

**EFFECT OF CORPORATE GOVERNANCE ON
FINANCIAL PERFORMANCE OF CROSS-LISTED FIRMS
IN EAST AFRICA COMMUNITY SECURITIES
EXCHANGES**

BY

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OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE
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DECLARATION

This Research Project is my original work and has never been submitted for a degree in any other University.

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Date

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This Research Project has been submitted for examination with my approval as University Supervisor.

Signed.....

Date

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DEDICATION

I would like to dedicate this study to my son Liam, for being my source of motivation for completion of this course.

May God bless you.

ACKNOWLEDGEMENT

I wish to express my sincere appreciation to my family for their understanding and support during the project.

I would also like to express my sincere thanks to the supervisor Dr. Duncan Elly Ochieng for having agreed to supervise this research paper and his patience in reading the drafts and guiding me, without which the research would not have been a reality.

Lastly, I thank Almighty God for his guidance and providence which enabled me to undertake this project.

ABBREVIATIONS

EAC:	East Africa Community
CEO:	Chief Executive Officer
EABL:	East Africa Breweries Limited
KCB:	Kenya Commercial Bank
OECD:	Organization for Economic Cooperation and Development
NMG:	Nation Media Group

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ABSTRACT

The objective this study is to investigate the effect of corporate governance on financial performance of cross-listed firms in East Africa community securities exchanges. The study utilized secondary data that was collected from respective firms and their websites. The sample of the study was five cross-listed firms that were listed in the Nairobi Stock Exchange and a five-year data was collected from 2011 to 2015. Regression and correlation analysis was utilized in analyzing the secondary data that was collected. The study established that cross-listed firms in East Africa community securities exchanges have no CEO duality since the role of the CEO and the board chair were found to be clearly separated. There were small variations among the firms as far as board composition and size and ownership structure and control were concerned. Moreover, all the firms were owned by shareholders. In addition, the range for the number of directors was between 8 and 17. Furthermore, there were significant inverse relationship between return on assets and ownership structure. In addition, there was strong positive relationship between ROA and board size and composition. Multivariate regression results revealed that corporate governance accounts for 50.2 percent of the ROA of cross-listed firms in East Africa community securities exchanges. The implication of this is that; the independent variables of board size and composition and ownership structure explain 50.2 percent of the variance in the financial performance of cross-listed firms in East Africa. The study recommended that cross-listed firms in East Africa community securities exchanges should seek always to improve their corporate governance practices since they account for significant portion of their financial performance. However, further research will be required on the same topic but over a longer duration of time such as 20 years. A comparative study may also be done to compare companies in other countries as well as replicating the study after another five years to observe the trend.

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

Corporate financial scandals have hit many firms across the globe in the recent past and this has drawn attention to corporate governance issues among corporate institutions. Investors are more interested than ever before to invest in markets that have lower risk and better corporate governance structures in order to maximize their returns (Amba, 2012). Sound corporate governance is the recipe for good financial performance of any organization since it ensures better management, fair, efficient and transparent administration that enables an organization to meet clearly defined objectives. A well-functioning corporate governance system provides an organization with the opportunity to enhance its performance in all aspects (Bairathi, 2009).

This study is based on three theories. The first theory is the shareholder theory which has a combination of two main theories. The first theory is the principal agent theory. According to Coelho *et al.* (2003) and Friedman (1970), the assumption that the main aim of a corporation was maximization of shareholder wealth was the basis of development of the principal agent theory. In this regard, the model views the self-regarding behavior by management in a general principal-agent relationship as main challenge of corporate governance. The myopic market model agrees with this model that the organizations should only serve the interests of the shareholders. The second theory is the stakeholder theory which posits that the management of an organization is given powers that they may abuse for selfish interests. The third theory is the agency theory. The agency theory

also views corporate governance as management performed who are agents representing the shareholders (Solomon and Solomon, 2004).

1.1.1 Corporate Governance

As per OECD, Corporate governance is, “a set of relationships between a company's board, its shareholders, and other stakeholders. It also provides the structure through which the objectives of the company are set, and the means of attaining those objectives, and monitoring performance, are determined” (OECD, 1999). As defined by Bairathi (2009), corporate governance is a system of operating, controlling and structuring the company with the aim of achieving long term planned goals to satisfy organization's stakeholders as well as complying with other regulations. Furthermore, Bhagat and Black (2002), claim that the most common attribute of corporate governance is control and direction while the only contrasting feature is the scope. That is, whether the scope is restricted to the shareholders alone or extended to other stakeholders such as creditors, suppliers, employees and among others.

In the past decades, corporate governance has formed a key policy agenda in most market economies that are developed. More so, this agenda has continuously gained weight in Africa in the recent past. In this regard, most organizations in emerging countries are taking up this idea of good governance as it has proven to be able to enhance positive maintainable growth. Moreover, good governance is believed to uplift the confidence and goodwill of the investors. On the other hand, due to the notion that good governance improves valuation and enhances bottom lines, most corporations are now refining their

corporate governance practices. Additionally, according to the article by Claessens et al. (2002), good corporate frameworks are beneficial as they ensure that organizations have good access to finances, ensures better performance, reduce capital cost, enhanced performance and ensure that shareholders receive good treatment.

Corporate governance is not only based on the interest alignment as well as board structure for its own benefit, but extends to achieved benefits in terms of capital attraction and retention which also means good market capitalization to many corporations. Based on an international survey regarding corporate governance, it was evident that most investors were ready and willing to pay more on those organizations that had good and effective corporate governance practices and structures. As a result, Latin America, Asia and among other emerging economies experience lower share premium as compared to continental Europe who experiences higher premium. More so, UK and US capital markets receives even better premiums according to McKinsey & Co. (2005) since disclosure of information to shareholders is enhanced via best practices codes or strict securities laws.

1.1.2 Financial performance

The effectiveness of utilization of assets and ability of a firm to generate revenue over a specified time period is what is referred to as financial performance of the firm. This measure is used for comparison among the companies in the same industry using an average standard. According to Brealey et al. (2009) financial performance of an organization can be determined based on profitability, financial efficiency, solvency,

liquidity, and repayment capacity of a firm. In this regard, profitability is used to measure the revenue a firm makes by utilization of its productive resources in terms of assets. Liquidity on the other hand measures how well a firm is able to meet its interim and long-standing financial obligations whenever they are deemed due. Additionally, solvency is used to determine the firm's ability to settle financial obligations relating to the firm in entirety in event of sale of all assets. In this case, it is vivid that cash flows, assets performance or net operating income can be used to determine a firm's financial performance.

As an integral management tool, financial performance cannot be overlooked since it is essential on the existence of every organization. Where financial performance is not good, an enterprise may shut down. Therefore, the prosperity of an organization relies on capacity to effective management financial matters.

To measure performance, firms can employ various measures such as, first, the liquidity measures. This measure usually relies on the association between liabilities and the assets of the firm. Secondly are solvency measures; indicating the ability of the business to settle all its debts by selling all the assets. Lastly is the profitability measures that are achieved using ratio computations such as Return on Equity (ROE). Another example is Return on Assets (ROA)

1.1.3 Corporate Governance and Financial Performance

According to Bhagat and Jefferis (2002), Demsetz and Villalonga (2002); A well laid down and operating corporate governance system assists an organization to lure investment, fortify the foundation for firm financial performance and raise funds. More so, the article postulates that good corporate governance safeguards a firm from future financial distress to vulnerability.

More so, Claessens *et al.* (2002) postulate that weak corporate governance leads to not only risky financing patterns and poor firm financial performance, but also to macroeconomic crises such as East Asia crisis that occurred in 1997. In addition, other scholars such as Donaldson (2003) insist on the importance of sound corporate governance in boosting confidence among investors and market liquidity.

According to the article by Parker (2007), explains differentiation of shareholder ownership and control of management and the resulting problem. which deemed to arise when the shareholders who are the principal lack monitoring and control capacity of the manager, who is the agent. Furthermore, failure of aligning compensation between the principal and agent results to governance problem.

Thus, according to McKinsey and Co. (2005), with regard to the existing problem inherent in corporations, financial performance is a function of the firm's corporate governance structures quality. In an efficient capital market, it is by the expected level of managerial agency costs that investors will discount the price they are keen to pay for a

company's shares. It is therefore assumed that for a firm chooses corporate governance which is efficient in minimizing agency costs in order to prosper. Additionally, (Roe, 2003) contended the political structure of a country ultimately influences the excellence of its corporate governance practices" (Roe, 2003).

1.1.4 Cross listed companies in East Africa

Since the opening of East Africa community, business growth within and across the border has increased exponentially. In this regard, most of the major companies listed in Nairobi Stock Exchange have grabbed this opportunity and invested in countries such as Uganda, Rwanda, Tanzania, and Burundi. Some of the sectors that have seized this opportunity include banking sector such as KCB group and Equity bank group, media companies such as Nation Media Group, manufacturing industries such as East Africa Breweries Limited and Insurance companies such as Jubilee Insurance group and among others. However, this cross boarder investment is facilitated by rational board members and other stakeholders of the company. Thus, governance of every organization is vital in fostering expansion of the business and hence maximizing the shareholders returns as they normally make decision regarding expansion of the entity. Moreover, one of the main objectives of EAC was aimed at broadening and deepening association among the partners in the fields of economic, social and political arena and come up with a common market. Thus, due to cross listing of the companies that have been experienced since 2010, the objectives of the EAC are being realized (Kenya Revenue Authority, 2011).

These cross-listed firms have remained one of the most profitable ventures in East Africa. The financial position of the companies is published in the financial reports which the companies release each year. The financial statements also contain the issue of the corporate governance which reflects the stakeholders' interests and the political intervention. From the annual reports, the measures of corporate governance are seen to have an effect to the companies' financial performance. Evidence points towards board size as well as split chairman/CEO roles affecting corporate governance quality making these companies deliver higher return on their investments to the investors. Corporate governance at the company level, measured through better accounting standards, appears to matter for financial performance and result in a lower cost of capital for the companies.

1.2 Research Problem

Every time there is a financial crisis in an organization, regulators, academicians and governments tend to put more focus on corporate governance in order to restore investor confidence. Most financial challenges that befall many organizations across the globe have largely been attributed to failure in corporate governance structures or adoption of poor corporate governance practices. Companies implementing efficient corporate governance ensure good returns to the shareholder and minimize investment risk. According to Brown and Caylor (2004), the relationship amid quality of corporate governance and firm profitability dominates corporate governance studies.

In East Africa, numerous firms are concerned by corporate governance both in the public and in private sector where financial scandals have re-ignited the scrutiny of corporate

governance practices of various organizations. Many firms either have been wound up due to poor corporate governance practices or have been put under statutory management. This has forced the government of East African states to enact laws that are aimed at putting in place better corporate governance structures more especially among public sector entities. Lack of transparency and efficient administration in organizations has led to several corporate scandals that have seen firms lose money and resources in addition to degeneration in the financial performance of such organizations (Otieno, 2012).

Based on global research on corporate governance and financial performance, there emanates mixed results. For instance, Gompers *et al.* (2003) failed to deduce significant association relating to firm's governance and financial performance. Based on the research by Mak and Yuanto (2003), they re-iterate the findings above in firms listed in Malaysia and Singapore. Findings reveal that firm valuation is highest in a firm with a five-member board, rather small in these markets.

In Kenya, Otieno (2012) conducted a study on the effect of corporate governance on financial performance of Kenyan Commercial banks. Findings from the study revealed importance of corporate governance on bank performance, stability and bank's ability to provide liquidity in unfavorable market environments. Wandabwa (2010) carried out a study on corporate governance and financial performance of broadcasting stations in Kenya. The study established that corporate governance had a significant effect on financial performance. Kinuthia (2014) carried out study on the effect of corporate

governance on the financial performance of telecommunication companies in Kenya. It was revealed that corporate governance had a significant effect on financial performance on the companies. Evidence exists of expansive research on corporate governance but the findings differ greatly with some researchers Gompers *et al.*, (2003); Mak and Yuanto (2003) finding no significant relationship while others such as Otieno (2012); Kinuthia (2014) found a significant relationship. On the other hand, effect of corporate governance and financial performance of Cross-listed companies in East Africa security exchanges has not been studied. This therefore remains a unique area that requires to be studied. This study will thus seek to bridge the identified gap by seeking a response: what is the effect of corporate governance on the financial performance of cross-listed companies in East Africa community securities exchanges.

1.3 Research Objective

To determine the effect of corporate governance on financial performance of cross-listed firms in East Africa community securities exchanges.

1.4 Significance of the Study

The study is of importance to the companies cross-listed in East Africa community securities exchanges as they will be able to know for certain how corporate governance plays a more significant role in shaping their operations and how they affect their levels of financial performance. It will also enable them to put in place appropriate corporate governance practices to enhance their performance.

The findings will also be helpful to scholars as well as researchers, and influencing further research. This study will be used by students and academics as a foundation for deliberations on the corporate governance practices adopted by East Africa firms and how these affect their financial performance.

More so, the industry regulator will also find value in the results of this study, because it will be able to identify the corporate governance practices that enhance financial performance to an individual firm and as so establish whether such practices adopted in the industry conform to the government-provided industry guidelines.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter is an evaluation of literature on the effect of corporate governance on the financial performance of an organization. The specific areas covered here are theoretical review, corporate governance, determinants of good corporate governance, importance of good corporate governance, corporate governance and firm performance and empirical review.

2.2 Theoretical Review

This section presents the theories that this study is based on. There are three main theories that underpin this study. They include the shareholder theory, the stakeholder theory and the agency theory. The theories are discussed next in detail.

2.2.1 Shareholder Theory

The shareholder theory was first proposed by Milton Friedman who was an American Economist. Governance relating to shareholders is explained by two main theories. These are the myopic market model and the principal-agent. The principal-agent model originates from the assumption corporation's main aim is shareholder wealth maximization. (Coelho *et al.*, 2003; Friedman, 1970). The model sought to address the self-interest behavior by management in a general principal-agent relationship as main challenge of corporate governance the agent and the principle do not always agree on

common on objectives, resulting in agency problems. Additionally, the differentiating control and ownership rises professional managers' influence and self-preservation objectives and interests at the shareholders' cost (Berle and Means, 1932).

Similarly, the myopic market model purports that the only the interests of the shareholders' interests should be served. However, the model blames the shortcoming of corporate governance on the system as it inspires efforts on interim performance by forfeiting long-standing value and organizational competitiveness. The financial markets often diverge managers behavior from the maximizing long-term shareholders wealth (Blair, 1995). This theory seeks to explain the main responsibility of top management as that of ensuring good financial performance in order to maximize shareholder wealth. This implies that corporate governance is the main concern of shareholders.

2.2.2 Stakeholders Theory

This theory was first proposed by Edward Freeman who believed that the theory was an important element of corporate social responsibility. The stakeholder theory seeks above all to describe what a corporate organization is. The theory posits that an organization has stakeholders who have different interests and expectations. According to Donaldson and Preston (1995) stakeholders refers to persons or groups that have legitimate interests in the operations of a corporate enterprise. They further argue that in most cases each stakeholder has different interest from those of the other stakeholder. The interests of each stakeholder are of intrinsic value and therefore an organization has to find ways of ensuring that they are addressed.

The stakeholder theory therefore seeks to eliminate the notion that managers are the only ones who are given the responsibility of making decisions for an organization. The theory explains that stakeholders play a significant role in shaping the decisions that are made by the top management of an organization. Decisions made by the executive in the organization have to reflect the legitimate interests of the stakeholders of the organization. However, the theory does not imply that all stakeholders must be identified and their interests addressed and that they be equally involved in all processes and decisions. It instead confirms the significance of stakeholders in corporate governance. Relevancy to this study: The corporate governance practices adopted by a firm must meet the needs of all stakeholders (Donaldson and Preston, 1995).

2.2.3 Agency Theory

This theory was originally developed by Barry Mitnick and Stephen Ross individually and roughly simultaneously. The economic theory of agency was originated by Ross while Mitnick originated the institutional theory of agency. Nonetheless, these approaches are fairly similar as far as the underlying basic are concerned (Solomon and Solomon, 2004). Shareholders, management and the boards of directors are the primary participants. Others include players, suppliers and partners, staff, customers and the community in general. Therefore, corporate governance ensures accountability of the board to shareholders as well as non-shareholder stakeholders. Secondly, it also ensures accountability to those with a stake in a properly governed corporation. (Carter and Lorsch, 2004; Leblanc and Gillies, 2005) claim board process is more important for good

corporate governance as compared to board structure. However, current regulations seem to favour the latter.

In the principal-agent relationship, potential for conflicts within a firm is inherent because of existing differences between the economic incentives facing the principals and those facing the agents (ISDA, 2002). The problem of agency is relevant to all organizations, and as a result action plans are formulated to deal with the problem. These include action plans include monitoring and control of the actions of agents, offering monetary rewards as incentives for agents to act in the interest of the principle, and separating control from risk taking functions (ISDA, 2002). The importance of this theory to this study since it assist in clarifying the position of management as agents who have been given powers to act on behalf of the owners. The corporate governance practices they put in place must reflect no their personal interests but rather the objectives of the owners.

2.3 Determinants of cross-listed firms' Financial Performance

Cross-listed companies as any other business organizations need to achieve better financial results in order to maximize shareholder returns and meet stakeholder needs. The costs the firms incur as far as operations activities are concerned, the revenue structure of the firm as well as the market structure largely determines the profits earned by the cross-listed companies in East Africa community securities exchanges. However, these three depend on several factors that determine the level of financial performance

that the firms can achieve. These determinants include size, ownership structure, and split of chairman and CEO roles. These are discussed next.

2.3.1 Board Size and Composition

Evidence shows that board size materially influences the corporate governance quality while a number of studies suggest that dysfunctional board of directors are mainly attributed to large size. Hermalin and Weisbach (2003) favour smaller board sizes to larger ones which are often plagued with free riders and are difficult to monitor. For instance, Eisenberg et al. (1998) and Yermack (1996) find an inverse relationship between board size and firm value, The findings showed that smaller boards are more effective as they are able to communicate and coordinate efficiently and effectively.

Board member number is deemed to influence on performance. It is the mandate of the board is to manage the firm and its operations. However, scholars are yet to agree whether a small or a large board prevails. Yermack (1996) purports is that the lesser the number board members, the better the firm's performance and that grander boards tend have a slow decision making process. In their studies, Abor (2007) and Wen *et al.*(2002) and also supported a positive relationship between board size and leverage, arguing that large boards with an enhanced ability to enforce monitoring have access to borrowing to grow the value of the firm.

2.3.2 Independence of Directors

According to theory (Fama and Jensen, 1983), board independence is a critical point of focus of the agency. An extended argument is that a board that is more effective in monitoring is one that is comprised of majority of independent directors (Baysinger and Butler, 1985; Bhagat and Black, 2002; Kaplan and Minton, 1994; Morck and Nakamura, 1994). They are also more likely to make changes in management in cases of poor performance, (Weisbach, 1988). Including replacing a non-performing CEO with someone outside the firm (Huson, 2001; Borokhovich et al., 1996).

2.3.3 Split Chairman/CEO Roles

There are instances whereby the CEO of a firm doubles up as the chairman of the board. In other organizations, the roles are split. This has been an area of controversy and the issue has been studied extensively to identify the advantages and disadvantages of a split role. Jensen (1993) argues it is in the shareholders' interest to separate these roles. Similarly, big corporations trading at higher price-to-book multiples are those without CEO duality (Yermack, 1996). They are also seen to have a better financial performance level than firms in which the roles have not been split.

Additionally for the board, it is difficult to replace a non-performing CEO when he or she is also the chairman of the board (Shivdasani and Zenner, 2004). There is therefore difficulty in addressing performance decline (Goyal and Park, 2002). In contrast, Brickley et al. (1997) did not find any proof to link improved performance of a firm

resulting from separating these roles. In fact, the CEO is appointed chairman after outperforming others within the firm and thus earning the power from the combining the positions of chairman (Brickley et al., 1997). It therefore works as compensation for superior performance; acting as an implicit vote of confidence by outside directors. Then, splitting the two positions would rob the boards of a key motivation tool for new Chief Executive Officers (Brickley et al., 1997).

2.3.4 Separation of Ownership and Control

According to Shleifer and Vishny (1997), the role of corporate governance is to check to ensure that managers neither make bad investment decisions nor steal capital from the firm. Agency problems between investors and managers stem from segregation of ownership and control (Berle and Means, 1932). Investors demand to know how maximize their wealth and how their investments are. They also want eliminate management expenses that they deem to be excessive and unnecessary.

It is clear that the firm's key objective is to ensure maximized shareholder wealth and corporate governance is deemed a means to achieving this goal as per the shareholder model. Consequently, there is an anticipation of a positive relationship between corporate governance and firm performance. For firms, the risk of being taken over or replaced is a probable eventuality if they fail to adopt corporate governance mechanisms aimed at cost reduction (Elloumi and Guelie, 2001).

2.4 Empirical Studies

Research shows that firms that were performing better and had higher market value or Tobin's q were those noted to have higher corporate governance (based on developed indices) (Bauer and Guenster, 2003; Beiner et al., 2004; Schmidt and Zimmermann, 2004). Furthermore, a selection of corporations with better corporate governance delivered a 2.1 per cent higher return in comparison to corporations of poor corporate governance (Bauer and Guenster, 2003).

2.4.1 Board Size and Financial Performance

Ranti and Fakile (2012) carried out a study on the effects of board size on the financial performance of listed banks in Nigeria. The study took the design of a survey that critically reviewed listed banks only. The relationship was measured by regressing the number of the board of directors with the banks financial performance that was measured using ROA. Results showed that smaller boards for banks (below 13) had higher viability Vis a Vis banks with many board members (board size above 13). Another revelation was that board size also had an effect on financial performance as banks with larger boards performed better with smaller boards as they recorded higher profits. The resulting conclusion was a significant inverse relation between the size of the board and bank financial performance with a t- value of -1.977 and a p- value of 0.053.

A similar study was carried out by Rodriguez (2014). The main goal of the study was to investigate whether board size really matters when it come to the financial performance

of the firm. The sample involved 50 European firms. The financial performance of the firms was measured using ROA. The study findings revealed an existing strong and negative relation between firm size and financial performance.

2.4.2 Board Composition and Financial Performance

A study was carried out by Ongore, K'Obonyo, Ogut and Bosire (2015) on board composition and the financial performance of companies listed at the Nairobi Securities Exchange. Forty-six firms listed in the Nairobi Securities Exchange in the year 2011 were covered in the study. Multivariate regression analysis was utilized on panel data. Performance indicators used include Dividend Yield, Return on Equity and Return on Assets. The results of the study revealed that gender diversity had a material effect on financial performance, but an independent board did not and there was an inverse between the size of the board and relationship financial performance.

Ness, Miesing and Kang (2010) equally studied the Board composition effect on the financial performance in the new era of Sarbanes-Oxley (SOX). These are important legislations relating to securities; influencing firms that are publicly traded since 1934 when the Securities and Exchange Commission was formed. The enactment of the United States law on July 30, 2002 was in response to multiple corporate scandals. The independent variables of the study were CEO duality, proportion of outside directors, gender, age, occupational expertise and tenure. The dependent variable was ROA. The control variables included firm size and lagged financial performance. The study

established that board tenure, CEO, occupational expertise and board size were significantly influenced the financial performance of the firm.

2.4.3 CEO Duality and Financial Performance

Erah, Eyenubo and Izedonmi (2012) carried out a study on the CEO duality and financial performance of firms in Nigeria. The study was a cross sectional survey of several firms that was drawn from different industries in Nigeria. Secondary data that was obtained from the Nigerian Stock Exchange was used. The data was for the period 2001 to 2010. Regression analysis was applied to estimate the relation and its results showed that CEO duality was detrimental to financial performance of a firm.

Moscu (2013) similarly conducted a study on CEO duality and corporate performance. The main objective of the study was to determine existence of an effect on the performance of an entity where there was CEO duality. Bases of the study included the agency theory and secondary data from Listed Romanian from the Bucharest Stock Exchange. The sample involved 62 companies are listed at the Bucharest Stock Exchange. Regression analysis findings revealed both positive and negative relationships observed.

2.4.4 Corporate Governance and Financial Performance

Shahwan's (2015) study titled effects of corporate governance on financial performance and financial distress in Egypt was a survey of Egyptian listed firms. As an evaluation of

the corporate governance practice level at a firm, the study constructs a corporate governance index (CGI) which comprising of four dimensions:

- i) disclosure and transparency
- ii) board of directors- composition
- iii) shareholders' rights as well as investor relations
- iv) Ownership and control structure.

A total 86 non-financial firm listed on the Egyptian Exchange were sampled for the study. The results showed no significant relation between corporate governance practices and financial performance of a firm.

2.5 Summary of Literature Review

The literature review has focused on a number of issues that are relevant to corporate governance and financial performance. Three main theories: the shareholder theory, stakeholder theory and the agency theory have been reviewed. These are the studies that underpin the current study. The literature review reveals that there are diverse findings relating to the relationship between corporate governance and financial performance. Some researchers such as Ranti and Fakile (2012) finding significant relationship and others such as Shahwan (2015) finding no significant relationships. This is an indication that the results vary from industry to another and this provides a strong reason why the current study needs to be conducted.

2.6 Conceptual Framework

As illustrated in the conceptual framework in figure 2.1 a relationship exists between corporate governance and the financial performance of a firm. Corporate governance is measured using four variables that are considered independent in this study. These variables include CEO duality, the size of the board and composition, CEO duality and ownership structure. The dependent variable is the financial performance of the firm that is measured using ROA.

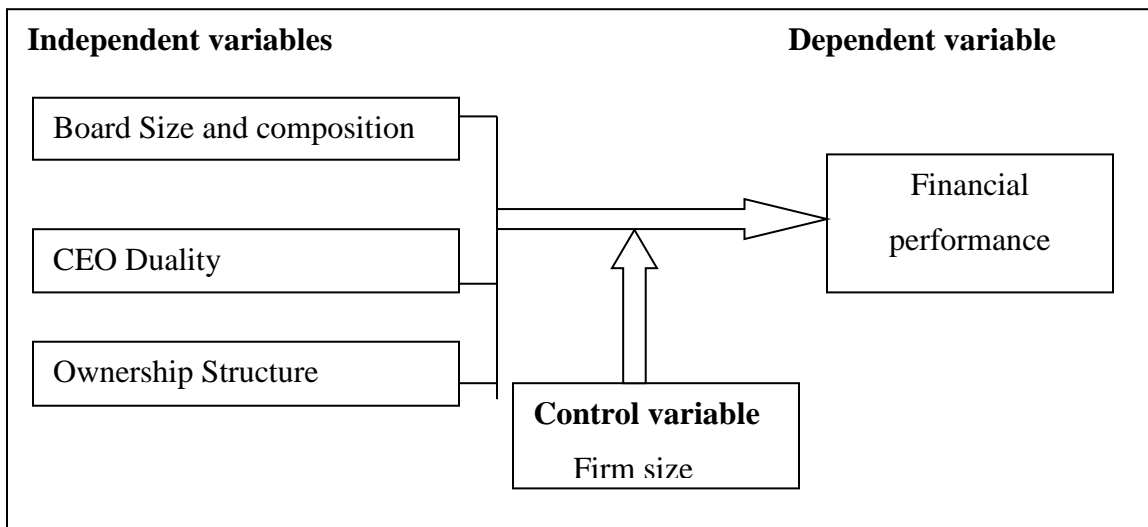


Figure 2.1: Conceptual Framework

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

In this chapter, the research methodology is presented in the following order, research design, target population, sampling procedure, data collection methods, instruments of data collection as well as data analysis techniques.

3.2 Research Design

According to Donald (2006), research design is a structure that binds together all the parts of the study project. The appropriate design for this study was descriptive research design. This research design is responsible for measuring occurrence frequency the variables occurs or the association between variables. Cooper and Schindler (2003) purported “a descriptive study is concerned with finding out the what, where and how of a phenomenon.” Therefore, this approach best suited this study, as the researcher aimed at collecting data via descriptions and for testing variables as well as hypothetical constructs.

3.3 Population

According to Bryman and Bell (2003), the definition of population is a set of things or people that the researcher is aiming to investigate and thus it's expected to homogeneous in most cases. More so, Cooper and Schindler (2003) viewed population as group of element from which reference can be made. According to the Solomon Stockbrokers

Limited (2017), more than 10 Kenyan companies are cross-listed in East Africa community securities exchanges. Therefore, we randomly selected five of the company to form our sample. Since the sample was small, we decided to collect data for each company for a period of five years, that is, from 2011 to 2015 hence forming our sample size

3.4 Data Collection

The study utilized secondary data. The secondary data related to four variables. This included data on board size and composition, CEO duality and ownership structure. Data on the financial performance of the firms was collected in form ROA. To enable the researcher to capture the relevant data, a data collection schedule was used to collect the data.

Data on the financial performance was collected from the annual financial statements of the cross listed firms. The data was for the duration from 2011 to 2015. By collecting data for the last five years, it was possible to establish the latest position as far as the relationship between corporate governance and financial performance is concerned. Since all the cross-listed firms were private companies, the researcher obtained an introduction letter from the University that enabled her collect the required data from the firms. Moreover, most of the data was available on the companies' website hence could be acquired easily.

3.5 Data Analysis and Presentation

To estimate the impact of corporate governance on cross-listed firms' financial performance, regression analysis was deemed appropriate. On the same breath, correlation analysis was employed to determine the association among variables. Furthermore, multiple regression was also used to measure the impact of the individual variables on the financial performance of the firms.

3.5.1 Model Specification

The following model was used in conducting the multivariate regression analysis.

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon_{it}$$

Where β_0 is constant of the model, and $\beta_1, \beta_2, \beta_3$ and β_4 are the coefficients of the independent variables. Y represented the financial performance that was measured using the ROA, X_1 = represents CEO duality and was measured using actual number of cases with or without CEO duality, X_2 represented board size and composition was measured using the actual number of directors, X_3 represented ownership structure that was measured using number of shareholders and ε_{it} = an error term for the model.

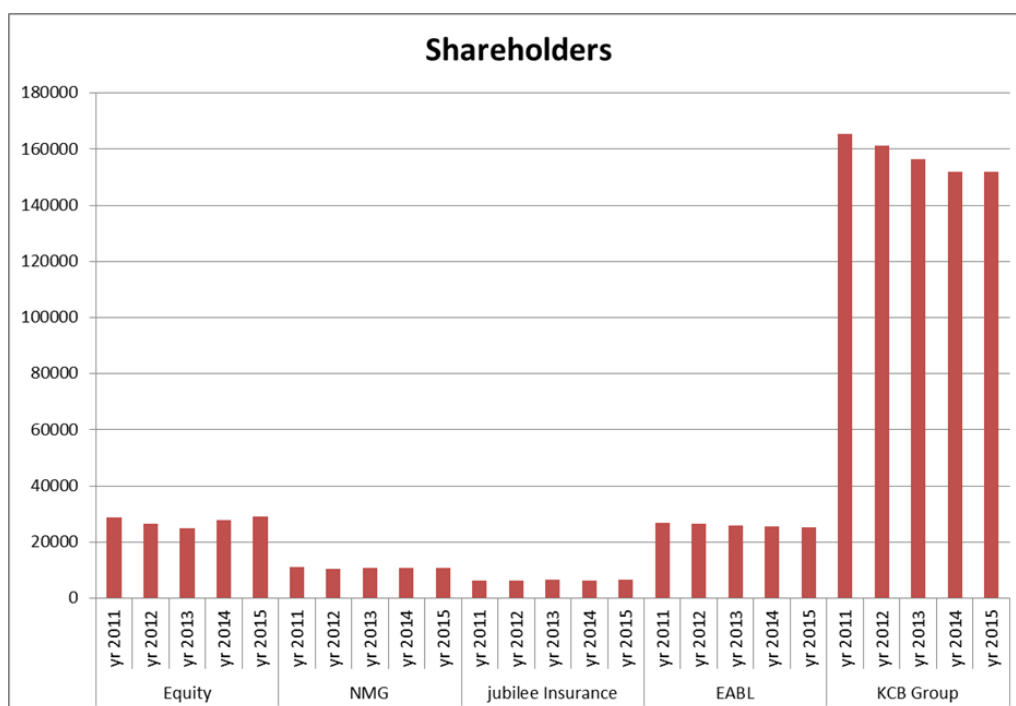
CHAPTER FOUR: DATA ANALYSIS AND INTERPRETATION

4.1 Introduction

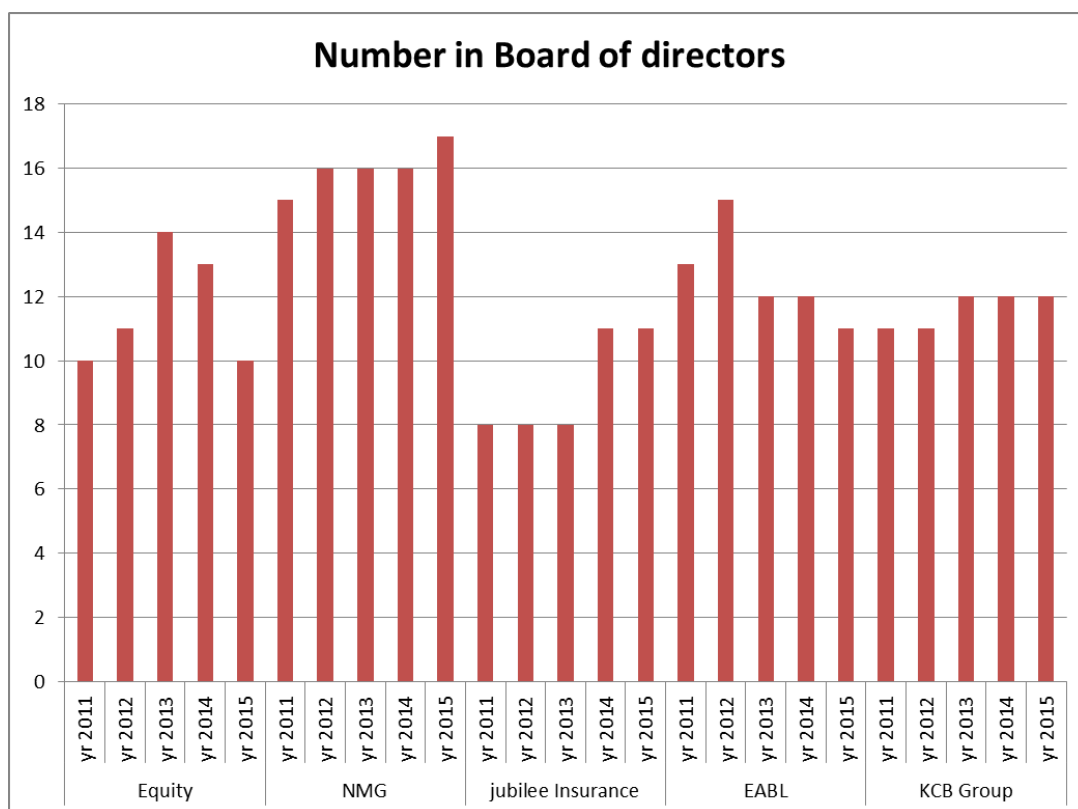
This study was carried out with the objective of investigating how corporate governance affects the financial performance of listed companies in community securities exchanges that include Nation Media Group, Kenya Commercial Bank, Equity group, East African Breweries Limited, and Jubilee Insurance. The study utilized secondary data that was collected from stock exchanges East Africa. Secondary data was collected from all the five companies over a period of five years adding up to 25 observations. This chapter presents the data analysis results and their interpretation.

4.2 Descriptive Statistics

Descriptive statistics including the mean and the standard deviation were obtained for three variables, beginning with the independent variables. The number of shareholders ranged from 6,224 to 165,448. This implied that on average, each of the companies has about 45,562 shareholders with a standard deviation of approximately 57,740 shareholders. However, this average number is not a true representation of the distribution of shareholders across the sampled companies. Figure 1 below represents actual distribution across the companies as well as over the five-year period. Kenya Commercial Bank had highest number of shareholder with over 165,000 while Jubilee Insurance had the least number of shareholders averaging 6,500.



The number of directors for each of the companies ranged from 8 to 17, implying that on average the board size was about 12 members. There were fluctuations over the five-year period with the number of directors increasing or decreasing due to administrative reasons. For instance, equity bank group had between 10 and 14 directors while Kenya Commercial Bank had either 11 or 12 board of directors' members for any given year of interest. Nation Media Group had between 15 and 17 members in the board of directors, Jubilee Insurance had between 8 and 11 members, while East African Breweries Limited had between 11 and 15 members. This is shown in figure 2 below:



Finally, there was no CEO duality in all the cases. Therefore, it could not be summarized or analyzed since it was a constant. Table 1 below shows the descriptive statistics for the board of directors and number of shareholders for each company.

Table 1: Descriptive Statistics for the independent variables

	N	Minimum	Maximum	Mean	Std. Deviation
number of Shareholders	25	6224	165448	45562.00	57739.343
Number of directors	25	8	17	12.20	2.566
CEO duality	25	0	0	.00	.000
Valid N (listwise)	25				

The Dependent variable was analyzed in its own respect for each of the sampled companies. The return on assets ranged from between 3 percent and 34 percent with an average of 12.56 percent and a standard deviation of 10.34 percent. Return on assets for the cross-listed companies was fairly normally distributed since the skewness was less than 1 (Skewness = 0.706). East African Breweries Limited had the highest value of about 34 percent while Kenya Commercial Bank had the least value of ROA averaging 4 percent. The distribution of the return on assets across the companies over the five-year period is represented in figure 3 below:

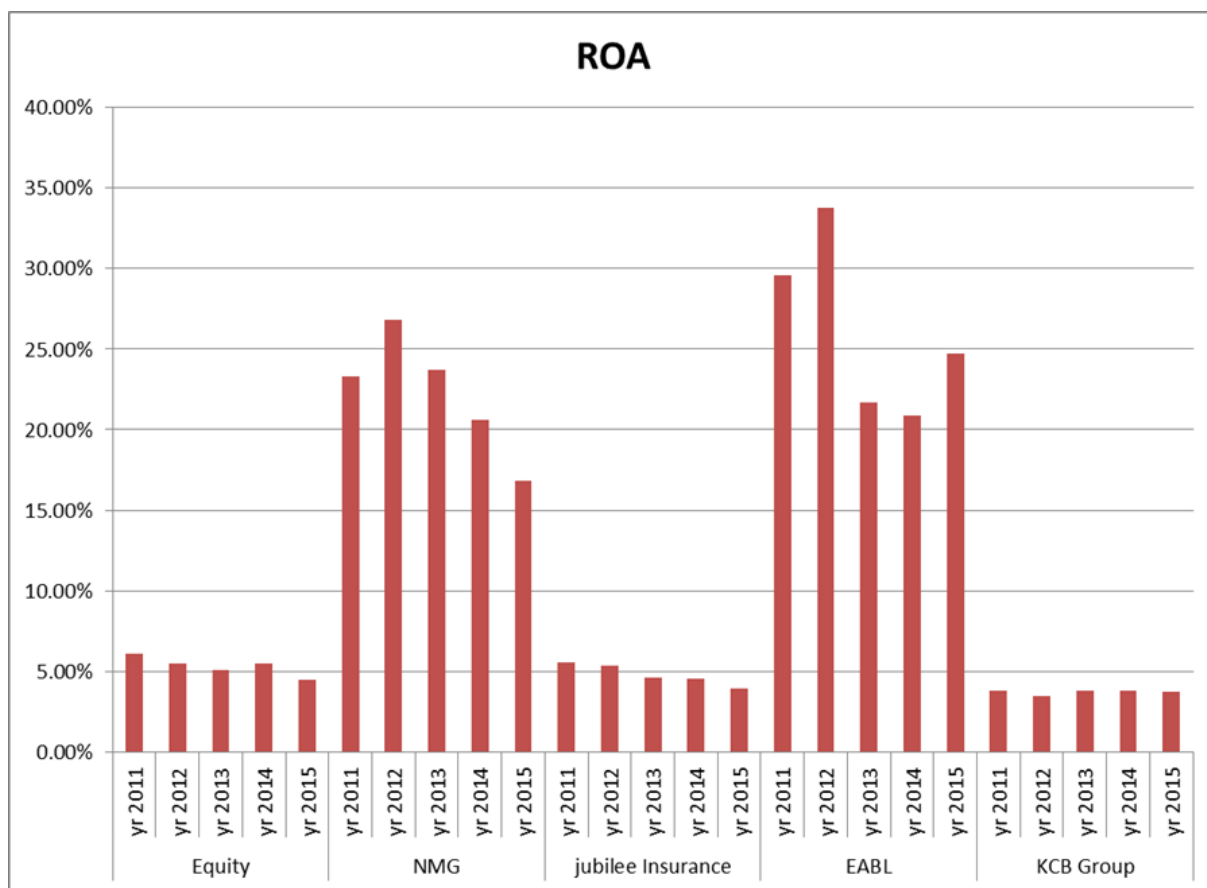


Table 2 below shows the descriptive statistics for the dependent variable.

Table 2: Descriptive Statistics for the dependent variable

	N	Minimum	Maximum	Mean	Std. Deviation	Skewness	
	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic	Std. Error
Return on Assets	25	.03	.34	.1256	.10336	.706	.464
Valid N (list wise)	25						

4.3 Correlation analysis

In order to determine the relationship that existed between the variables of the study, correlation analysis was conducted. A two tailed significance test was used to test the significance of the relationship between the variables. No correlations were calculated for CEO duality because it is a constant variable. There was a moderate negative linear correlation between return on assets and number of shareholders while there was a strong positive linear correlation between return on assets and the number of directors in the board. Additionally, there was a weak and insignificant positive relationship between the number of shareholders and the size of the board of directors. The correlation results are illustrated in Table 4.3 below

Table 4.2: Correlation analysis results

		Correlations			
		number of Shareholders	Return on Assets	Number of directors	CEO duality
number of Shareholders	Pearson	1	-.406*	-.116	
	Correlation				
	Sig. (2-tailed)		.044	.581	.
	N	25	25	25	25
Return on Assets	Pearson	-.406*	1	.624**	
	Correlation				
	Sig. (2-tailed)	.044		.001	.
	N	25	25	25	25
Number of directors	Pearson	-.116	.624**	1	
	Correlation				
	Sig. (2-tailed)	.581	.001		.
	N	25	25	25	25
CEO duality	Pearson				
	Correlation				
	Sig. (2-tailed)
	N	25	25	25	25

*. Correlation is significant at the 0.05 level (2-tailed).

**. Correlation is significant at the 0.01 level (2-tailed).

4.4 Corporate Governance and Financial Performance

The sole objective of this study was to determine the effect of corporate governance on the financial performance of the cross-listed companies in community securities exchanges. In order to achieve this, board size, CEO duality, and number of shareholders were the predictor variables while the financial performance represented by ROA was the dependent variable. A multivariate regression analysis was conducted and the results presented the tables below. The model summary indicates that the overall correlation

between the dependent and the independent variables was 0.707, which was a high positive linear correlation. The coefficient of determination was also high ($r = 0.502$), implying that the set of independent variables (Number of shareholders and number of members in the board of directors) explained about 50.20 percent of the variability observed in return on assets.

Table 3: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.709 ^a	.502	.457	.07618

The High overall correlation warranted formation of a linear model to create the cause-effect relationship between the return on assets and the independent variables. The adequacy of the intended model was tested using the Analysis of Variance procedure that showed that the model would adequately represent the relationship ($F = 11.093$, $p < 0.05$). This is represented in the table below.

Table 4: Analysis of Variance

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	.129	2	.064	11.093	.000 ^b
Residual	.128	22	.006		
Total	.256	24			

Finally, the actual model was developed using multiple linear regression procedure. The intercept was found to be insignificant ($\beta_0 = -0.134$, $t = -1.714$, $p < 0.101$). However, the coefficients of the predictors were significant in the model ($\beta_1 = -6.050\text{E-}007$, $t = -2.231$, $p < 0.05$) for the number of shareholders and ($\beta_1 = 0.024$, $t = 3.861$, $p < 0.05$) for the number of directors in the board of directors. This implies that as the number of shareholders decrease, the return on assets as a measure of profitability increases. The results also indicate that as the size of the board of directors' increases, there is a likelihood of the return on assets to increase. As such, having an additional board member can increase the return on assets by 2.4 percent.

Table 5: Regression Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-.134	.078		-1.714	.101
	number of Shareholders	-6.050E-007	.000	-.338	-2.231	.036
	Number of directors	.024	.006	.585	3.861	.001

4.5 Summary and Discussion of Findings

The study established that there was a strong proportional relationship between the board size and Return on Assets. This implies that the larger the boards size the higher the financial performance of the firm. These findings seem to contrast with other researchers

such as Yermack (1996) and Eisenberg et al. (1998) who found a negative relationship between board size and firm value, indicating that smaller boards are more effective since they experience fewer communication and coordination problems. The findings also contrast with Hermalin and Weisbach (2003) who believe that board size proxies for the board's activity, explaining why smaller board sizes are better than larger ones that may be plagued with free rider and monitoring problems.

It was also observed that there was a moderate negative relationship between number of shareholders and Return on Assets. This indicates that the higher the number of shareholders a firm has the lower the financial performance of the firm. This finding is inconsistent with Elloumi and Guelie (2001) who established that the ultimate goal of the firm is to maximize shareholder wealth and corporate governance has to be seen as a mechanism to realize this goal. They further argue that consequently a positive relationship is expected between ownership structure and firm performance.

However, duality of the CEO was not used in the analysis because it remained constant in all cases, with none of the CEO doubling up as the chairman. The current study agrees with the findings from Ness, Miesing and Kang (2010) established that duality, occupational expertise, board size and composition, and board tenure were significant influences on firm financial performance.

Concerning the relationship between corporate governance and financial performance of the cross-listed companies in East African Community Exchanges, it was clear that corporate governance explains 50.2 percent of the financial performance. This implies

that corporate governance practices are very important in determining the financial performance of the cross-listed companies. This position is also held by Adekunle and Aghedo (2014) who established existence of a positive and significant relationship between the size of the board of directors as an independent variable and firm performance. In contrast, the findings of Shahwan (2015) indicated no significant relationship between corporate governance practices and financial performance of a firm.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Introduction

The main objective of this study was to determine the effect of corporate governance on the financial performance of cross-listed companies in the East Africa community exchanges. Corporate governance was measured used the corporate governance practices while financial performance was measured using ROA. In this chapter, a summary of research findings, research conclusions, study recommendations and areas for further research are presented.

5.2 Summary of Findings

The descriptive statistics results on the variables of the study revealed that most of the cross-listed companies in community securities exchanges had a ROA that was almost similar since there was very slight deviation of the observed values from the mean. It is important to indicate that no sampled company had a situation where the CEO was also serving as the chair of the board of directors. All of them had these two roles clearly separated. The size of the board among the sampled companies was found to vary significantly with some cross-listed companies having as low as eight directors and others having as many as 17 directors. Finally, the ownership structure findings revealed that all the companies traded publicly with the number of shareholders varying significantly between 6,500 and 165,000.

The correlation results also revealed that there were significant inverse and direct relationships between the study variables. For instance, there was a moderate inverse relationship between return on assets and the number of shareholders which implies that the smaller the number of shareholders, the higher the financial performance of the firm. There was also a strong positive relationship between board size and ROA. This was an indication that the larger the board size, the higher the profitability of the firm. This can be attributed to experience of the directors. .

The multivariate regression results revealed that corporate governance accounts for 50.1 percent of the ROA of cross-listed companies in Kenya. However, almost half of the variance on the financial performance of the cross-listed companies is explained by other variables that are outside the scope of this study. Independent variables, board size and number of shareholders were found to have statistically significant relation with ROA while CEO duality was found to be irrelevant in the model.

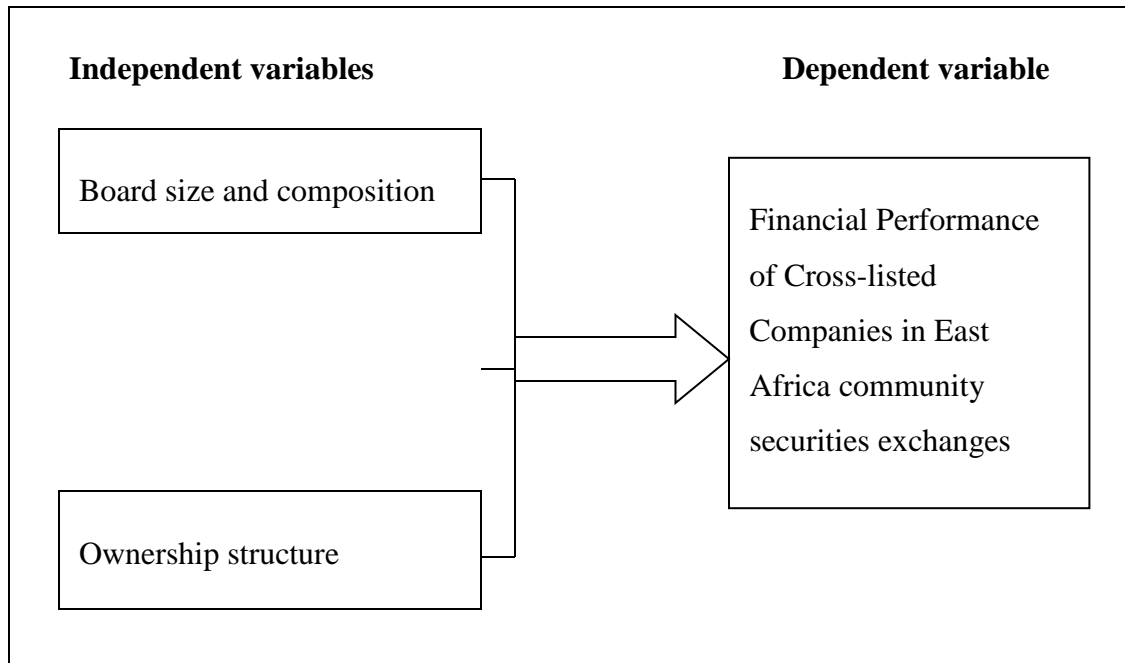
5.3 Conclusions

The study established that return on assets and ownership structure had an inverse relationship. However, a strong positive relationship exists between board size and board composition and ROA. All these correlations were found to be statistically significant indicating that they influence financial performance of the cross-listed companies.

It was further evident from the study findings that cross-listed firms in East Africa have no CEO duality since the role of the CEO and chair of the board were found to be clearly separated. In addition, there were very clear variations among the companies as far as board size and composition and ownership structure were concerned. Nonetheless, all the companies were owned by shareholders.

The multivariate regression results revealed that corporate governance accounts for 50.2 percent of the ROA of cross-listed firms in East Africa community securities exchanges. This implies that the influence of corporate governance on the financial performance of the cross-listed firms in East Africa community securities exchanges is significant. Only two independent variables, board size and composition and ownership structure were found to influence financial performance. This leads to a refined conceptual framework as illustrated in Figure 5.1 below.

Figure 5.1: Refined Conceptual Framework



5.4 Recommendations

Board composition and ownership structure were found to have statistically significant relationships with ROA. The cross-listed companies should be encouraged to improve on these two corporate governance practices in order to enhance their financial performance.

Corporate governance was also found to explain 50.2 percent of the financial performance of the cross-listed companies in community securities exchanges. This is a huge percentage of financial performance that depends on corporate governance practices. It is therefore important for the cross listed companies to be advised to give careful consideration to corporate governance issues since they will determine the financial success of the firm.

The study further established that there was a strong positive relationship between ownership structure based on the number of shareholders and the financial performance of the cross-listed.

5.5 Limitations of the Study

The study revealed that the three independent variables of board size and composition and ownership structure explain 50.2 percent of the financial performance of cross-listed firms in East Africa community securities exchanges. This study can therefore only apply to these three variables and their influence on the financial performance of the cross-listed companies.

This study only focuses on corporate governance and financial performance of the cross-listed firms in East Africa community securities exchanges. The findings can therefore be applicable to these firms only and may not represent the situation in other countries.

This study focused on corporate governance and the financial performance of cross-listed firms in East Africa community securities exchanges using data belonging to five years. The findings are therefore only relevant to the duration under study: 2011 to 2015. They cannot therefore be used to refer to any other duration that is not within the scope of this study.

5.6 Suggestions for Further Research

This study reveals that 50.2 percent of the financial performance of cross-listed firms in East Africa community securities exchanges is attributed to corporate governance. This means that 49.8 percent of the financial performance is explained by other factors that are not known. There is need to carry out a study to uncover these factors.

A comparative study needs to be carried out to compare the findings of this study with those of other cross-listed companies in other countries. This will assist in discovering areas of agreement and differences.

There is need to carry out a study that can be able to cover a longer duration say 20 years or ten years with the same variables and find out whether the same findings will apply. It will also be necessary to replicate this study after every five years to monitor the trend.

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APPENDICES

Appendix I: List of cross Listed Companies

1	Equity Bank Group
2	Nation Media Group
3	Jubilee insurance Holdings
4	Kenya Commercial Bank Group
5	East Africa Breweries Limited

Appendix II: Data Collection Schedule

Year	NET INCOME	TOTAL ASSETS	CEO DUALITY	BOARD SIZE	NUMBER OF SHAREHOLDERS
2010					
2011					
2012					
2013					
2014					
2015					