.7%. Paper & Board was 3.8%, Chemical & Allied was 3.8%, and Textiles & Apparel was 2.9%

Table 4.3.1: Sector of Operation of Organization

	Frequency	Percent
Building, Mining & Construction	7	6.7
Pharmaceutical & Medical Equipment	8	7.6
Energy, Electrical & Electronics	7	6.7
Food & Beverages	10	9.5
Leather & Footwear	12	11.4
Metal & Allied	8	7.6
Motor Vehicle Assemblers &Accessories	15	14.3
Paper & Board	4	3.8
Chemical & Allied	4	3.8
Plastics & Rubber	9	8.6
Textiles & Apparel	3	2.9
Timber, Wood & Furniture	11	10.5
Fresh Produce	7	6.7
Total	105	100

4.3.2 Organization Existence in the Market (In Years)

The study attempted to establish the organization's existence in the market (in years) which is simply the time period the SMME has been operating. Outcomes in figure 4.3.2 disclosed that a majority of the companies (28.6%) had been in the market for 6 to 11 years. 24.8 % of the small and medium manufacturing enterprises (SMMEs) happened to be in market for 12-21 years, 23.8 % had been in existence for 22 and above years and finally 22.9 % accounted for those companies who had been in existence for 1-5years.

Table 4.3.2: Organization Existence in the Market (In Years)

	Frequency	Percent
1-5 years	24	22.9
6-11 years	30	28.6
12-21 years	26	24.8
22 and above	25	23.8
Total	105	100

4.3.3 Number of Employees

The researcher sought to ascertain the number of employees working in small and medium manufacturing enterprises (SMMEs). This would be an indication of the relative size of majority of the SMMEs. Results in table 4.3.3 revealed that majority of the SMMEs (18.1%) had 1-20 employees. Those with 21- 40 employees constituted 17.1%. The same results were replicated at firms with 41-60 employees. Those with 61-80 employees constituted 16.2%. The same results were replicated at firms with 81-100. SMMEs with 101 and above employees accounted for only 15.2% which was the least.

Table 4.3.3: No of Employees

	Frequency	Percent
1-20 employees	19	18.1
21-40 employees	18	17.1
41-60 employees	18	17.1
61-80 employees	17	16.2
81-100 employees	17	16.2
101 and above employees	16	15.2
Total	105	100

4.3.4 Branches

The respondents were asked if the organization had other branches. This was intended to find out the level of growth and also determine the level of financial success of SMMEs operating within Nairobi County. The majority as appearing in figure 4.3.4, that is 70% indicated that they did not have other branches while 30% agreed that they had other branches.

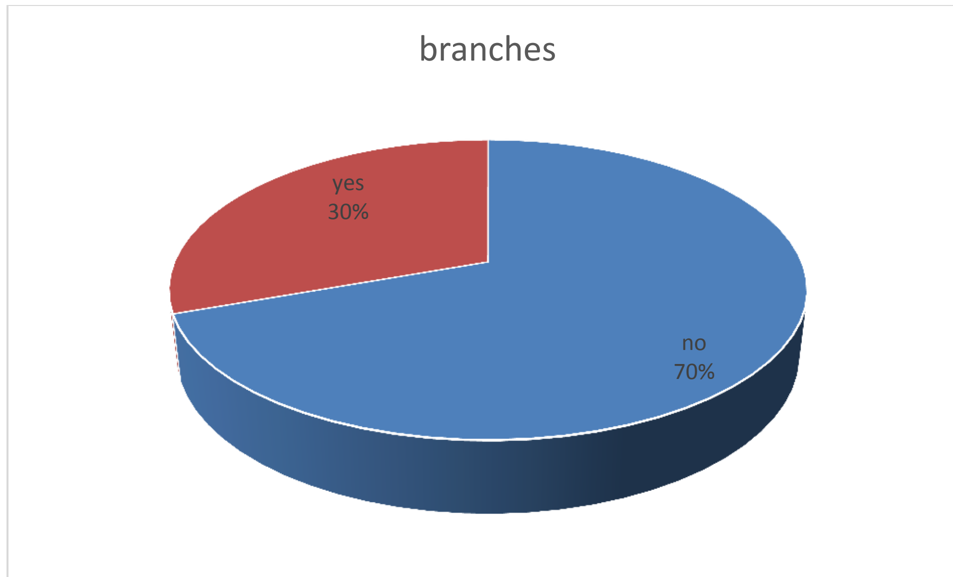

Figure 4.3.4: Branches

4.4 Descriptive Data Analysis

Descriptive statistics was employed in converting the raw data into a manner by which it can be easily comprehended and explained. As stated by Adejimi, Oyediran and Ogunsanmi, 2011, analysis initially involves computation of averages, frequency distributions and percentage distributions. In order to perform the data analysis, means and frequencies were utilized. These assisted in deriving conclusions and generalizations pertaining to the population. The mean scores were used to rate the factors, CEO duality, board size, board independence, frequency of board meetings, age of firm, total assets in order of their importance. Standard deviation of each of the factors was calculated to measure the variability of the responses.

Table 4.4: Descriptive Statistics

	N	Mean	Std. Deviation
Is the CEO the same as the Chairperson of the Board within your organization	105	0.66	0.477
Does the organization have clear and documented rules for appointment and removal of Chairperson	105	0.57	0.497
What is the size of your board of directors	105	2.03	1.087

A larger board would provide more resources for your organization	105	0.62	0.488
A smaller board would enhance your organization's performance	105	0.65	0.48
Is there a disclosure of academic qualification and professional qualification of each member	105	0.69	0.466
Does the board have executive and non-executive directors	105	0.53	0.501
Do the views of non-executive members have a significant weight in the board meetings	105	0.49	0.502
Does the firm have a system of evaluating outside directors	105	0.54	0.501
Has the board agreed on a schedule of meetings	105	0.59	0.494
How often are board meetings held in one financial year	105	2.17	1.096
Which committees exist in your organization	105	2.89	1.489
What is the frequency of committee meetings	105	2.02	0.82
Does the board hold impromptu meetings to address urgent issues	105	0.55	0.5
Valid N (listwise)	105		

CEO duality was determined by establishing whether the CEO was the same as the Chairperson of the Board within the respondent's organization. The results in table 4.4 indicate the mean for this statement was 0.66 implying most of the manufacturing companies CEOs had dual responsibilities in the firm. The standard deviation was 0.477 meaning the responses were varied. The respondents were also asked to state if the organization had clear and documented rules for appointment and removal of Chairperson. The results showed that the mean for this response was 0.57 implying that majority of the companies had clear and documented rules for appointment and removal of Chairperson. However, the standard deviation of 0.497 implied that the results were fairly dispersed. The size of the board of directors mean results were 2.03 implying that many boards had a minimum of two members however the dispersion was recorded at 1.087. The respondent's response on whether a larger board would provide more resources for your organization had a mean of 0.65 indicating that majority agreed with the statement although the responses were varied at 0.48. The respondents were asked to ascertain if there was a disclosure of academic qualification and professional qualification of each member, results obtained showed that the mean response was 0.69 implying that that was standard formality, however the measure of dispersion was

0.466.The mean results for the firm having executive and non-executive directors was 0.53 indicating that most firms had both executive and non-executive directors. The responses were varied as shown by standard deviation of 0.501.

Results for the statement on whether the views of non-executive members have a significant weight in the board meetings indicated the mean was 0.49, implying that non-executive members did not have a significant weight in the board meetings. However, the responses were varied as shown by a measure of dispersion of 0.502. The mean of 0.54 showed that the firm had a system of evaluating outside directors. The responses were varied, however, as shown by a measure of dispersion of 0.501. The board had agreed on a schedule of meetings. This was shown by a mean of 0.59. However, the measure of dispersion around the mean was 0.494, showing a variation of responses. The mean of 2.17 indicated that board meetings held in one financial year were at least 2. Nonetheless, the number of meetings varied, as shown by a standard deviation of 1.096. Each firm had at least 3 committees, as pointed out by the mean of 2.89. Nevertheless, the standard deviation was 1.489, indicating that there were different types of committees. Most of the organizations had 2 meetings, as indicated by a mean of 2.02. The standard deviation of 0.82 indicated, on the other hand, that the number of meetings held varied for each organization. A mean of 0.55 indicated that majority of the organizations boards held impromptu meetings to address urgent issues. Conversely, a standard deviation of 0.5 indicated diverse responses.

4.5 Diagnostic Test Results

The pre-estimation tests carried out on the variables and the model revealed absence of autocorrelation and multi-collinearity among the variables while the model was found to be consistent and a good measure of the estimates. The diagnostic tests that were carried out include the Graphical Histogram for normality, Durbin- Watson test for autocorrelation and test for multi-collinearity specified as follows:

4.5.1 Histogram

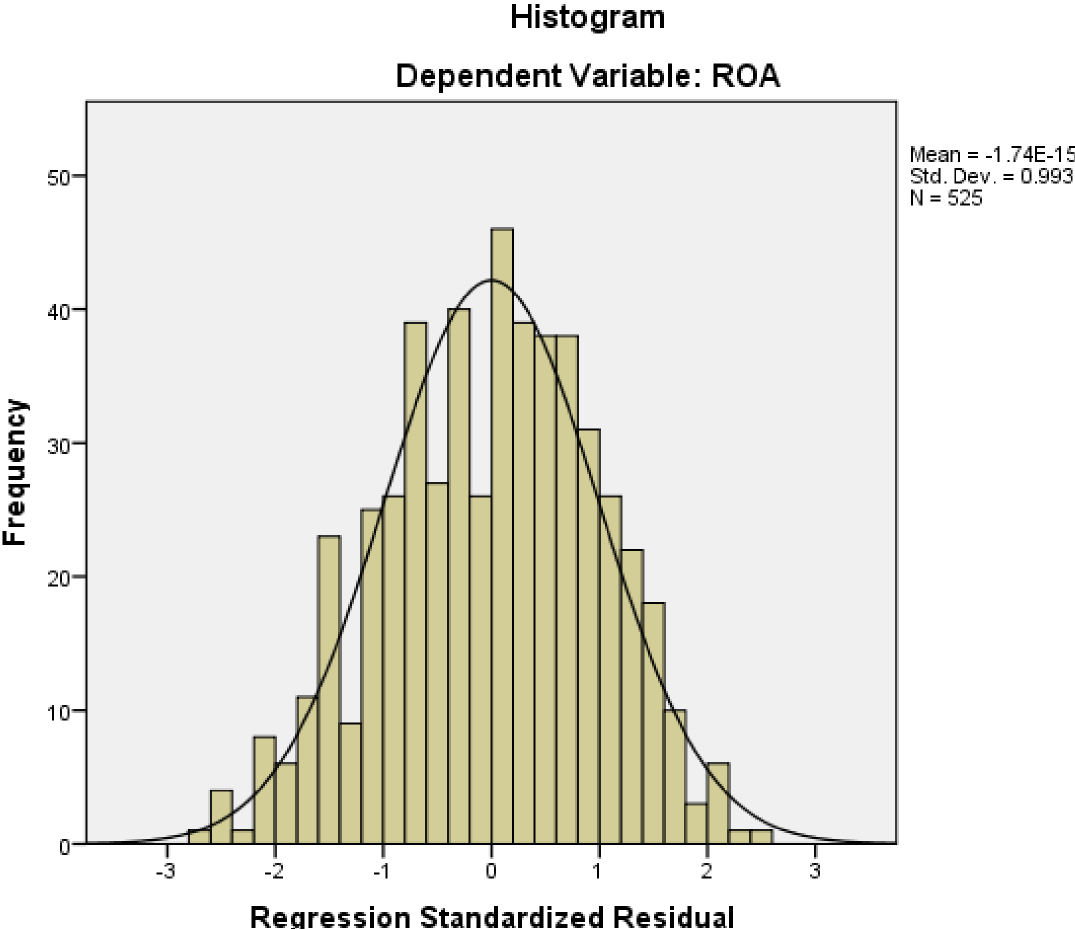

Figure 4.5.1: Histogram

The graphical method (histogram) was used to test for normality. This ensured the variables used in the analysis were distributed normally as seen above.

4.5.2 Test for Autocorrelation

Table 4.5.2: Durbin-Watson

Model	Durbin-Watson
1	1.660[a]

Source: Research Findings

The result above suggest that there does not exist any form of autocorrelation since the test results (1.660) falls between 1.5 and 2.5 which is the accepted threshold for autocorrelation.

4.5.3 Test for Multicollinearity (Variance Inflation Factor- VIF)

Table 4.5.3: Variance Inflation Factor (VIF)

Model		Collinearity Statistics	
		Tolerance	VIF
1	Duality	.950	1.053
	Board size	.895	1.117
	Board Diversity	.591	1.692
	Board independence	.613	1.632
	Board meetings	.677	1.477
	Age of firm	.912	1.097
	Size of the firm	.812	1.232

Source: Research Findings

From the output, it is clear that all variables have a variance inflation factor which is less than 10. This implies that the model does not have a problem of multicollinearity and therefore the model fits as a good measure of estimates.

4.6 Correlation Analysis

Correlation analysis avails one with information on whether a relationship exists between two variables, the direction of that association and consequently the magnitude of the connection. Correlation coefficient values fluctuating between -1 and 1 gauge the extent to which two variables are linearly linked. Consequently, greater magnitude denotes a higher extent of connection between two variables. It is usually denoted by r. As said by Adejimi, Oyediran and

Ogunsanmi (2011), correlation coefficient with a magnitude 0.3 to 0.5 depicted medium linear dependence between two variables whereas 0.5 to 1.0 revealed strong linear dependence.

The correlation summary shown in Table 4.6 indicates that the associations between each of the independent variables and the dependent variable at the 95% confidence level. Correlation analysis was used to determine the connection between corporate governance practices and financial performance of small and medium manufacturing enterprises (SMMEs) in Nairobi County. A 5% significance level was used to test for the correlation coefficient.

Table 4.6: Correlation

	Duality	**Board Size**	**Board Diversity**	**Board Independence**	**Board Meetings**	**Age Of Firm**	**Size Of The Firm**	**ROA**
Duality	1							
Board Size	-.121**	1						
	0.006							
Board Diversity	0.042	-.180**	1					
	0.335	0						
Board Independence	-0.02	-.183**	.596**	1				
	0.702	0	0					
Board Meetings	0.002	0.019	-.412**	-.370**	1			
	0.961	0.667	0	0				
Age Of Firm	-.115**	.238**	-.153**	-.150**	0.072	1		
	0.008	0	0	0.001	0.1			
Size Of The Firm	-.121**	-.093*	-0.07	-0.04	.380**	-0.08	1	
	0.005	0.034	0.102	0.377	0	0.088		
ROA	-.290**	.302**	0.045	.152**	.201**	0.026	.359**	1
	0	0.00	0.00	0.307	0.00	0.00	0.552	0

Source: Research Findings

The results indicated that there was a negative relationship (r= -.290) between CEO duality and financial performance of SMMEs. This intimates that CEO duality conversely affects the financial performance of the manufacturing SMMEs attributed to the fact that the CEO is playing two roles, hence not performing optimally. There could also be issues of accountability. In addition, the researcher found the relationship statistically significant at 5% level (p=0.00., <0.05). This means that when a company adopts CEO duality practices, the performance of the company will decrease by -.290.

The findings indicated that there was a positive association (r= 0.302) between Board size and financial performance of SMMEs. Increase in 1 unit of board size will lead to improved financial performance of manufacturing SMEs by 0.302. Additionally, the researcher found the relationship to be statistically significant at 5% level (p =0.00., <0.05). This means that when a company changes its Board size, there is more sharing of responsibilities, thus the performance of the company will increase by 0.302.

There was a positive relationship (r=0.045) between Board diversity and financial performance of SMMEs, as indicated by the results. A unit increase in board diversity will lead to enhanced financial performance of manufacturing SMEs by 0.045. Moreover, the researcher found the link to be statistically insignificant at 5% level (p=0.00, <0.05). This can be attributed to increase in capabilities and skills brought about by diversity of board members.

Findings of (r= 0.152) showed that a positive relationship existed between Board independence and financial performance of SMMEs. A unit increase of board independence will lead to improved financial performance of manufacturing industries by 0.152. Likewise, the researcher found the relationship to be statistically insignificant at 5% level (p=0.307., >0.05). Therefore, it is clear that despite the fact that board independence would lead to improved financial performance, the impact would not actually be felt by the organization.

The study indicated a positive relationship (r=0.201) between the frequency of Board meetings and financial performance of SMMEs. A unit increase of frequency of Board meetings will lead to improved financial performance of manufacturing industries by 0.201. Furthermore, the

researcher found the relationship to be statistically significant at 5% level (=0.00., <0.05). This could be attributed to the ability to solve issues as soon as they occur due to the frequency of the meetings.

The results pointed towards a positive relationship (r=0.026) between Age of firm and financial performance of SMMEs. A unit increase in age of firm led to improved financial performance of manufacturing industries by 0.026. Also, the researcher found the relationship statistically significant at 5% level (p= 0.00, >0.05). Firms that have stayed longer in the market were thus found to be more stable and therefore their performance could be easily stabilized which makes it easier for them to make borrowings and also increase the investors' confidence.

The findings signaled a positive relationship (r=0.359) between Size of the firm and financial performance of SMMEs. In addition, the researcher found the relationship statistically insignificant at 5% level (p=0.552, <0.05). This could be due to the fact that success of the organization could be attributed to other factors such as management and not firm size. Moreover, it is clear that some larger firms may not be performing as well as smaller one and thus the size of the firm was not necessarily a major contributing factor to the financial performance.

4.7 Regression Analysis

This gives an explanation of the intensity of fluctuations of the dependent variable as explained by fluctuations in the independent variables. It is the proportion of variation of the dependent variable (ROA) as rationalized by changes in the independent variables (CEO Duality, Board Size, Board Diversity, Board Independence, Board Meetings).

Table 4.7: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.603a	0.363	0.355	2.798

Source: Research Findings

Table 4.7 presents the regression coefficient of independent variables against dependent variable. The results of revealed a significant positive relationship between dependent variable

(financial performance of small and medium manufacturing enterprises (SMMEs) and the independent variables (CEO Duality, Board Size, Board Diversity, Board Independence, Board Meetings, Age of Firm, Size of the Firm.). The independent variables reported R value of 0.603 signifying a perfect relationship between dependent variable and independent variables. R square value of 0.363 means that 36.3 % of the corresponding variation in financial performance of small and medium manufacturing enterprises (SMMEs) can be explained or predicted by (CEO Duality, Board Size, Board Diversity, Board Independence, Board Meetings, Age of Firm, Size of the Firm) which indicated that the model fitted the study data. This implied that additional factors not examined in this study contributed 63.7% of SMMEs financial performance. Adjusted R square in table 4.7 is called the coefficient of determination which indicates how financial performance of small and medium manufacturing enterprises varied with variation in effects of factors which includes; CEO Duality, Board Size, Board Diversity, Board Independence, Board Meetings, Age of Firm, Size of the Firm.

In this study, the significance of the relationship between the dependent variable and all the independent variables pooled jointly was also established. Regression analysis was conducted to find the proportion in the dependent variable (financial performance of SMMEs) which can be predicted from the independent variables (CEO Duality, Board Size, Board Diversity, Board Independence, Board Meetings, Age of Firm, and Size of the Firm).

Table 4.8: Model of Co-efficient

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	10.36	1.46		-7.11	0.00
	Duality	-1.64	0.28	-0.21	-5.88	0.00
	Board Size	2.86	0.29	0.37	9.89	0.00
	Board Diversity	0.59	0.40	0.07	1.47	0.14
	Board Independence	2.41	0.42	0.26	5.78	0.00
	Board Meetings	1.43	0.30	0.21	4.83	0.00
	Age Of Firm	-0.02	0.02	-0.03	-0.79	0.43
	Size Of The Firm	0.99	0.13	0.30	7.73	0.00
a Dependent Variable: ROA						

Source: Research Findings

Summary Equations

From the table 4.8 above, the multiple linear regression equation was established as:

$ROA= 10.36-1.64X_1+2.86X_2+0.59X_3+2.41X_4+1.43X_5-0.02X_6+0.99X_7$

Of importance is the p-value which signifies the intensity of the relation of the independent versus the dependent variables. If the significance number obtained is below the critical value, better known as the probability value (p) statistically set at 0.05, then the deduction would be that the model is important in rationalizing the relationship; otherwise the model would be considered as not statistically significant.

The above regression equation ascertained that taking all factors under consideration (CEO Duality, Board Size, Board Diversity, Board Independence, Board Meetings, Age of Firm, Size of the Firm) constant at zero, financial performance of small and medium manufacturing enterprises (SMMEs) can be justified or predicted by the independent variables. The findings showed that taking all other independent variables at zero, a unit increase in CEO duality will

result in a decrease of -1.64 in financial performance of SMMEs. The P-value was 0.00 which is less than 0.05 and thus the relationship was significant. This indicated that having the same person as both the CEO and Chairman would impact negatively on the financial performance of the SMMEs.

Nonetheless, all other independent variables taken at zero, an increase of one unit in Board diversity would lead to an increase of 0.59 in financial performance of SMMEs. The P-value was 0.14 which is more than 0.05 and thus the relationship was insignificant. This implied that despite the diversity of the board having a positive effect on finance, the relationship wasn't as significant and thus this shouldn't be a matter of great concern for the SMMEs. Conversely, a unit increase in Age of firm will result in a fall of -0.02 in financial performance of SMMEs. The P-value was 0.19 which is more than 0.05 and thus the relationship was insignificant. This suggested that the age of the firm had so little bearing on its financial performance.

Additionally, it was established that a unit increment in Board size will result in to an increase of 2.86 in financial performance of SMMEs. The P-value was 0.00 which is less than 0.05 and thus the relationship was significant. This was similarly replicated by other variables such as Board Independence where a unit increase would lead to an increase of 2.41 in financial performance of SMMEs, a unit increase in frequency of Board Meetings will result in to an increase of 1.43 in financial performance of SMMEs, a unit increment in Size of the firm will lead to an increase of 0.99 unit in financial performance of SMMEs. As such all these variables impacted greatly on the financial performance of the firm and thus all SMMEs must take them under serious consideration when undertaking their daily operations.

Analysis of Variation

ANOVA was utilized in justifying how best the model fits the data. That is, it tests the model's goodness of fit.

Table 4.9: ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	2309.383	7	329.912	42.14	.000b
	Residual	4047.6	517	7.829		
	Total	6356.983	524			

Source: Research Findings

Table 4.9 presents the outcome on the analysis of the variance (ANOVA). The conclusions signify that the overall model was statistically significant. Additionally, the findings further pointed towards the independent variables being good predictors of performance. This was reinforced by an F statistic of 42.14 and the reported p value (0.000) which was lower than the conventional probability of 0.05significance level.

4.8 Interpretation of Findings

It is quite clear form the above analysis that conferring the CEO and chairman duties in one individual creates difficulty for a board to substitute a non-performing CEO. Consequently, the board flexibility of addressing huge declines in performance is greatly hampered. Therefore, this implies for good corporate governance mechanism to be seen to be effective then firms must adopt the separation of the role of the Chairman and the CEO. This autonomy will allow for separation of power and ownership which would result in better decision making ad overall management that will in turn impact positively on financial performance of the firms.

Furthermore, larger boards are better for corporate performance since they have a variety of expertise to assist in decision making. This would make it difficult for a powerful CEO to dominate. A bigger board size also assumes a better supervision of the management team and a higher quality of corporate decisions. This is due to the fact there is expected to be greater wealth of experience that would offer guidance where necessary and a proper exchange of ideas that would help catapult the firm to greater heights.

While the case of politically connected director's fits well with the resource dependence view of boards that of directors with financial expertise is more complex. Directors with experience in

the financial sector are more likely to borrow highly with regards to their investment opportunities and to regularly take part in value-destroying. Nonetheless, some of these members are expected to bring their expertise to the firm which will save on costs and even enable them to make decisions that would result in the growth of the firm. Experts including lawyers and financial analysts would be considered valuable to a firm especially in its early stages so as to charter its course in an already very competitive environment.

Board independence is the ability of the board to make their decisions without the interference from insiders in the organization. This is particularly useful when board members are drawn outside the organization and display high professionalism in their decision making process. A board is more independent if it has more non-executive directors. Empirical results have been indecisive on how this relates to the firm. In one breath, it is claimed that executive (inside) directors are more acquainted with a firm's activities and, consequently, are better placed to scrutinize top management. Conversely, it is contended that non-executive directors may act as "professional referees" so as to make sure that competition among insiders stimulates actions in harmony with shareholder value maximization.

The committees of the board are the working systems which are headed by persons with specific skills and knowledge especially from trained professionals. In order for them to perform their oversight role appropriately, they are expected to have non-executive members making decisions. These committees are also able to meet more frequently and deal with matters as they arise and thus are able to avoid bigger failures in future that would otherwise not be avoided had they not meet. In addition to that, they are also able to make decision faster that may impact on the performance of the firm.

The age of the firm is not a factor that influences performance in this dynamic business environment. This is because how long a firm has been in existence in the market does not necessarily translate to the level of performance. In actual sense, how well a firm is able to adapt to a rapid changing environment would determine how well their financial performance is. This basically contrasts with the notion that having being in operation for a longer time period implies that you are performing better. Some firms that have been in operation for lesser time periods and are seen to be adapting to changes faster and are seen to outperform those that

have been there longer and have refused to adapt to changes. Therefore, SMMEs must strive to not only survive longer but also adjust to changes in their operating environment to as to thrive and flourish.

Finally, the size of firm is seen to matter greatly which can be attributed to economies of scale that is, evidence in huge businesses. They have advantages as they can buy raw materials at cheaper prices and also control bigger market niche. As such, firms with larger sizes are most likely to enjoy benefits that would not otherwise be enjoyed by their smaller counter-parts. They may also be able to get financing easier as they may have collateral for say, loans and so on. Thus investors would most likely be willing to invest in them than in smaller firms. SMMEs are without a doubt expected to work on increasing their size, in this case, their asset base, in order to enjoy such benefits.

CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter addresses the summary of the key findings, the conclusions, and limitations of the study, recommendations for practice and policy and suggestions for further investigation. This is done in line with the objective of the study.

5.2 Summary of Findings

The findings showed that CEO duality and financial performance are negatively and significantly related. This means that CEO duality lead to a negative improvement on financial performance of small and medium manufacturing enterprises (SMMEs). This outcome was in concurrence with Maranga (2014) who established that the SME leadership was crucial in appointment and monitoring of the CEO and that division of the role of the CEO and Chairman was fundamental to ensure better financial performance. Nonetheless, in most SMEs, the case of duality of the two roles prevailed predominantly. The outcome indicated that Board size and financial performance of small and medium manufacturing enterprises (SMMEs) are positively and significantly related. This denotes that adoption of bigger Board Size leads to an improvement on financial performance of SMMEs. The results digress from those of Kamonjo (2012) who established that the larger board size lead to lower financial performance as shown by the ROCE.

It was revealed that Board diversity and financial performance of small and medium manufacturing enterprises (SMMEs) are positively and insignificantly related. This suggests that improvement in Board Diversity does not necessarily lead to an improvement in financial performance of SMMEs. The results correspond to Moenga (2015) who found out that majority of the MFIs had small boards and though they were independent, board diversity was yet to be embraced as some of the firms hardly had any female members on their boards which implied that the relationship was insignificant to their performance. The results showed that Board independence and financial performance of small and medium manufacturing enterprises (SMMEs) are positively and significantly related. This signifies that board independence leads to an improvement of financial performance of SMMEs. This was as replicated by Marikio

(2014) who concluded the inclusion of independent board directors optimistically impacted the firm's performance.

The outcome revealed that Board meetings and financial performance of small and medium manufacturing enterprises (SMMEs) are positively and significantly related. This points towards a rise in the frequency of board meetings resulting in an improvement in financial performance of SMMEs. This affirms Lishenga (2015) study that concluded that a firm's value positively responded to changes in board meeting frequency. The results showed that Size of the firm and financial performance of small and medium manufacturing enterprises (SMMEs) are positively and significantly related. This means organizations with more assets are beyond probable to have better financial performance. This is in concurrence with Marikio (2014) study that indicated firms with a superior asset base are more likely to register increased profitability which is directly related to their ability to generate high levels of revenues.

The findings showed that Age of firm and financial performance of small and medium manufacturing enterprises (SMMEs) are positively and insignificantly related. This implies that firms that may have been in existence for a longer time may not necessarily have better financial performance than those that have existed for a shorter period of time. This is similar to Marikio (2014) who concluded that the age of the firm had an insignificant contribution to the firm performance, as older firms would not perform well simply because they had been in operation for a longer time period.

5.3 Conclusions

The research worked towards establishing the impact of corporate governance practices on the financial performance SMMEs in Nairobi County. Based on the findings above, the study concluded that CEO Duality, Board Size, Board Independence, Board Meetings, Size of the Firm affect the financial performance of SMMEs. Nonetheless, the Age of the firm and Board Diversity are insignificant to the financial performance of SMMEs.

The results indicated that most of the SMMEs had one individual who acted as both the manager and the owner. Despite this fact, most of the SMMEs appreciated the need to separate the two roles so as to achieve better financial performance as decisions making process would

be more objective and faster. It is important to note that most of the SMMEs had actually embraced the presence of a board in their organization. This especially assisted in overall supervision and monitoring of the firm's activities thereby ensuring improved financial performance. Of importance to note is the positive effects attributed to adoption of proper corporate governance practices such as enhanced management, improved internal controls, increased growth opportunities, enhanced competitiveness and increased investor confidence.

It is undoubtedly clear the relevance of corporate governance mechanism as it imparts on both financial performance and managerial practice. The outcome also suggested that SMMEs have appreciated and incorporated corporate governance practices in the running of their business which has positively impacted their operations. However, it is vital to note that they are yet to fully embrace these practices mainly because most of them still consider it a large firm practice while others consider it too costly to implement both resource-wise and financially. Additionally, the lack of tailor- made governance practices to suit their operations has also been considered as an impediment to the implementation process. On the other hand, some consider the rigid government regulations to be a lagging factor.

Unquestionably, furthering knowledge on this relationship between corporate governance and financial performance, with particular emphasis on this sector (manufacturing), would trigger better formation of policy guidelines in order to assist all stakeholders in the governance of SMMEs. To this extent, management personnel are made conversant with best industry practice when it comes to corporate governance. Therefore, this study invigorates further discernment into this vital pillar of any organization that would build on further to the theory and enhance better appreciation of corporate governance mechanisms vis-a-vis financial performance of SMMEs in most emerging nations.

5.4 Recommendations

This study adds on to the vast knowledge of theory and academia and therefore recommends for other studies to be carried out in order to either reinforce the existing theory. For instance, studies on the specific corporate governance practices such as CEO duality and its impact on performance. This may be used to either support or bring a different perspective on the

stewardship theory. Additionally, the current business environment is rapidly evolving and thus studies done should reflect on the same whereby one may explore the external variables rather than the internal variables that have been the norm. They may also include studies on how executive compensation packages impact on performance. A wider scope of coverage could also be included in the study in order to come up with enhanced generalizations of the existing theories already in place.

Notwithstanding the above, the study also recommends for support from the relevant authorities including the government, bodies like the Centre of Corporate Governance (COCG) and Capital Markets Authority (CMA) in establishing sector based guidelines for enhanced adoption of corporate governance practices especially among the SMMEs. This would eliminate the notion of corporate governance being a large firm practice only. Moreover, the government should be able to make policies that will benefit the manufacturing sector and facilitate the realization of vision 2030. This study should be used by the Micro and Small Enterprises Authority (MSEA) in order to improve their regulatory framework by tailor- making structures and mechanisms that can be adopted by SMMEs which are crucial in enhancing sustainability, effectiveness, efficiency and improving productivity in their business operations.

The study recommends for adoption of corporate governance practices .This is because effective governance advances answerability, candidness, adeptness and rule of law in all institutions at all stages. Additionally, this permits sound and professional management of resources including financial resources for equitable and sustainable development. It was contended adopting return on assets as a gauge of financial performance provided confirmation that firms with superior governance have higher operating performance. Moreover, management of SMMEs should be better enlightened on the necessity of adopting and employing corporate governance in their firms. They should thus contemplate on the need of monitoring finance through the board to enhance accountability. They should also come up with statutes on appointment of the CEO and Chairman and clearly defining their roles separately. They should also increase improve on their board diversity by including more women in the boards as this has been seen to enhance performance.

5.5 Limitations of the Study

Taking into consideration the sensitivity of the matters concerning financial performance of small and medium manufacturing enterprises (SMMEs), majority of the sections keep their records confidential. Additionally, departments have inaugurated guidelines to treat with stringent discretion access to such information. Consequently, the researcher bumped into hurdles in obtaining this fundamental information however assurance of confidentiality was given to the respondents and also the introduction letter from the University gave assurance of the nature of the study.

Another major limiting factor encountered was that of time as the research was being carried out within a short time period. Nevertheless, this was neutralized by putting more emphasis on the respondents who were forth-coming with their information that enabled generalizations of the findings to the target population.

Lastly, this study was restricted to a sample of manufacturing SMEs thus making the outcome only applicable to firms that are similar to those under this review. However, this may not always be the case as similar studies done have had varied outcomes which may complement the one in this study.

5.6 Suggestions for Further Research

The study sought to find the effect of corporate governance practices on financial performance of small and medium manufacturing enterprises (SMMES) in Nairobi County. Thus further studies should be done in different sectors of the economy such as insurance firms, agricultural, mining, transport and banks. Replica studies should also been carried out in order to encompass a wider scope such as the inclusion of entities in other counties or states in order to determine whether similar conclusions gotten in this study will hold true.

Additionally, area for further studies could consider effect of individual corporate governance practices such as board composition, board independence and board diversity on financial performance of SMMEs. Such studies could apply different research instruments such as group discussions as this would allow for detailed information that would improve firm performance.

For instance, studies on whether CEO duality would contribute to better financial performance should be done with group discussion as one of the methods of collecting data.

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APPENDICES

APPENDIX 1: QUESTIONNAIRE

The objective of this research is to find, "The Effect of Corporate Governance Practices on the Financial Performance of Small and Medium Manufacturing Enterprises."

SECTION A: GENERAL INFORMATION

i. Name of respondent (optional)…………………………………………………………..

ii. Gender: Female [ ] Male [ ]

iii. Position of the respondent: Top Management [ ]

Senior Management [ ]

Junior Management [ ]

a. Name of your Entity………………………………………………………………….

b. Sector of operation of your organization (please mark below as appropriate)

Building, Mining & Construction [ ] Paper & Board [ ]

Pharmaceutical & Medical Equipment [ ] Chemical & Allied [ ]

Energy, Electrical & Electronics [ ] Plastics & Rubber [ ]

Food & Beverages [ ] Textiles & Apparel [ ]

Leather & Footwear [ ] Timber, Wood & Furniture [ ]

Metal & Allied [ ] Fresh Produce [ ]

Motor Vehicle Assemblers &Accessories [ ]

c. How long has your organization been in existence in the market (in years)

1-5 [ ] 6-11 [ ] 12-21 [ ] 22 and above [ ]

d. How many employees are in your organization?

1-20 [ ] 21-40 [ ] 41-60 [ ] 61-80 [ ] 81-100 [ ] 101 and above [ ]

e. Does your organization have any branches?

Yes [ ]   No [ ]

If yes, specify the number of branches………………………………………………

SECTION B: CORPORATE GOVERNANCE PRACTICES WITHIN YOUR ENTITY

CEO DUALITY

I. Is the CEO the same as the Chairperson of the Board within your organization?

Yes [ ]

No [ ]

II. Does the organization have clear and documented rules for appointment and removal of Chairperson?

Yes [ ]

No [ ]

If no, who makes the decisions for your organization? (Please specify)……………………………………………………………………………….

BOARD SIZE

III. What is the size of your board of directors? (mark as appropriate)

2-5 [ ] 6-9 [ ] 10- 13 [ ] 13 and above [ ]

IV. A larger board would provide more resources for your organization?

Yes [ ]

No [ ]

V. A smaller board would enhance your organization's performance?

Yes [ ]

No [ ]

BOARD DIVERSITY

VI. How many members of the board are: Male…………Female……………

VII. Is there a disclosure of academic qualification and professional qualification of each member?

Yes [ ]

No [ ]

BOARD INDEPENDENCE

VIII. Does the board have executive and non-executive directors?

Yes [ ]

No [ ]

If yes, how many are non-executive directors? (Please specify)………..

IX. Do the views of non-executive members have a significant weight in the board meetings?

Yes [ ]

No [ ]

X. Does the firm have a system of evaluating outside directors?

Yes [ ]

No [ ]

FREQUENCY OF BOARD MEETINGS

XI. Has the board agreed on a schedule of meetings?

Yes [ ]

No [ ]

XII. How often are board meetings held in one financial year? (mark as appropriate)

1-3 [ ] 4-6 [ ] 6-9 [ ] 10 and above [ ]

XIII. Which committees exist in your organization? (mark as appropriate)

Audit committee [ ]

Remuneration committee [ ]

Corporate Governance committee [ ]

Nominating committee [ ]

Ethics committee [ ]

Any other, (please specify)………………………………………………….

XIV. What is the frequency of committee meetings? (mark as appropriate)

Monthly [ ]

Quarterly [ ]

Half- yearly [ ]

Others (please specify)…………………………………………………………

XV. Does the board hold impromptu meetings to address urgent issues?

Yes [ ]

No [ ]

SECTION C: THE FINANCIAL PERFORMANCE OF YOUR ORGANIZATION

DATA COLLECTION TEMPLATE

YEAR	**2012**	**2013**	**2014**	**2015**	**2016**	**AVERAGE**
NET INCOME						
TOTAL ASSETS						

THANK YOU

APPENDIX 2: INTRODUCTORY LETTER

To Whom It May Concern

Dear Respondent,

<u>RE: MSC-FINANCE RESEARCH STUDY</u>

I am a student at the University of Nairobi pursuing a Master's degree in MSC- Finance. In partial fulfillment of the requirements of the award of the Master's degree, I am required to carry out a research and write on, "The Effect of Corporate Governance Practices on the Financial Performance of Small and Medium Manufacturing Enterprises in Nairobi County."

In this effect, I kindly request for your assistance by availing your time to respond to the questionnaire. The information hereby submitted will be treated with confidentiality and utmost good faith. A copy of the final report will be availed to you upon your request.

Your kind assistance will be highly appreciated.

Yours Faithfully,

Jennifer Osiako

D63/74580/2014

Email: jennifer.osiako@gmail.com

APPENDIX 3: LIST OF TARGET MANUFACTURING FIRMS

KAM MEMBERS IN NAIROBI COUNTY

1. BUILDING, MINING & CONSTRUCTION	**8. METAL AND ALLIED**
Deluxe Inks Ltd	Crystal Industries Ltd
Flamingo Tiles (Kenya)Limited	Devki Steel Mills Ltd
Glenn Investments Ltd C/O The Mehta Group Ltd	East Africa Spectre Ltd.
International Green Structures Manufacturing Kenya Limited	Easy Clean Africa Ltd.
Kenya Builders & Concrete Ltd	Elite Tools Ltd.
Koto Housing Kenya Ltd	Fine Engineering Works Limited
Orbit Enterprises Ltd	GZI Kenya Ltd
Pearl Industries Ltd	Heavy Engineering Ltd.
Sandblasting & Coating	Insteel Limited
Savannah Cement Ltd	Iron Art Ltd
Space and Style Ltd	Kab Kam Enterprises Ltd
Tana River Quarrying Ltd.	Kenyon Limited
Tile & Carpet Centre	Khetshi Dharamshi & Co. Ltd
2.CHEMICAL AND ALLIED	Mecol Limited
Crop Nutrition Laboratory Services Ltd	Metal Crowns Limited
Desbro Kenya Limited	Mitsubishi Corporation Nairobi Liaison Office
Diversey Eastern & Central Africa Ltd.	Modulec Engineering Systems Ltd
Evonik East Africa	Napro Industries Limited
Galaxy Paints Coating Co. Ltd.	Palak International Limited
H.B. Fuller Kenya Limited (Formerly Continental Products Ltd)	Prime Steel Limited
Henkel Polymer Company Ltd	Red Oak Limited
Highchem East Africa Ltd	Sheffield Steel Systems Ltd
IMCD Kenya Ltd (Formerly Chemicals and Solvents (EA) Ltd)	St Theresa Industries Kenya Limited
Interconsumer Products Ltd.	Steel structures Ltd

Kel Chemicals Limited	Sufuria World Limited
Ken Nat Ink & Chemicals Ltd	Tensiles EA Ltd
L'Oreal East AfricaLtd	Tononoka Rolling Mills Ltd
Maroo Polymers Ltd	Tononoka Steel Ltd
MEA Limited	Top Steel Kenya Limited
Mekan (Kenya) Limited	Towertech Africa Limited
Metoxide Africa Ltd	Varomotech Limited
Norbrook Kenya Limited	Vivek Investments Ltd
Odex Chemicals Ltd	Warren Enterprises Ltd
Orbit Products Africa Limited (Formerly Orbit Chemicals)	Welding Alloys Ltd
PolyChem East Africa Ltd	Wire Products Limited
Procter & Gamble East Africa Ltd	Zenith Steel Fabricators Ltd
Protea Chemicals Kenya Ltd	**9. MOTOR VEHICLE ASSEMBLERS & ACCESSORIES**
PZ Cussons EA Ltd	Alamdar Trading Company Ltd
Reckitt Benckiser (E.A.) Ltd	Dalcom Kenya
Rok Industries Ltd	Dodi Autotech
Sadolin Paints (E.A.) Ltd	Honda Motorcycle Kenya Ltd
Sanergy Ltd	Kibo Africa Ltd (formerly Koneksie Ltd)
Style Industries ltd (Previously Strategic)	King Finn Kenya Ltd
Syngenta East Africa Ltd	Labh Singh Harnam Singh Ltd
Synresins Ltd	Load Trailers
Tropikal Brand (Afrika) Ltd	Master Fabricators Ltd
Twiga Chemical Industries Limited	Megh Cushion Industries Ltd
Unilever Kenya Ltd	Mobius Motors Kenya Ltd
3. ENERGY,ELECTRICAL AND ELECTRONICS	Passion Profit Limited
Ibera Africa Power EA Africa	R.T. (East Africa) Limited
Kenwest Cables Ltd	Ruidu (Kenya) Company Linited

Kenya Power Co. Ltd	Scania East Africa Limited (Merged with Kenya Grange Vehicles)
Metlex International Ltd	Simba Caetano Formula Limited
Metsec Cables Ltd	Sohansons Ltd
Muhoroni Briquette Co. Limited	Theevan Enterprises Ltd
Nationwide Electrical Industries Ltd	Toyota Tshusho East africa Limited
Oilzone (East Africa)	Varsani Brakelinings Ltd
Patronics Services Limited	**10. PAPER AND BOARD**
Philips East Africa Limited	ASL Packaging Limited
Powerex Lubricants Limited	Avery Dennison Kenya Limited
Protel Studios	D. L. Patel Press (Kenya) Limited
Repelectric (K) Ltd	Digital Hub Ltd.
Siera Cables	Dodhia Packaging Ltd.
Socabelec (EA) Ltd	Economic Industries
Steam Plant Ltd	Elite Offset
Synergy Lubricant Solutions Ltd	Ellams Products
4. FOOD AND BEVERAGES	English Press Ltd.
Africa Spirits Ltd	Euro Packaging Ltd
Afrimac Nut Company	General Printers Ltd.
Danone Baby Nutrition Africa and Overseas	Green Pencils Ltd.
DPL Festive Ltd.	International Paper & Board Supplies Ltd
East African Sea Food Ltd.	Kenafric Diaries Manufacturers Ltd
Elekea Ltd.	Kenya Stationers Ltd
Elle Kenya Ltd.	Manipal International Printing Press Ltd
Erdermann Co. (K) Ltd.	Mega Pack (K) Ltd
Europack Industries Limited	Ndalex Digital Technology
Excel Chemicals Ltd	Paperbags Limited

Farmers Choice Ltd	Pressmaster Ltd
Frigoken Ltd	Printing Services Ltd
Giloil Company Ltd.	Punchlines Ltd
Global Fresh Ltd	Ramco Printing Works Ltd
Gonas Best Ltd.	Regal Press Kenya Ltd
Green Forest Foods Ltd.	Rodwell Press Ltd
Honey Care Africa	Sintel Security Print Solutions Limited
Kamili Packers Ltd	Skanem Interlabels Nairobi Limited
Kenafric Industries Limited	Statpack Industries Ltd
Kenya Nut Company Ltd	Taws Limited
Kenya Sweets Ltd	The Print Exchange Ltd.
Kenya Wine Agencies Limited	Twiga Stationers & Printers Ltd
Kevian Kenya Ltd	**11. PHARMACEUTICAL & MEDICAL EQUIPMENT**
Kuguru Food Complex Ltd	Dawa Limited
Kwality Candies & Sweets Ltd	Elys Chemicals Industries Ltd.
Landeco Ltd	KAM Industries Limited
Luma Stores & Supplies Enter. Ltd	Medisel Kenya Ltd
Melvin Marsh International	Medivet Products Ltd
Mini Bakeries (Nbi) Ltd	Pharm Access Africa Ltd
Mjengo Limited	Questa Care Ltd
Monwalk Investment Ltd	Regal Pharmaceuticals Ltd
NAS Airport Services Ltd	Vetcare Kenya Limited
Norda Industries Ltd	**12. PLASTICS AND RUBBER**
Olivado EPZ Limited	ACME Containers Ltd.
Palmhouse Diaries Ltd	Afro Plastics (K) Ltd
Promasidor (Kenya) Ltd	Coninx Industries Ltd.
Rafiki Millers Ltd.	Dune Packaging Ltd.
Razco Limited	Elgon Kenya Ltd.
Sahara Venture Capital Company Ltd	Eslon Plastics of Kenya Ltd

Sameer Agriculture & Livestock (Kenya) LTD	Finlay Brushware Ltd
SBC Kenya Limited	Five Star Industries Ltd
Sigma Supplies Ltd	Flair Kenya Ltd
Simply Foods Ltd	Jumbo Quality Products
Spice World Ltd	Just Plastics Limited
Stawi Foods and Fruits Limited	Kamba Manufacturing (1986) Ltd
Trufoods Ltd	L.G. Harris & Co. Ltd
Valuepak foods	Laneeb Plastic Industries Ltd
Vava Coffee Ltd	Packaging Masters limited
W. E. Tilley (Muthaiga) Ltd	Plastic Electricons
Winnie's Pure Health	Polyblend Limited
Wrigley Company (E.A.) Ltd	Polyflex Industries Ltd
Zheng Hong (K) Limited	Premier Industries Ltd
5.FRESH PRODUCE	Prosel Ltd
Flamingo Horticulture Kenya Limited	Safepak Limited
Fresh Produce Exporters Association of Kenya	Sanpac Africa Ltd
From Eden	Signode Packaging Systems Ltd
Kenya Horticultural Exporters (1977)	Silafrica Kenya Ltd (Formerly Sumaria Industries)
Mahee Flowers Limited	Silpack Industries Limited
Rainforest Farmlands Kenya	Solvochem East Africa Ltd
Salim Wazarani Kenya Company	Springbox Kenya Ltd
6. LEATHER AND FOOTWEAR	Styroplast Limited
Leather Industries of Kenya Limited	Super Manufacturers ltd
7. TEXTILES AND APPAREL	Techpak Industries Ltd
Dharamshi & Co. Ltd	Treadsetters Tyres Ltd
Hela Intimates EPZ LTD	Uni-plastics
Insight Kenya	Vectus Kenya Ltd
Kenya Trading EPZ Ltd	**13. TIMBER, WOOD & FURNITURE**
Manchester Outfitters Limited	Fine Wood Works Ltd

Mills Industry Ltd	GreenPot Enterprises
Oriental Mills Ltd	Kenya Wood Products Limited
Panah Limited	Marvel Lifestyle Ltd
Sunflag Textile & Knitwear Mills Ltd	Match Masters Ltd
Tarpo industries	Newline Ltd
Teita Estate Ltd	Panesar's Kenya Ltd
United Aryan (EPZ) Ltd	PG Bison Ltd
Vaja's Manufacturers Limited	Rosewood Furniture Manufacturers Ltd
	Shah Timber Mart Ltd
	Shamco Industries Ltd
	Woodmakers (K) Ltd
	Woodtex Kenya Ltd