THE EFFECT OF CORPORATE GOVERNANCE ON FINANCIAL PERFORMANCE OF INVESTMENT FIRMS LISTED AT THE NAIROBI SECURITIES EXCHANGE

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DECLARATION

This research project report is my original work and has not been presented for the award of a degree in this or any other university

Signature……………………………. Date ………………………………..

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The research project report has been submitted for examination with my approval as the University Supervisor.

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DEDICATION

To God the Almighty for the gift of life and good health during my scholarly period and for the insights He gave me during the entire process. To my loving family for their words of encouragement during my time of studying

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ABBREVIATIONS

NSE	Nairobi Securities Exchange
CMA	Capital Market Authorities
SPSS	Statistical Package for Social Sciences
ROA	Return on Assets

ABSTRACT

This paper examined the effects of corporate governance on the financial performance of investment firms in Kenya listed at the Nairobi Securities exchange. Through the research multiple corporate governance variables were examined; board size, board composition, board committees, board meetings and board gender diversity. The variable employed to measure financial performance was Return on Asset. A descriptive design was used in this study. The population involved in this study was all the 7 investment firms listed at Nairobi Securities Exchange (NSE) in Kenya for the period 2012 to 2016 which is believed to be long enough to provide a justified and rigorous regression analysis. Secondary sources were used to obtain information; data from the firms' published annual financial reports and from the NSE. The findings of the study show that the bigger the size of the board, the less effective the board in monitoring and the higher the agency cost. From the regression analysis, board size was found to negatively affect the financial performance of the investment companies listed at the NSE as it had a coefficient of – 6.46. On the effects of board composition and board committees on the financial performance of the listed firms, the study established that they affect the financial performance by a factor of 106.75 and 2.67 respectively. The study thus concludes that composition of the board and board committees positively influence financial performance of listed companies. There was no significant relationship between ROA, board meetings and board gender diversity

CHAPTER ONE

INTRODUCTION

1.1 Background of the study

Corporate governance as defined by (Capital Markets Act, 2002) is the structure and process used to manage and direct business undertakings of the firm in order to enhance success and corporate accounting while considering other stakeholders interests with realizing shareholders long-term value being the objective.

The idea of corporate governance is presently receiving much of consideration globally in both public and private sectors. It is all about how the control of a corporate entity is applied in the management of the entity's total asset portfolio and resources with an objective to sustain and grow shareholder value alongside fulfillment of the other stakeholders involved in the perspective of its corporate undertaking. It is also the processes by which corporate entities are directed and held accountable. Corporate governance incorporates the leadership, stewardship, answerability, authority, control and direction exercised in corporation (Centre for Corporate Governance , 2005).

The "principal-agent" or "agency" problem has conventionally been linked to corporate governance. This relationship, "principal-agent" comes about when the owner of a firm is different from the person managing and controlling the firm. For instance, financiers or investors (principals) employ executives (agents) to operate the firm. These investors require the executives' expertise to make proceeds on their investments, and executives on the other hand require the investors' funds as they may lack adequate resources to be able to invest on their own. A separation thus exists between the management and financiers of the firms.

1.1.1 Corporate Governance

In 2002, corporate governance guidelines for publicly listed firms at the Nairobi Securities Exchange were introduced by the Capital Markets Authority (CMA). The guidelines conceive their authorized base from the CMA Act under Section 12 which orders the CMA to create regulations and guidelines which are necessary in fulfilling its objective to ensure standardization of stock market activities.

In Kenya, the capital markets' corporate governance principles are applied on the "comply or explain" principle basis. Companies which are listed therefore need to conform to regulations and laws put down by the national assembly or the capital market authority. In an event that the company fails to comply with the laws, the directors of the company must give reasons for not complying, otherwise they face the serious sanction risks.

Listed companies, brokering firms and banking institutions mandated to perform as agents are required by the capital market authorities to file annual returns. Failure of a company to file returns, the directors of the company are required by law to give comprehensive reasons for failing to do so and in the event the directors fail to give reasons, the agent or the firm may then risk suspension from the activities of the stock market up to when it conforms with this prerequisite (Capital Markets, Regulations 2011)

From a study done by (Mboya & Wachudi, 2009), corporate governance is deemed to have gained importance in Kenya this being the case in other countries as well. This has been triggered to some extent by poor performance of public and private companies as well as by corporate failure (Hancock, Izan, & Barako, 2006).

1.1.2 Measures of Corporate Governance

Board Size: Most researchers unanimously agree that board size is linked to firms' performance. Nonetheless, some findings are contrary on whether it is a wide, rather than a small board that is more effective. Yermack (1996) claims that large boards are more likely to be slow in decision making hence can be a hindrance to change. (Lipton & Lorsch, 1992; Yermack 1996) have a second reason supporting small board size which is, directors seldom criticize top managers policies and this increases with the number of directors.

Board Committees: Laux and Laux (2006), argue that in order to enhance the productivity of the board, it's vital for boards to delegate functions of the board to smaller sub groups as this reduces free rider problem. A board of at least 6 committees with different roles is most preferred as it makes it possible for the board to discharge their duties and responsibilities effectively and efficiently. Such committee may include; audit, investment, nomination, remuneration, risk management, ethics, among others.

Board Meetings: According to Jensen (1993), board meetings are usually more formal, and the discussions are more focused on the daily affairs rather managers' assessment, which ultimately increase costs. A majority of the board are inactive; they would only interfere with the decisions of management in the exceptional circumstances.

Board Composition: Boards mostly compose of executive and non-executive directors. For effective working of board and for unbiased monitoring, at least one third of non-directors directors are preferred in board. Executive directors have insider knowledge of the organization which is not available to outside directors and this makes them important because they can misuse this knowledge by gaining from the wealth of other stockholders (Beasly, 1996).

Board Gender Diversity: There is a broader perspective in the board with the presence of gender diversity (council of microfinance equity funds, 2012). Resource dependence theory is in support of this argument. According to Adams and Ferreira (2009), there is increased monitoring activities in firms having more gender diversity in their boards.

1.1.3 Financial performance

Financial performance is a subjective measure of how well a firm can use assets from its primary mode of business and generate revenues

Rutagi, (1997) defines financial performance as to how well an organization is performing. Other researchers define performance of the organization as the extent to which an organization achieves its intended outcome, Namisi, (2002).

Management researchers prefer accounting variables as performance measures such as return on equity (ROE), return on investment (ROI), and return on assets (ROA), along with their variability as measures of risk. Earlier studies typically measure accounting rates of return. These include: (ROI), return on capital (ROC), return on assets (ROA) and return on sales (ROS) (Hendrik and Elaine 2009).

1.1.4 Corporate Governance and Financial Performance

Financial performance is an essential question for those investors who are concerned about the ethical consequences of their investments and, at the same time, want to obtain an adequate financial return from those investments.

Rajagopalan and Zhang (2009) firmly felt that investors gain confidence in those firms that practice good corporate governance and these firms are at added advantage in accessing capital compared to firms that lack good corporate governance.

Kenyan companies need to integrate ethics into their corporate culture and concentrate on putting appropriate corporate governance mechanisms in place (Muchoki, 2013). As the investors look for emerging economies to diversify their investment portfolios to maximize returns they are equally concerned about governance factors to minimize risks in these economies. The improvement of corporate governance practices is widely recognized as one of the essential elements in strengthening the foundation for the long-term economic performance of countries and corporations.

1.1.5 Investment Firms Listed at the NSE

Kenya Investment Authority (KenInvest) is a statutory body established in 2004 through an Act of Parliament (Investment Promotion Act No. 6 of 2004) with the main objective of promoting investments in Kenya. It is responsible for facilitating the implementation of new investment projects, providing After Care services for new and existing investments, as well as organizing investment promotion activities both locally and internationally. The core functions of KenInvest include; Policy Advocacy; Investment Promotion; Investment Facilitation which includes Investor Tracking and After Care Services.

Investment firms listed in the NSE include; Trans-Century Limited, Olympia Capital Holdings, Centum Investments, Home Africa, Kurwitu Ventures , Stanlib Kenya and Nairobi Securities Exchange Limited. Their Services include; construction and real estate, property development, sharia compliant investment products, property income funds just to mention a few.

Following the recent scandals at TransCentury that was linked to corporate governance failure, it is worth studying corporate governance and its impact on financial performance on investment firms. Investment Industry is a key participant in the economy of Kenya and so it requires uttermost focus.

1.2 Research Problem

According to (Miller C.A., 2010), (Bourne & Franco, 2003), existing studies on firms with good corporate governance practices have been observed to have an impact that is positive to their performance. It's paramount for companies to embrace good practices of corporate governance as this helps in preventing scandals, fraud as well as enhancing the image of an organization in the eyes of the public as one that is worthy of shareholder and debt capital holder. It also becomes essential for companies to improve firm performance, ensures investor rights, and enhances investment atmospheres well as encourages economic development (Braga & Shastri, 2011).

It is evident that the subject of corporate governance is a grey area for research interest in Kenya. A small number of studies have endeavored to uncover a range of concerns, this includes, (Hancock, Izan, & Barako, 2006), whereby the writers' chief focus was on Voluntary disclosure. Board gender diversity and how it affects the performance of commercial banks in Kenya was explored by (Mboya & Wachudi, 2009). (Opanga Bernard, 2013) studied the link between corporate governance and financial performance of insurance firms in Kenya.

Corporate governance has abundant effect on the entire wellbeing of the economic system in a country as shown by the variables of these studies, having great implications on the outcome and performance of the firms that have been studied. A similar result is reported by (Amba, 2013), on a study done in Bahrain on corporate governance and financial performance. The economic wellbeing of a nation mirrors the companies' performance. This therefore means that poor corporate governance principles lead to a reduced level of growth for developing nations. (David, Tobias Olweny, 2013). The present literature thus puts more focus on good corporate governance it being a key problem facing the development of countries, Kenya being one of them.

In Kenya, most studies have based their results on the insurance, banking, manufacturing and other service sectors thereby ignoring other sectors like the investment sector which is still predisposed to corporate governance issues as witnessed by the recent Trans Century Limited issue. Investment Industry is a key participant in the economy of Kenya and it's frightening to note that no research has been carried out on corporate governance's effect on the financial performance of investment firms in Kenya. This study hence sought to bridge the existing gap.

Therefore, this research strived to respond to the resulting query: How does corporate governance influence the financial performance of the investment companies listed at the NSE?

1.3 Research Objective

To examine the effects of Corporate Governance on financial performance of Investment Companies in Kenya listed at the NSE.

1.4 Value of the Study

Boards of corporations make key corporate decisions on investments, employment, portfolio management which eventually has an effect on the incomes, employment and livelihoods of the whole society. This study will thus help the boards to make sound and informed decisions.

The present study is therefore set to benefit the whole Kenyan society, together with the Kenya Investment Authority, the government and the investment companies in Kenya. The research is also generally significant for sensible, goal oriented executive and proficiency in decisions made by corporates which eventually influence the earnings achieved by the investment firms studied herein.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

The current crisis on the economy has led to the attention on corporate governance company practices globally. Governance as a fundamental driver of corporate performance is being given recognition more and more by the regulators and capital market authorities and the business community

2.2 Theoretical Literature Review

To explain the contributing factors of corporate governance, most scholars have reinforced their research by following three main theories. The theories include; the Stewardship Theory, Resource Dependence Theory, and lastly the Agency Theory.

2.2.1 The Stewardship Theory

The stewardship theory proposes that zero agency costs exist between principals (owners) and the agents (managers). The need to monitor the management to increase shareholders wealth is very minimal since the interests of the shareholders and managers are in harmony. The theory also comments that for greater efficiency in decision making by the board, the proportion of inside directors should be weighty.

This is for the reason that inside directors who are the Executive Directors are better familiar with the business and are thus better in making decisions in comparison to outside directors also known as Non-Executive Directors. There is an assumption that improved firm performance has a close relation with the decisions made by inside directors since their main aim is to maximize the wealth of shareholders (Davis, Schoorman, & Donaldson, 1997). To add on this, more arguments arise on the fact that directors for the fear of tarnishing their reputation tend to be very careful about their relationship with shareholders.

This study sought to find out whether among other variables the board size and board committees affects the financial performance of investment firms. The board acts as the stewards whose focus may not be to advance their interest but to promote the interest of the principals by pursuing both the objectives of their principals and their own objectives or interest at the same time (Davis et al., 1997). Various elements of the board were studied to establish whether they are acting as good stewards. Therefore, this justified the use of the theory in the study.

2.2.2 Resource Dependence Theory

Resource dependence theory was first contributed by Penrose (1959) with Chandler (1962) making significant contributions to it. These scholars argued that organizational resources are critical and significantly affect the organizations performance by creating a competitive advantage over the other firms.

Jonson et al.(1996) says that the theory is built on the idea that external directors to the company bring valuable expertise to the organization. According to him the organization significantly benefits for free of charge or at lower fee the expertise that it would otherwise highly paid for to get. For example an external director who is a lawyer offering free legal advice to the firm.

Hilman et al. (2000) says that directors play a significant role in accessing resources that are critical to the company as a result of their connections to the external environment. According to his argument directors appointed to the firm should be on the basis of what advantage are they bringing to the firm.

Peace et al.(2012) argue that it is in the firms directors that organizational competitiveness can be achieved and sustained while Eisenhardt and Martin (2000) add saying that an organization can only be competitive if its resources are valuable, unique in the sense that cannot be replicated and non-substitutable. According to them it is this competitive advantage that brings the difference on performance of various organizations in the same industry.

The study focused on board committees and their effect on financial performance of investment firms. Such committee may include; audit, investment, nomination, remuneration, risk management, ethics, asset liability management as well as policyholder protection committees. The board members need to be a resourceful and skillful to be able to spear head the committees effectively, hence the relevance of this theory to this study.

2.2.3 Agency Theory

The theory of Agency according to Jensen & Meckling, (1976) has been viewed as the common framework well-thought out in evaluating mechanisms of internal corporate governance. Agency theory majorly focuses on difficulties that arise due to conflict of interest between principal and agent. It essentially describes how costs of inefficiencies generated through the unhealthy relationship between shareholders and manager affect the performance of a firm. (Morck, Shleifer, & Vishny, 1988), reasoned that though greater levels of ownership minimize traditional agency problem caused by the split-up of ownership and control, two new problems still creep in. These problems are owed to the following reasons;

Firstly, entrenchment effects may come about as a result of the outrageous increase in managerial shareholding and have a smaller exposure to external and internal governance mechanisms.

Secondly, fresh problems involving several principals with different goals are converted by these huge block holdings from the ancient principal agent problem. These dissimilarities between principal-principal goals cause distrain of minority shareholders and bondholders and have become a key worry in emerging nations. This is according to (Dharwadkar, George, & Brandes, 2000).

(Henry, 2004) Notes that managers pay more attention to their interests at the expense of shareholders by making out of order investment decisions, availing huge perks and engaging in fraudulent practices. The managers, nonetheless, are at the risk of an aggressive takeover or could be acquired by prevailing shareholders. Shareholders are thus interested in inspecting managerial behavior.

This study established whether board size, board committees and board composition has an impact on the financial performance of investments firms. The shareholders are the principal while the board members are the agents. The shareholders have yielded decision making authority to the board. The shareholders have rights which the board should respect and uphold. The board is also under the obligation to disclosure some information to shareholders and to be transparent in their operations. Since the study focused on shareholders as principal and board as the agents, it justifies the use of the theory.

Corporate governance systems seem to differ all over the world. However, a joint opinion exists among various stakeholders that given measures should be put in place in order to lessen matters of bribery, misconduct and corruption by making sure corporate transparency and disclosure is observed.

2.3 Measures of Financial Performance

2.3.1 Asset Turnover

Total asset turnover also referred to as asset utilization ratio measures the efficiency of a firm to get revenues by utilizing its assets as defined. This is defined by Jose (2010). Pricing strategy is indicated by this ratio. Businesses with a high asset turnover have low profit margins, and those with high profit margins tend to have a low asset turnover.

2.3.2 Leverage Ratios

A firm's ability to meet its obligation in the long-term can be addressed through leverage ratios. Leverage ratios indicate a firm's level of financial leverage which shows the ability of the firm to manage their economic exposure to unexpected losses (Adam and Buckle, 2003)

2.3.2 Internal Factors

Internal factors such as capital size, size and composition of credit portfolio, labour productivity, size of deposit liabilities, interest rate policy are variables specific to specific firms which influences their profitability. The factors differ from firm to firm and are within the firm's scope to manipulate them.

2.4 Empirical Literature Review

Halder et al (2013) examines the usefulness of the presence of independent directors on firm value in Indian companies using both market based performance measure Tobin's Q and accounting based ratios Economic Value Added ROA and ROE. They considered 200 firms listed in India and collected data of period 2004–2007. They found that independent directors insignificantly affect firm value except in the case of ROE. Generally they noted that that independent directors positively impact financial performance (ROE) when they are in majority and when they are in minority, instead of adding value, independent directors have a negative impact on firm values.

A study by Khurelbaatar and Bavuudorj (2013) on corporate governance mechanisms and firm performance in the Mongolian Stock Exchange revealed that determinants of corporate governance are not correlated to the performance measures of the organization. The model showed that corporate governance don't affect companies return on equity and return on assets. This analysis mainly focused on the relationship between return on equity (ROE) and return on assets (ROA) and the total corporate governance index. The results of the study provide evidence that the corporate governance measures are negatively related with ROE and ROA which were used as the financial performance measures.

Olweny, (2013) conducted a research on corporate governance and its effect on the financial performance of insurance firms listed in Kenya. The variables used to represent corporate governance were; board composition, leverage and CEO duality. The firm's performance was measured using ROA and ROE. Descriptive research design was adopted. The study established that a very strong relationship exists between the corporate governance practices (under study) and the financial performance. Board composition and leverage positively affected the firm financial performance. Board size effect on the financial performance was negative. Role of CEO and Chair if separated positively influenced the financial performance of the insurance firms.

The study by Kayitesi Raissa, (2013) sought to examine corporate governance's effect on financial performance of commercial banks in Rwanda with board sub-committees, board composition, board size and board meetings being the independent variables. ROA was used as a representation of financial performance. The study embraced a descriptive research design to explore the link amid corporate governance and financial performance of commercial banks in Rwanda. The outcome of the study was that all measures of corporate governance are not significant predictors of financial performance of commercial banks in Rwanda. The board size, board composition, the sub-committees and board meetings were found to be insignificant in explaining the profitability of commercial banks in Rwanda.

Albert Wandera, (2014) researched about corporate governance's impact on financial performance of Insurance companies in Kenya. In the research study, he embraced a descriptive research design and all 49 companies registered in Kenya were investigated. He used multiple linear regression to determine the relationship among variables. The findings of the study showed that indeed corporate governance influences the financial performance of insurance companies in Kenya. He established that, leverage and board composition significantly influences performance of insurance companies. However, the performance is not significantly influenced by board size and the numbers in the risk committee.

Myles Fondo's, (2016) study focused on state owned corporations in the service industry in Kenya. It looked at the correlation between corporate governance and financial performance of the aforementioned Industry. Financial performance of the state owned corporations was measured return on assets while the corporate governance attributes used included board composition, board size, independence of committees and duality. The study used descriptive research design. The study population was 127 state owned corporations and a sample of 50 was selected for the study. Data were obtained from 35 out of the 50 selected corporations and analyzed using descriptive statistics and multiple regression analysis between the months of September2016 and November 2016. In conclusion, the research yielded a correlation which is positive between corporate governance and financial performance. ROA was used as a representation for financial performance. This means that practicing good corporate governance enhances the financial performance of state owned corporations

The above empirical review evidently proves that corporate governance significantly affects the financial performance of firms and therefore should be treated with a lot of attention. Great corporate governance spares the association from different misfortunes, for example those occasioned by fraud, comparable irregularities.

2.5 Conceptual Framework

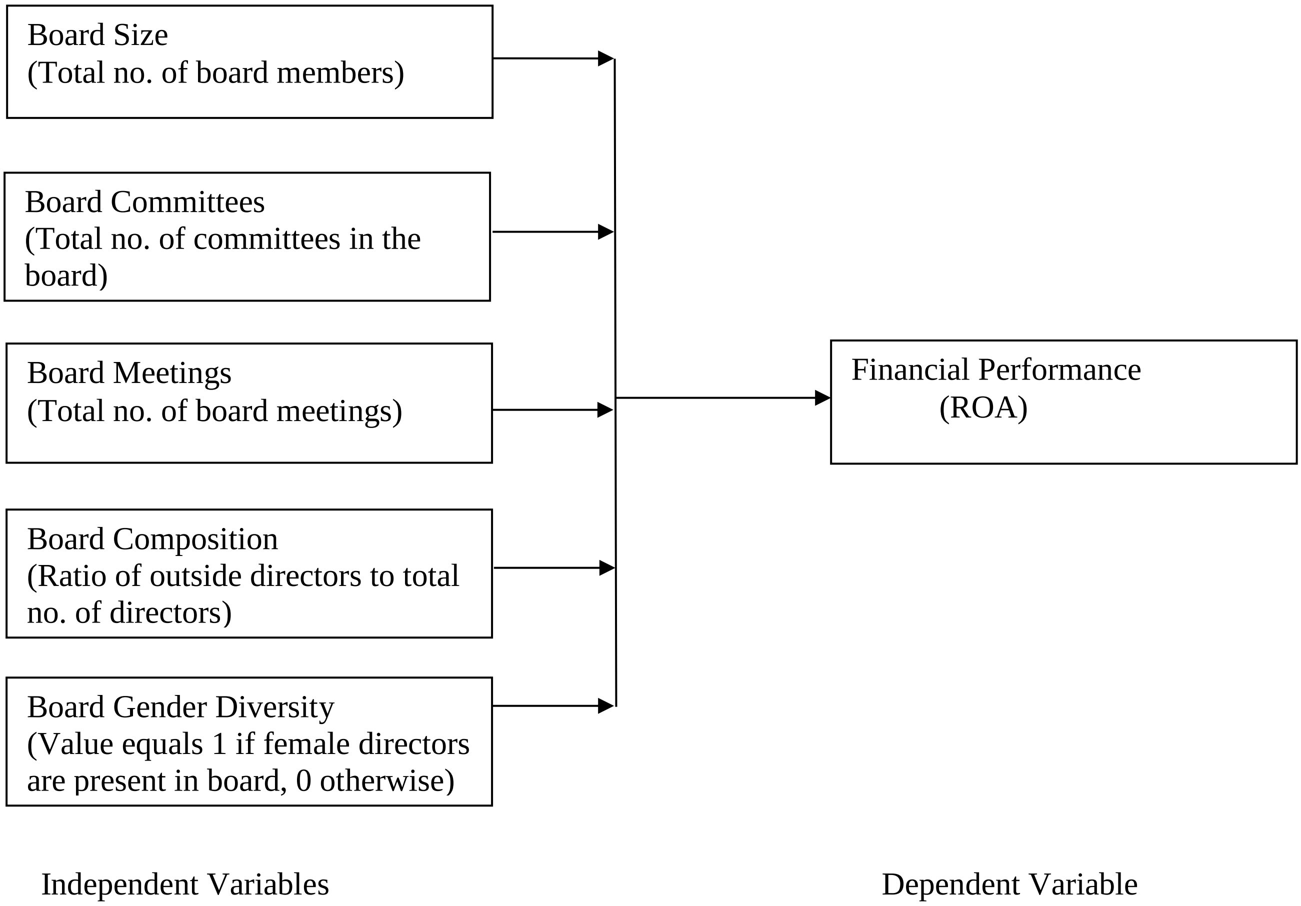

Figure 2.1: Conceptual Framework

2.5.1 Board Size

Most researchers unanimously agree that board size is linked to firms' performance. Nonetheless, some findings are contrary on whether it is a wide, rather than a small board that is more effective. Yermack (1996) claims that large boards are more likely to be slow in decision making hence can be a hindrance to change. (Lipton & Lorsch, 1992; Yermack 1996) have a second reason supporting small board size which is, directors seldom criticize top managers policies and this increases with the number of directors.

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According to Jensen (1993), board meetings are usually more formal, and the discussions are more focused on the daily affairs rather managers' assessment, which ultimately increase costs. A majority of the board are inactive; they would only interfere with the decisions of management in the exceptional circumstances.

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Boards mostly compose of executive and non-executive directors. For effective working of board and for unbiased monitoring, at least one third of non-directors directors are preferred in board. Executive directors have insider knowledge of the organization which is not available to outside directors and this makes them important because they can misuse this knowledge by gaining from the wealth of other stockholders (Beasly, 1996).

2.5.6 Board Gender Diversity

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2.5.7 Financial Performance

Return on asset is an indicator of how profitable a company is related to its total assets. It gives a view as to how efficient management is at using its assets to generate earnings, that is, it measures efficiency of the business in using its assets to generate net income. It is a profitability ratio. Calculated by dividing a company's annual earnings by its total assets, ROA is displayed as a percentage. Sometimes this is referred to as "return on investment".

Return on assets is the ratio of annual net income to average total assets of a business during a financial year. Net income is the after tax income. It can be found on income statement. Average total assets are calculated by dividing the sum of total assets at the beginning and at the end of the financial year by 2.

Total assets at the beginning and at the end of the year can be obtained from year ending balance sheets of two consecutive financial years. The formula to calculate return on assets is:

ROA = Annual Net Income/Average Total Assets

2.5 Summary of Literature Review

There is evidence from the various empirical studies reviewed that the financial performance of any organizations is impacted by corporate governance practices. However the level of relationship varies from one organization/ industry to another.

In Kenya most studies done on corporate governance have mainly been on financial institutions that is banks and insurance companies and other service sectors. Because of the shortage on the topic on other industries, the study tried to discover the corporate governance effect on the financial performance of listed Investment companies in Kenya.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter built upon the last two chapters to provide the 'how' of addressing the research objectives put forward. Evidently, the study was quantitative in approach. This chapter therefore considering this approach developed the procedure of arriving at the results of the study. With this in mind, a clear direction was established and clarity of the method put out. The chapter began by defining and bringing close what and why quantitative research technique was the approach of this research.

3.2 Research Design

The research adopted descriptive research design method. (Dooley, 2007), points out that the structure of a research is a research design. A good research design should be able to gather as much information as possible while providing various avenues of researching the same problem (Kothari, 2004)

The choice of the descriptive study design was based on the fact that the research was interested on the state of affairs already existing in the field and no variable was manipulated. This study therefore generalized the findings to a larger population. The main focus of this study was quantitative.

3.3 Population

This study targeted the listed investment companies in the Nairobi Securities Exchange. This is because these companies have their financial records and performance publicly available, their performances therefore is sanctioned by the economic forces interacting in the stock market, which intern determine their stock prices in the stock market.

Their performances in the market generally determine their profits and hence dividends to the shareholders. This study interrogated this performance in relation to the decision made by the board or management as a whole. The choice of these firms gave the study a clear direction for such finding which intern was generalized to the rest of investment companies in Kenya.

The study therefore settled for the entire population of the listed investment companies in the NSE (Appendix 1). The study period ranged from 2012-2016 which is believed to be long enough to provide a justified and rigorous regression analysis

3.3 Data and Data Collection Instruments

Secondary data was used in the study and it was gotten from the publications and financial reports of firms in the current study. Data was also acquired from the Nairobi Securities Exchange.

Since the study adopted secondary data for the entire population of the entire listed investment companies in Kenya, the data collection was through the quantitative analysis of the secondary data for return on assets, board size, board committees, board composition, board meetings and board gender diversity of the seven investment companies in the study.

3.4 Data Analysis

Quantitative Data was collected and therefore analysed by descriptive analysis techniques. The main terms of measurement for the variables are described as shown in the table below.

Table 3.1 Description of Variables

Variable	Notation	Predicted Effect	Terms of Measurement
Return on Assets	ROA	Significant	Percentage of net income divided by average total assets
Board Size	BS	Positive	Entire number of directors on the board
Board Committees	BCOMM	Positive	Entire number of committees in the board.
Board Composition	BOCOMP	Positive	Ratio of outside directors to total number of directors
Board Meetings	BM	Positive	Total number of Board meetings
Board Gender Diversity	BGD	Positive	Value equals 1 if female directors are present in board, 0 otherwise.

3.4.1 Conceptual Model

Multiple linear regression analysis was employed in this research study with the ROA as a representation of the company's financial performance and being a dependent variable and independent variables consisting of board size, board committees, board composition, board meetings and board gender diversity.

The regression equation is as follows;

$ROA = f\,(BS, BCOMM, BM, BCOMP, BGD)$

3.4.2 Analytical Model

This is the algebraic expression of the conceptual model. It has the constant term, the coefficients, and the error term.

The relationship between the variables of corporate governance and financial performance would therefore be determined through below equation:

$$\boldsymbol{ROA_t = \alpha_0 + \alpha_1 BS_t + \alpha_2 BCOMM_t + \alpha_3 BM_t + \alpha_4 BOCOMP_t + \alpha_5 BGD_t + \varepsilon_t}$$

Whereby:

ROA_t =Return on Assets at time t

BS_t = Board Size at time t

$BCOMM_t$ = Board Committees at time t

BM_t = Board Meetings at time t

$BOCOMP_t$ = Board Composition at time t

BGD_t = Board Gender Diversity at time t

α_0 = is an intercept that captures all other explanatory variables which affect Return on Assets, but are not captured in the model.

$\alpha_1, \alpha_2, \alpha_3, \alpha_4, \alpha_5$ = are the coefficients of financial performance (measured using Return on Assets) with respect to Board Size, Board Committees and Board Meetings, Board Composition and Board Gender Diversity respectively

ε_t = is the error term

3.4.3 Diagnostic Tests

These are procedures used to examine the variables and steps taken to control for extraneous influences that might threaten the findings of the study. Joppe (2009) explained that in quantitative research, validity defines whether the research accurately measures what it is planned to measure. According to Mugenda & Mugenda, (2003) reliability is a measure of how the research instrument produces consistent results after repeated trials.

The analysis was subjected to robustness checks in order to have authority in the econometric model output. This study administered the following test;

a. Normality Test

Normality tests are used to determine if a data set is well-modeled by a normal distribution and to compute how likely it is for a random variable underlying the data set to be normally distributed.

The study carried out a skewness/kurtosis tests for normality.

b. Heteroskedasticity

One of important assumption of Regression is that the variance of Error Term is constant across observations. If the error has constant variance, then the errors are called homoscedastic, otherwise heteroscedastic. In case of heteroscedastic errors (non-constant variance), the standard estimation methods becomes inefficient.

White test (Halbert White, 1980) proposed a test which is very similar to that by Breusch-Pagen. White test for Heteroskedasticity is general because it does not rely on the normality assumptions and it is also easy to implement. Because of the generality of White's test, it may identify the specification bias too. Both White's test and the Breusch-Pagan test are based on the residuals of the fitted model.

3.4.4 Significance Tests

The test of significance used was analysis of variance (ANOVA). This means, variances and standard deviation of the variables used in the study were calculated and compared and interpretation drawn using stata application.

CHAPTER 4

DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This section gives an analysis of data in terms of descriptive as well as inferential statistics. In particular, section 4.2 discusses summary statistics, section 4.3 discusses the results for diagnostic test, section 4.4 discusses the results of regression analysis, section 4.5 presents the discussion and section 4.6 presents the summary.

4.2 Summary Statistics

Table 4.1 Summary Statistics

Variable	Variation	Mean	St. Dev	Min	Max
ROA	**overall**	7.48	10.03	-9.16	25.82
	between		10.23	-3.05	18.68
	within		4.24	-1.84	14.62
BS	**overall**	8.80	2.17	5.00	14.00
	between		1.90	6.00	10.20
	within		1.36	6.60	12.60
BCOMM	**overall**	4.60	1.93	3.00	9.00
	between		2.09	3.00	7.40
	within		0.52	3.60	6.20
BM	**overall**	5.85	3.30	4.00	18.00
	between		2.70	4.00	9.80
	within		2.26	3.05	14.05
BOCOMP	**overall**	0.288	0.13	0.05	0.51
	between		0.12	0.11	0.36
	within		0.63	0.22	0.47
BGD	**overall**	0.95	0.22	0.00	1.00
	between		0.10	0.80	1.00
	within		0.21	0.15	1.15

Source; Research Findings

From the summary, we can observe that the dependent variable, return on assets, has a mean of 7.48 and varies from -9.16 to 25.82. Standard deviation of the variable is 10.03 but it had between standard deviation and within standard deviation of 10.23 and 4.24 respectively.

The variable on board size had a mean of 8.80 and varied from 5 to 14 board members. Overall standard deviation of the variable was 2.17 but it had between standard deviation and within standard deviation of 1.9 and 1.36 respectively.

Board committees had a mean of 4.6 and varied from 3 to 9 committees. Overall standard deviation of the variable was 1.93 but it had between standard deviation and within standard deviation of 2.09 and 0.52 respectively.

Variable representing board meeting had a mean of 5.85 and varied from 4 to 18 meetings. Overall standard deviation of the variable was 3.30 but it had between standard deviation and within standard deviation of 2.7 and 2.26 respectively.

Board composition had a mean of 0.288 and varied from 0 to 1. Overall standard deviation of the variable was 0.13 but it had between standard deviation and within standard deviation of 0.05 and 0.51 respectively.

Board Gender diversity had a mean of 0.95 and varied from 0 to 1. Overall standard deviation of the variable was 0.22 but it had between standard deviation and within standard deviation of 0.12 and 0.63 respectively.

The study therefore notes that there is more variation in most variables between the companies than it is within the company itself over time. For instance on the variables on return on assets and size. Some also portray an almost equal variation within and between the companies.

4.3 Results of Diagnostic Tests

These are procedures used to examine the variables and steps taken to control for extraneous influences that might threaten the findings of the study. Joppe (2009) explained that in quantitative research, validity defines whether the research accurately measures what it is planned to measure. According to Mugenda & Mugenda, (2003) reliability is a measure of how the research instrument produces consistent results after repeated trials.

Classical linear regression model (CLRM) assumptions showed that using the ordinary least squares (OLS) estimators' possessed desired properties for hypothesis tests to be validly and reliably carried out.

4.3.1 Normality test

Table 4.2 Skewness/Kurtosis tests for Normality

Variable	Pr (Skewness	Pr (Kurtosis)	adj chi2 (2)	Prob>chi2
Roa	0.125	0.000	11.75	0.0028
Bs	0.506	0.234	2.00	0.3686
Bcomm	0.000	0.085	12.58	0.0019
Bm	0.012	0.342	6.53	0.0382
Bocomp	0.000	0.056	13.02	0.0015
Bgd	0.000	0.000	25.21	0.0000

The study carried out a skewness/kurtosis tests for normality. The study found that the data was normally distributed as the two measures approached zero and therefore concluded that the data was normally distributed and could go ahead to carry out a linear regression on the variables.

4.3.2 Heteroskedasticity

Breusch-Pagan / Cook-Weisberg test for heteroskedasticity

Ho: Constant variance

Variables: fitted values of Roa

chi2 (1) = 0.04

Prob > chi2 = 0.8354

Imtest, white

White's test for Ho: homoskedasticity

Against Ha: unrestricted heteroscedasticity

chi2 (13) = 13.54

Prob > chi2 = 0.4069

Cameron & Trivedi's decomposition of IM-test

Table 4.3 Test for Heteroscedasticity

Source	**chi2**	**df**	**p**
Heteroskedasticity	13.54	13	0.4069
Skewness	9.04	5	0.1074
Kurtosis	0.05	1	0.8226
Total	22.63	19	0.2539

From the test it is evident that the computed ϴ (half of ESS) does not exceed the critical Ҳ2 (chi-square) at 5% level of significance, hence we fail to reject the hypotheses of homoscedasticity. This implies that the variances of the error term do not vary across observations. Therefore the data does not suffer from heteroscedasticity hence the OLS estimators will have minimum variances.

4.4 Results of Correlation Analysis

Presents the results of the correlation analysis which was done to examine any serial correlations among the independent variables which, when entered into the model for regression analysis, would lead to spurious results.

Table 4.4 Results of Correlation Analysis

	Roa	Bs	Bcomm	Bm	Bocomp	Bgd
Roa	1.0000					
Bs	0.0577	1.0000				
Bcomm	0.8052	0.3574	1.0000			
Bm	0.6197	0.0693	0.6599	1.0000		
Bocomp	0.3590	0.9262	0.5519	0.2482	1.0000	
Bgd	0.1657	0.1955	0.1951	0.0607	0.1461	1.0000

The Table also shows that the ROA is positively related to board size, board committee, board meetings, board composition and board diversity. The positive relationship between ROA and board committee can be explained by the fact that firms which maintain various board committees then have a higher efficiency in board performance and thus interpreted into the return on assets. The correlation coefficients are significant at 5% level of significance.

4.5 Results of Regression Analysis

Panel models were employed to look at the relationship between the variables of corporate governance and financial performance would therefore be determined through below equation:

$$ROA_t = \alpha_0 + \alpha_1 BS_t + \alpha_2 BCOMM_t + \alpha_3 BM_t + \alpha_4 BOCOMP_t + \alpha_5 BGD_t + \varepsilon_t$$

The study carried out five panel data model whose results were estimated and the best fit model was used to draw inferences for the study. The panel data model estimated Pooled OLS regression. This was to ensure use of estimators that are consistent and at the same time ensuring efficiency.

Table 4.5 Summary Model

ROA	BS	BCOMM	BM	BOCOMP	BGD	Constant	R2	Adj R-squared	Prob > F
Pooled OLS regression	-6.46*	2.67*	0.11	106.75*	6.30	14.63	0.86	0.81	0.0000
	(-4.35)	(3.03)	(0.27)	(3.79)	(1.32)	(1.88)			

Source; Research Findings

The table shows the results of the regression using various estimators. Values in parenthesis represent the t values of the estimators and the values with stars are statistically significant at 95% confidence level.

4.6 Discussion

From the findings, some of the coefficients were not significant. The board size variable was significant in at 95% confidence level. The value of the coefficient was -6.46 implying that for every unit increase in the board member, then the return on assets of the company decreases by 6.46 times. This can be thought to be caused by an increase in the operating expenses due to addition of a board member.

For the board committees the estimator resulted into statistically significant coefficient at 95% confidence level. The board committee variable was statistically significant with a coefficient value of 2.67. This meant that an increase in number of board committees by a one would translate into an increase in the return on assets by 2.67 units. This is because increase in board committees translates into increased efficiency of the board in its strategic role.

Board meetings estimator was statistically insignificant at 95% confidence level. The value of 0.11 meaning that for every increase in board meeting by one would lead to an increase in the return on asset by 0.11 units.

Board composition was statistically significant at 95% confidence level. The value of coefficient was 106.75 meaning for every increase in the board composition by one unit leads to an increase in the return of assets by 106.75 times. This is because an increase in board composition translates to increased independence of the board hence better decision making.

Board gender diversity variable was also statistically insignificant. The value of the coefficient was 6.30 implying that for every increase in board gender diversity, lead to increase in the return on assets by 6.30 times. The R-squares show the estimator can explain 86% of the dependent variable.

4.7 Summary

There was a significant relationship between ROA, board size, board composition and board committees. There was no significant relationship between ROA, board meetings and board gender diversity. Board size was found to negatively affect the financial performance of the investment companies listed at the NSE as it had a coefficient of – 6.46. On the effects of board composition and board committees on the financial performance of the listed firms, the study established that they affect the financial performance by a factor of 106.75 and 2.67 respectively. The study thus concludes that composition of the board and board committees positively influence financial performance of listed companies

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Introduction

The chapter provides the findings summary from chapter four as well as gives the conclusions and recommendations of the study based on the study's objectives. The objective of the study was to determine the effect of corporate governance on financial performance of investment companies in Kenya. The chapter also presents the limitations of the study and recommendations for any further research on the subject matter of the present study.

5.2 Summary of the Study

The study examined the relationship that exists between firm performance, using ROA and five corporate governance mechanisms (board size, board composition, board meetings, board committees and board gender diversity). A population size of 7 listed investment companies for the period 2012 - 2016 was used. The method of analysis was multiple regressions and the method of estimation was Ordinary Least Square.

The study revealed the following results: There was a significant relationship between ROA, board size, board composition and board committees. There was no significant relationship between ROA, board meetings and board gender diversity.

From the study, it was established that the bigger the size of the board, the less effective the board in monitoring and the higher the agency cost. From the regression analysis, board size was found to negatively affect the financial performance of the investment companies listed at the NSE as it had a coefficient of – 6.46. On the effects of board composition and board committees on the financial performance of the listed firms, the study established that they affect the financial performance by a factor of 106.75 and 2.67 respectively. The study thus concludes that composition of the board and board committees positively influence financial performance of listed companies.

5.3 Conclusion

From the findings on the effect of board size on the financial performance of the listed investment firms, the study found a significant influence. From the regression analysis, board size was found to negatively affect the financial performance of the listed investment firms at the NSE. On the effects of board composition and board committees on the financial performance, the study established they do have a positive influence on the financial performance of the listed investment firms. Board meetings and board gender diversity were found to have no significant influence of financial performance of the said listed firms.

The study concludes that corporate governance is important to investment companies and is an ingredient to better financial performance. The study therefore prescribes that firms' to adopt appropriate corporate governance structures so as to achieve higher financial performance.

5.4 Recommendation for Policy

The study recommends that board size, board composition and board committees to be considered since they affect the financial performance of the investment companies listed at the Nairobi Securities Exchange. The number of non-executive directors needs to be selected keenly since they have a huge effect on the financial performance of the firms.

Investment firms should embrace best practices of corporate governance. This will in turn improve their financial performance. Embracing good corporate governance will also ensure adequate risk management measures are put in place and that standards are not only in writing but that they are practiced as a daily routine. The board should establish proper structures to compel the investment firms' management to implement good corporate governance by installing strong control mechanisms.

5.5 Limitations of the Study

The researcher encountered difficulties in acquiring secondary information from the examined variables of a portion of the investment companies since some of these investment companies did not reveal a few perspectives of corporate governance or had not yet posted the published financial reports as at the time of this research.

5.6 Suggestions for Further Research

To start with, the study concentrated on a few parts of corporate governance. Future studies ought to concentrate on different parts of corporate governance in organizations. The studies should take into contemplations different variables influencing the financial performance. This will empower generalization of the findings.

This study focused entirely on the investment companies that are listed on the Nairobi Securities Exchange only and this may not be the actual representation of other firms. To enable generalization of the research findings, future researchers could consider carrying out a similar study in a different sector or sectors to assess any variation in responses. Additionally, other variables of corporate governance should be considered other the ones investigated by this study.

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APPENDIX 1: LIST OF INVESTMENT COMPANIES LISTED AT THE NSE

No.	Name of Investment Company
1	Centum Investment Company Limited
2	Olympia Capital Holdings Limited
3	Trans-Century Limited
4	Home Afrika limited
5	Kurwitu
6	Nairobi Securities Exchange Limited
7	Stanlib Fahari