RELATIONSHIP BETWEEN CORPORATE GOVERNANCE PRACTICES AND FINANCIAL PERFORMANCE OF COMMERCIAL STATE CORPORATIONS IN KENYA

BY

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DECLARATION

This research project is my original work and has not been submitted for award of any degree in any University.

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This research project has been submitted for examination with my approval as University of Nairobi supervisor.

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ABSTRACT

The reform of public enterprises has become an issue of top priority for developed as well developing countries, in the last fifteen years.

A well defined and functioning corporate governance system helps a firm to attract investment, raise funds and strengthen the foundation for firm financial performance.

Kenya many State Corporations have been characterized by monopolistic production, highly indigenized management and appointments of a large number of top managers based on political considerations. This has led to many of the State Corporations in Kenya to struggle to regain their foothold. The major objective of the study was to find out the relationship between corporate governance practices and performance in Commercial State Corporations in Kenya.

The study adopted a survey design. The population of the study consisted of 27 commercial state corporations. The study used questionnaire to collect the primary data from the chief finance officers.The primary data collected through the questionnaire was analysed using descriptive statistics such as measures of central tendency which include mean, median and mode using SPSS version 17.5 and Microsoft excel.

The study concludes that Good corporate governance approach aims at performing the main function of separating the firm's principals and agent and corporate governance themes in a corporation separates management from the board. The study concludes that board size and composition, Splitting of the roles of chairman and chief executive, optimal mix of inside and outside directions, proportion of outside directors, executive remuneration, number of non-executive directors, participation of outside directors and number board of directors affected the financial performance of the corporation .

The study recommends that there should an increase meetings frequency if the situation requires a high quality supervision and control. The study also recommends that state owned enterprises should adopt good governance systems as they enhance the financial performance. The study therefore recommends that policy makers for state owned enterprises should take serious notice of these findings to implement policies that sustain the already existing strong corporate governance structures.

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CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

The reform of public enterprises has become an issue of top priority for developed as well developing countries, in the last fifteen years. In Greece, it has been a hotly debated issue, and relates to whether public enterprises can efficiently provide its services to the public, which in turn is related to whether a state-controlled company can have efficient, transparent and flexible corporate governance (Becht, Bolton and Roell, 2002). Within the context of globalization, almost all organizations around the world are currently undergoing significant changes. One of the major dimensions of these changes within these organizations is corporate governance. Corporate governance has indeed become the focus of increased attention of not only directors, investors and stakeholders, but also regulators, who are all watching more and more carefully whether organizations are "governed" efficiently, effectively and ethically (Brickly, Coles and Gregg, 1997). In particular, corporate governance scholars have come to the conclusion that firms across the world need to adopt commonly accepted corporate governance standards to be able to attract foreign capital, to become internationally more competitive and to deal with corporate governance problems in today's economy (Abor, 2007).

Corporate governance is not just about board structure and interests alignments for its own end. It is very much about perceived benefits in terms of attraction of capital and its retention. For corporations it could well mean enhanced market capitalization. Typically corporate governance structures adopted by firms experiencing declining performance

results in changes in; board meeting frequency, board composition insider share ownership and executive compensation (Monks and Minow, 2004). Board meeting frequency potentially carries important governance implication as it is less costly for a firm to adjust the frequency of its board meeting to attain better governance of the firm, than to change the composition of its board or ownership structures. Vafeas (1999) found that meeting frequency was influential in improving operating performance in a manner consistent with the agency theory.

A well defined and functioning corporate governance system helps a firm to attract investment, raise funds and strengthen the foundation for firm financial performance. Good corporate governance shields a firm from vulnerability to future financial distress (Demsetz and Villalonga, 2002; Bhagat and Jefferis, 2002). The argument has been advanced time and time again that the governance structure of any corporate entity affects the firm's ability to respond to external factors that have some bearing on its financial performance (Donaldson, 2003). In this regard, it has been noted that well governed firms largely perform better and that good corporate governance is of essence to firm's financial performance.

The subject matter of corporate governance has dominated the policy agenda in developed market economies for sometime especially among very large firms. Subsequently, the concept is gradually warming itself to the top of policy agenda in the African continent. Indeed, it is believed that the Asian crisis in 1992 and the seemingly poor performance of the corporate sector in Africa have made the concept of corporate

governance a catchphrase in the development debate (Berglof and von Thadden, 1999). It is believed that good governance generates investor goodwill and confidence. Again, poorly governed firms are expected to be less profitable. Claessens *et al.* (2002) also posits that better corporate framework benefits firms through greater access to financing, lower cost of capital, better financial performance and more favourable treatment of all stakeholders. They argue that weak corporate governance does not only lead to poor firm financial performance and risky financing patterns, but are also conducive for macroeconomic crises like the 1997 East Asia crisis. Other researchers contend that good corporate governance is important for increasing investor confidence and market liquidity (Donaldson, 2003).

The financial scandals initially tended to be a problem in the developed countries. (Okoth 2007) In Kenya, the past corporate governance reforms have concentrated on companies listed in the Nairobi stock exchange (NSE). However as Yener (2001) notes corporate governance is an essential tool to combat corruption, which is one of the major vices in State Owned Corporations. In Kenya the State owned enterprises have been established mainly with financial resources from tax payers. This means that the main shareholder in the State Organization Enterprises is the public, whose taxes have been invested in these corporations (African Governance Report ,2009) .

1.1.1 Commercial State Corporations in Kenya

The State Corporation Act is an Act of parliament to make provision for the establishment of state corporations and for control and regulation of state corporations. A state corporation has perpetual succession; in its corporate name is capable of suing and

being sued and is capable of holding and alienating movable and immovable property. The Kenya government forms state corporations to meet both commercial and social goals. They exist for various reasons including: to correct market failure, to exploit social and political objectives, provide education, health, redistribute income or develop marginal areas. According to the Guidelines on State Corporations from the Office of the President (2010) to date there are 176 operational State Corporations in Kenya. This study will concentrate on the state corporations which are Commercial based and they are 27 in number (appendix 1).

In spite of the reforms the government of Kenya has adopted over the last few years' financial scandals and collapses which have hit almost every country without exception have ensured that poor corporate governance practices in the public sector grow unabated. The resultant effects are low economic growth, insecurity, lack of investments and poor service delivery leading to under development.

Against the background of economic growth that started from an all time low of – 0.3 % GDP in 2001, Kenya has been experiencing positive growth rate that is still not good enough especially with its ambitious vision 2030. At its current economic growth there is still need for boosted strategies to achieve sustained growth of 10%.(ERS for Commonwealth 2003-2007) One of the factors that are and have a great potential to facilitate growth will be the State Corporations.

In Kenya many State Corporations have been characterized by monopolistic production, highly indigenized management and appointments of a large number of top managers based on political considerations. This has led to many of the State Corporations in Kenya to struggle to regain their foothold. This is evidenced by declarations of their bankruptcy and the resultant state of receivership. For example, in June 2006 Uchumi Supermarket was declared bankrupt and put under receivership over a 1.2 billion debt. However a fresh equity and debt arrangement approved by Uchumis' share holders paved way for lifting its receivership. (World Bank report 2006) This state of affairs has serious repercussions on the national economy and need to be addressed.

1.2 Statement of the Problem

According to Graham (2008), Greek experience, state owned telecommunication firms adopted effective corporate mechanism improving public revenue, efficiency, increased investments and better quality of services. Solomon *et al.* (2003) emphasize the importance of good corporate governance and claim that corporate governance involves a set of relationships between a SOE's management, its board, its shareholders and other stakeholders, with increasingly accepted "good" corporate governance practices. By adopting good corporate governance principles, co-operation will continue to play a crucial role in developing counties economies with high economic efficiency, personal savings will be well managed with investor confidence and pensions will be secured with monitored performance. Monksand Minow, (2004) noted that an important theme of corporate governance is the nature and extent of accountability of particular individuals in the organization, and mechanisms that try to reduce or eliminate the principal-agent problem (Graham, 2008).

Much of the local studies done focused on corporate governance adopted by companies listed in the Nairobi Stock Exchange and parastatals. Ogutu (2010) carried out a survey of corporate governance practices focusing on a case of in the Water Sector In Kenya, Washe (2010) established a relationship between corporate governance Practices and financial services of the Teachers' SACCO in Cost Province of Kenya . Very few studies have been done on the relationship between Corporate Governance practices and firm performance and hence the need for further studies in this area. Ngugi, (2007) carried out a study on relationship between corporate governance structures and Performance of insurance companies in Kenya. Nganga, (2007) carried out a study on compliance with capital markets authority corporate governance, guidelines by companies listed at the Nairobi Stock Exchange .Inspite of the government reforms in Kenya, financial scandals and collapses in the public enterprises continue unabated. This study therefore seeks to fill the existing knowledge gap by investigating the relationship between corporate governance practices and firm performance in commercial state corporations in Kenya?

The concept of board effectiveness will need further elaboration according to the role each board plays within its organisation. Because of the diversity in these roles this may be extremely complicated. Larcker *et al.* (2004) for instance identifies six different roles and consequently suggests that the measurement of board effectiveness should be reconsidered in line with these roles. Furthermore, the relative weight of each role will vary according to the structure of the board.

Conventional wisdom on corporate governance predicts that good corporate governance increases firm valuation and firm performance and reduces the cost of capital and financial fraud. However, there may be important empirical and theoretical reasons why these relationships do not hold.

1.3 Objective of the Study

To study the relationship between corporate governance practices and performance in Commercial State Corporations in Kenya.

1.4 value of the Study

The delivery of services emanating from good corporate governance practices in the majority of State Corporations in Kenya has in the past been alarming. It is perceived that lack of effective governance systems has led to poor performance in commercial state corporations. This has led to poor economic growth. (Public Service Integrity Program (PSIP) 2003).

The results will help the government to come up with appropriate governance practices to curb these vices. The findings from these study, will be useful to the government and the citizenry as when good corporate governance practices are effected this will boost the economy which will have a ripple effect on the citizens of Kenya. The government in the developing policy papers, policy making regarding corporate governance. The policy makers will know how well to incorporate the public sector effectively to ensure its full participation

The study will also be useful for policy makers to formulate policies which can be effectively implemented in governing commercial state corporations. The study will also assist shareholders and investors to give them an insight of how the board of directors operates. For the management in organizations, this study will also give them meaningful interaction to see where the organizations are going and what means will be used to get there.

The study will help shareholders know the various mechanisms through which they can exercise their control. Potential investors will also benefit as they will be able to determine companies that are properly governed in making their investment decisions.
The academicians who will be furnished with relevant information regarding credit the relationship between corporate governance and financial performance in the state corporations. The study will contribute to the general body of knowledge and form a basis for further research.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter deals with the available literature that has been reviewed for the study. The literature is mainly on the corporate governance practices. The specific areas covered include corporate governance in emerging economies, the interaction of different governance mechanisms, best practices, corporate governance index, corporate governance and stakeholders' participation, role of corporate governance and relationship between governance mechanism and performance in the commercial state corporations.

2.2 Theoretical Review

The main theoretical perspectives that have affected the development of corporate governance are the agency theory, transaction cost economics, stakeholders theory and stewardship theory.

2.2.1 The Agency Theory

A significant body of work has built up in this area within the context of the principal-agent framework. The work of Jensen and Mecklin (1976) in particular and of Fama and Jensen (1983) are important. Agency theory identifies the agency relationship where one party, the principal, delegates work to another party, the agent. The agency relationship can have a number of disadvantages relating to the opportunism or self interest of the agent: For example, the agent may not act in the best interests of the principal, or the

agent may act only partially in the best interests of the principal. There can be a number of dimensions to this including for example, the agency misusing his power for pecuniary or other advantage ,and the agent not taking appropriate risks in pursuance of the principals interests because he(the agent) views those risks as not being appropriate and the principal may have different attitudes to risks. There is also the problem of information asymmetry whereby the principal and the agent have access to different levels of information; in practice this means that the principal is at a disadvantage because the agent has more information.

In the context of corporations and issues of corporate control, agency theory view corporate governance mechanisms especially the board of directors, as being an essential monitoring device to try to ensure that any problems that may be brought about by the principal-agent relationship, are minimized. Baysinger and Butler (1996) states; managers are supposed to be the 'agents' of a corporations 'owners' but managers must be monitored and institutional arrangements must provide some checks and balances to make sure they do not abuse their power. The costs resulting from managers misusing their position, as well as the costs of monitoring and disciplining those to try to prevent abuse have been called 'agency costs'.

2.2.2 Transaction Cost Economics

Transaction cost economics (TCE) as expounded by the work of Williamson (1975, 1984) is often viewed as closely related to agency theory. Transaction cost economics views the firm as a governance structure whereas the agency theory views the firm as a nexus of contracts. Essentially, the latter means that there is a connected group or series

of contracts amongst the various players, arising because it is seemingly impossible to have a contract that perfectly aligns the interests of principal and agents in a corporate control situation.

As firms grow in size, whether caused by the desire to achieve economies of scale, or by technological advances, or by the fact that natural monopolies have evolved, they have increasingly required more capital which has needed to be raised from the capital markets and wider shareholder base has been established. The problem of the separation of ownership and control and the resultant corporate governance issues have thus arisen. Coase (1937) examines the rationale for the firm's existence in the context of a framework of the effectiveness of internal as opposed to external contracting. He states "the operation of a market costs something and by forming an organization and allowing some authority (an entrepreneur) to direct the resources, certain marketing costs are saved". The entrepreneur has to carry out his function at less cost; taking into account the fact that he may get factors of production at a lower price than the market transactions which he supersedes (Cadbury, 2002).

Hart (1995) states there are a number of costs to writing a contract between principal and agent, which include the cost of thinking about and providing for all the different eventualities that may occur during the course of the contract, the cost of negotiating with others, and the costs of writing the contract in an appropriate way so that it is, for example, legally enforceable. These contracts tend to mean that contracts are apt to be incomplete in some way and so contracts will tend to be revisited as and when any

omissions or required changes come to light. Hart indicates that,'in a world of incomplete contracts (where agency, problems are also present), governance structure can be seen as a mechanism for making decisions that have not been specified in the initial contract (Carver, 2000).

2.2.3 Stakeholder Theory

In juxtaposition to agency theory is stakeholder theory. Stakeholder theory takes into account of a wider group of constituents rather than focusing on shareholders. A consequence of focusing on shareholders is that the maintenance or enhancement of shareholders' value is paramount whereas when a wider stakeholder group such as employees, providers of credit, customers, suppliers, government and the local community is taken into account the overriding focus on shareholder value become less self evident.Nonethless many companies do strive to maximize shareholders value whilst at the same trying to take into account the interests of the wider stakeholder group. One rationale for effectively privileging shareholders over other stakeholders is that they are recipients of the residual free cash flow (being the profits remaining once other stakeholders such as loan creditors, have been paid).This means that the shareholders have vested interest in trying to ensure that resources are used to maximum effect, which in turn should be to the benefit of the society (Cho and Kim,2003).

Shareholder and stakeholders may favor different corporate governance structures and also monitoring mechanisms .According to CMA (2008), differences in the corporate governance structure and mechanisms of the so called Anglo-American model ,with its emphasis on shareholder value and a board composed totally of executive and non-

executive directors elected by shareholders, compared to the German model whereby certain stakeholder groups such as employees have a right enshrined in law for their representatives to sit on the supervisory board alongside the directors. .Enlighted value maximization utilizes much of the structure of stakeholder theory but accepts maximization of the long run value of the firm as the criterion for making the requisite trade-offs among its stakeholders and therefore solves the problems that arise from multiple objectives that accompany traditional stakeholder theory (Cohen, 2001).

2.2.4 Stewardship Theory

Stewardship theory draws on the assumptions underlying agency theory and TCE. The work of Donaldson and Davis (1991) cautioned against accepting agency theory as a given and introduced an alternative approach to corporate governance stewardship theory. The thrust of Donaldson and Davis paper was that agency theory emphasized the control of managerial opportunism by having board chair independent of the CEO and using incentives to bind CEO interests to those of shareholders.

Stewardship theory stresses the beneficial consequences of shareholders returns of facilitative authority structures which unify command by having roles of the CEO and chair held by the same person. The safeguarding of returns to shareholders may be along the track, not of placing management under greater control by owners, but of empowering managers to take autonomous executive action (Dixon, 2006).

2.3 Corporate Governance Structures

Corporate governance structures can be defined as the systems or mechanisms designed to monitor managers and improve corporate transparency. Typically corporate governance structures adopted by firms experiencing declining performance results in changes in; board meeting frequency; board composition (McCord, 2002) insider share ownership and executive compensation. Board meeting frequency potentially carries important governance implication as it is less costly for a firm to adjust the frequency of its board meeting to attain better governance of the firm, than to change the composition of its board or ownership structures. Vafeas (1999) found that meeting frequency was influential in improving operating performance in a manner consistent with the agency theory.

The publication of the OECD Principle of Corporate Governance (2003) and the Principles of Corporate Governance in Greece (1999) in the late 1990s led to fruitful debates on corporate governance in Greece, which however inclined at that time to view corporate transparency and accountability as rather "apocryphal" matters (Avlonitis and Mertzanis, 2002). Since then, the domestic implementation of a large number of EU directives, regulations and communications, the rise of diversified capital needs of Greek corporations within the new international environment of intensified financial competition and the gradual transformation of domestic corporate culture brought significant change in corporate relations and behavior. Corporate governance problems have appeared during the past decade but were not associated with major scandals threatening the integrity of the Greek market. Most corporate governance problems and

conflicts were depicted and dealt with by regulation and auditing. However, these principles and their market impact have not adequately been assessed. Public debate on corporate governance in developing has been stalled. The working group also recommends that public issuers be required to report against key corporate governance principles, or objectives (UK, Code of good practice, 2011).

Corporate governance comprises many dimensions. Based on the U.K. Code, it can be divided broadly into the role of directors, directors' remuneration, the role of shareholders, and accountability and audit. Some of the structures are complements while others are substitutes to certain extent. The previous research has found different governance patterns. For example, Peasnell *et al.* (2001) find evidence of a convex association between the proportion of outside board members and the level of insider ownership in the U.K. corporate control process. Shivdasani and Yermack (1999) observe, using U.S. data, that when the CEO serves on the nominating committee or no nominating committee exists, firms usually appoint fewer independent outside directors and more grey outsiders. Similarly, Vafeas (1999) discover that the likelihood of engaging a nominating committee is related to board characteristics such as inside ownership, number and quality of outsider directors for U.S. firms. Young (2000) investigate the board structure determinants before and after Cadbury Report. They either find managerial entrenchment is reduced or non executive directors are increased following the imposition of new standards of "best practice" regarding board structure.

2.3.1 Non-executive directors (independent and grey directors)

A number of studies suggest that non-executive directors play an important role in monitoring management. Independent directors are invited onto the board in order to oversee management on behalf of shareholders. Baysinger and Butler (1985) examine the relationship between board composition and financial performance and suggest that firms with more independent boards have superior performance. Vafeas (1999) study also suggests that a high proportion of independent directors is positively associated with excess returns. March, (2005) reveal that a higher fraction of independent directors on the board is linked to greater firm value. Nevertheless, Donaldson, (2003) argues that independent directors may not have adequate information and knowledge about the firm. The ability to maximize firm performance of independent directors may be eroded by limited time commitment.

2.3.2 Board Attributes

The corporate governance literature identifies four sets of board attributes; namely, composition, characteristics, structure and process (Abor, 2007). Board composition refers to the size of the board and the mix of different director's demographics (insiders/outsiders, male/female, foreign/local) and the degree of affiliation directors have with the corporations (Zandstra, 2002). Board characteristics encompass director's background, such as director's experience; tenure; functional background; independence; stock ownership and other variables that influence director's interest and their performance.

2.3.3 Board Committee

The primary roles of the board committee are to monitor and review financial statements, determine remuneration, and nominate new directors. Audit, remuneration, and nomination committees play very important roles. Brownbridge, (2007) suggests that a remuneration committee's task is to oversee the amount of all remuneration of senior managers and to design better remuneration schemes to alleviate conflict between managers and shareholders. Nomination committee's task is to monitor the quality of appointment of members to the board. Claessens et al. (2002) provide evidence that when CEOs are involved in nominating committees, fewer independent directors are appointed on the corporate board. Brown and Caylor, (2004) examines an association between committee composition and corporate value and reveals that there is no significant correlation between the percentage of non-executive directors on the audit and compensation committees and firm performance.

2.4 Relationship between Governance Mechanism and Financial Performance

Corporate governance may have an influence on the level of disclosure (Haniffa and Cooke, 2002) as well as timeliness of reporting, especially as it is the board of directors that manages information disclosure in annual reports (Gibbins et al., 1990). The quantity of information and especially voluntary items disclosed in the annual reports and the time the information to be released, are influenced by the board of directors. Thus, referring back to agency theory, when the board of directors are independent of the management

and observe their responsibility to be accountable and transparent to the shareholders or stakeholders, they will disclose on time all the relevant information, not just the mandatory ones but also the voluntary items (Cho and Kim,2003).

In view of the importance of the disclosure factor (Haniffa and Cooke, 2002) as well as timely reporting (Oh, 2003) in relation to corporate governance in Malaysia, this study attempts to test whether corporate governance practices can predict the level of transparency (more specifically the level disclosure and timeliness of reporting). Then, in turn, higher level of transparency may be able to positively affect firm performance based on the premise that improved disclosure as well as timely reporting may reduce cost of capital and mitigate information asymmetry (Euromoney Institutional Investor,2001) .
As the U.K. Code encourages institutions to take an active role in governance, the study may expect a positive relationship between institutional holdings and firm performance. Unfortunately, empirical evidence is not supportive of this recommendation. Both Faccio and) fail to find such a significant relationship for U.K. firms. Besides, de Jong *et al.* (2002) find that major outside and industrial shareholders negatively influence the firm value.

Good corporate governance is fundamental to any effective organisation and is the hallmark of any well-managed corporate entity. This Code seeks to promote good corporate governance in central government departments. When the original Code was first published in July 2005 (the 2005 Code), it was the first time the principles of corporate governance had been codified in central government. Those principles are now

largely common practice. This Code builds on the 2005 Code by incorporating recent changes in best practice in the public, private and charity sectors. It sets out the role and functions of departmental boards, including how government departments will be business-like through drawing on the expertise of senior business leaders who sit on the boards as non-executive board members.

In developing countries, the state-owned enterprise sector is an integral part of socio-economic activity. Most state-owned enterprises were established to fulfill the social objectives of the state rather than to maximize profits. However, rising stakeholder expectations have forced governments in many countries to reform the corporate governance systems of state-owned enterprises, with expectations of improving their operations to reduce deficits and to make them strategic tools in gaining national competitiveness (Coombs and Watson, 2001). The implementation of corporate governance restructuring included external boards of directors, statements of corporate intent, and business plans (Dahya, Lonie and Power, 2006).

Similar to global trends, Thai state-owned enterprises have operated as a state mechanism to provide essential services to citizens, such as utilities, infrastructure, and mass transportation. They have total assets of 5,519 billion baht ($US137.05bn), or 85 percent of GDP, and an annual capital investment of 352 billion baht (($US8.74 bn), or 70 percent of government capital expenditure (Minister of Finance, 2005). Beginning in 2004, the Ministry of Finance implemented a corporate governance restructuring program

to enhance the efficiency and effectiveness of Thai state-owned enterprises. So far, 53 of 58 Thai state-owned enterprises have restructured their corporate governance systems. During the 1980s, the applications of corporate governance were primarily focused on designing contractual mechanisms to control the self-interest of management. The board of directors has been a central institution in the internal governance of a company by providing a key monitoring function for aligning the interests of agents and shareholders (O'Regan et al., 2005). Many studies have also recognized the impacts of the characteristics of the board of directors (e.g. board composition and board leadership, and board size) on firm performance (Peng et al., 2003).

However, the failure of boards of directors at Enron and WorldCom highlighted the need for more appropriate instruments to prevent misconduct by boards of directors. Furthermore, the increasing complexity of organizations has challenged organizational scholars and practitioners to broaden the applications of corporate governance. During the last decade, corporate governance practices have been extended from monitoring and controlling to strengthening strategic policies and ensuring the integrity of managerial processes (Yoshikawa et al., 2004). With this, the strategic role of the board of directors has been expected (Charan, 2005). Additionally, many areas of management systems of organizations have been restructured to enhance the effective implementation of corporate strategy. Management systems have been widely developed, including risk management, internal control, internal audit, strategic human resource management, and information technology (Posthumusa et al., 2005).

The Code is drafted to offer flexibility in the way a board behaves, particularly to foster a sense of equal status and collective corporate behaviour amongst board members. In particular it may be appropriate in certain areas for the board to assume the characteristics of a supervisory body, in order to provide governance oversight to support the accounting officer. Each department needs to be pragmatic in the way they implement the principles of the Code. One size never fits all, but the comply or explain mechanism enables departments to deviate from the principles and supporting provisions if justifiable for the good governance of the department.

2.5 Empirical Review

Additionally, research conducted on firm-level data of corporate governance ratings across 14 emerging markets (not covering transition countries) reveals that better corporate governance is correlated with better operating performance and market valuation (Klapper and Love, 2002). Research has shown that companies with a higher corporate governance (based on developed indices) were performing better and had higher market value or Tobin's q (Bauer and Guenster, 2003; Beiner et al., 2004; Schmidt and Zimmermann, 2004). Moreover, a portfolio of companies with better corporate governance delivered a 2.1 per cent higher return as compared with companies of poor corporate governance (Bauer and Guenster, 2003). Schilling (2003) conducted on the sample of 242 of Europe's largest corporations listed in the FTSE Eurotop 300 index shows that companies with stronger corporate governance performance (measured by over 300 corporate governance rating variables)are on average also valued higher in terms of Tobin's q. These results indicating positive relationship between good corporate

governance and firm performance were supported by international research conducted on a sample of 526 Korean companies (Black et al., 2003).

Previous empirical studies have provided the nexus between corporate governance and firm financial performance with inconclusive results. Bebchuk and Cohen (2004) have shown that well-governed firms have higher firm performance. The main characteristic of corporate governance identified in these studies include board size, board composition, and whether the CEO is also the board chairmanFama (1980) states that when managers are less diversified than their shareholders' i.e. in addition to holding stock and stock options, their human capital is also specific to the firm. Consequently, the managers may increase leverage beyond the "optimal capital structure" to increase the voting power of their equity stakes and reduce the likelihood of a takeover and the resulting possible loss of job tenure (Heath and Norman 2004). In New Zealand companies have relied on debt as a source of capital and debtholders have a tendency to safeguard their investment, monitoring firm performance on a regular basis. It is assumed that the use of debt will have a positive effect on firm financial performance. Limiting board size is believed to improve firm performance because the benefits by larger boards of increased monitoring are outweighed by the poorer communication and decision-making of larger groups (Lipton and Lorsch 1992; Jensen 1993). Consistent with this notion, Yermack (1996) documents an inverse relation between board size and profitability, asset utilization, and Tobin's Q. Anderson et al. (2004) show that the cost of debt is lower for larger boards, presumably because creditors view these firms as having more effective monitors of their financial accounting processes.

Similarly, companies may set a target ratio of dividend to earnings as a control instrument similar to debt financing. The higher the payout ratio, the smaller the amount of free cash flows. Also, Crutchley and Hansen (1989) show evidence of dividend policy acting as a corporate monitoring vehicle. Farinha (2003) provides empirical evidence of dividend policy reducing agency problems either by increasing the frequency of external capital raising and associated monitoring by investment bankers and investors (Easterbrook, 1984) or it is reasonable to assume that dividend payouts will have a positive effect on firm performance. Good corporate governance is important for increasing investor confidence and market liquidity (Donaldson, 2003). With so many recent regulations focusing on corporate governance, such as those based on the Sarbanes-Oxley Act and the recent stock listing standards imposed by major U.S. exchanges, there is a widely held view that better corporate governance is associated with better firm performance, but the evidence is tenuous (LeBlanc and Gillies 2003).

Klein (2002) documents a negative relation between earnings management and audit committee independence, and Anderson et al. (2004) find that entirely independent audit committees have lower debt financing costs. Frankel, Johnson and Nelson (2002) show a negative relation between earnings management and auditor independence (based on audit versus non-audit fees), but Ashbaugh, Lafond and Mayhew (2003) and Larcker and Richardson (2004) dispute their evidence. Kinney, Palmrose and Scholz (2004) find no relation between earnings restatements and fees paid for financial information systems design and implementation or internal audit services, and Agrawal and Chadha (2005)

find no relation between either audit committee independence or the extent auditors provide non-audit services with the probability a firm restates its earnings.
Byrd and Hickman (1992) found that, on average, tenders offered to bidders with majority-independent boards earn roughly zero stock price returns. However, bidders without such boards suffer statistically significant losses of 1.8 per cent on average. You et al. (1986) also reported a significant negative correlation between the proportion of "inside directors" and bidder stock price returns. These results suggest that companies with relatively more independent directors tend to be more profitable than those with fewer independent directors. This may be due to independent directors acting to restrain the tendency of CEOs to build large, unsustainable financial empires. Denis and Sarin (1997) found that firms that substantially increase the proportion of independent directors have above-average stock price returns. In a study to assess investor reaction to the appointment of additional directors, Rosenstein and Wyatt (1990) found that stock prices increase by about 0.2 per cent, on average, when companies appoint additional outside directors. This increase was statistically significant, but economically small.

Previous evidence suggests that corporate governance has a positive influence over corporate performance. For example, based on industry-level view, Rajan and Zingales (1998) find that firms in industries that require large amounts of external financing grow faster in countries with high scores on their measures of financial development. Thus, corporate governance (measured through better accounting standards, stronger legal protection of investors, and a stronger rule of law) appears to matter for financial performance. In addition, Liang Li (1999), Williams (2000), Alves and Mendes (2002),

Drobetz et al. (2003) and Gemmill and Thomas (2004) concluded in their respective studies that there is a positive relationship between good corporate governance practices and firm value. A widely accepted statement is that good corporate governance results in influence accountability and efficiency in the organizations. One explanation is that good corporate governance will lead to lower firm risk and subsequently to a lower cost of capital (Heath and Norman, 2004).

According to Heath and Norman, (2004), when senior managers were given multiple objective to achieve it may become almost impossible to measure their success in improve the firm performance through accountability for achieve firm value leading to failure. Several studies suggest that firms with more independent directors perform worse than those with relatively fewer independent directors. For example, Agrawal and Knoeber (1996) reported a negative correlation between the proportion of outside *directors and Tobin's Q index (which is a measure of growth prospects of assets, defined* by the future profitability of the asset in relation to its replacement cost). This is consistent with evidence established by Bhagat and Black (1997) that a high proportion of independent directors is strongly correlated with slower past growth across a number of accounting variables, but not so with future performance. Evidence from Bhagat and Black (1997) and Klein (1997) also shows that a high proportion of independent directors correlate with lower past profitability.

2.6 Summary

Corporate governance is the process and structure used to direct and manage the business affairs of the company towards enhancing business prosperity and corporate

accountability with the ultimate objective of realizing long-term shareholder value, whilst taking into account the interest of other stakeholders. Corporate Performance is an important concept that relates to the way and manner in which financial resources available to an organization are judiciously used to achieve the overall corporate objective of an organization. It keeps the organization in business and creates a greater prospect for future opportunities. Institutions that practice good corporate governance are more likely to achieve institutional objectives and goals.

In fact, good corporate governance helps promote the general welfare of the society and should be of interest to the general public and governments. Corporate governance (measured through better accounting standards, stronger legal protection of investors, and a stronger rule of law) appears to matter for corporate performance. The main idea behind disclosure of corporate information and corporate governance is that it reduces information asymmetries between managers and shareholders and lowers its risk. Organizational structure, therefore, should be contingent on the extent to which the external environment in which the marketing tasks are performed is uncertain and dynamic.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter presented the research design and methodology that used to carry out the research. It presented the research design, the population, data collection, data analysis, validity and reliability.

3.2 Research design

Research design refers to the way the study is designed, that is the method used to carry out the research (Mugenda and Mugenda (2003). The study adopted survey design. According to Mugenda and Mugenda (2003) noted that survey is an attempt to collect data from members of a population to determine the current status of that population with respect to one or more variables. Survey research design is a self report study which requires the collection of quantifiable information from the sample

Survey research aim at obtaining information that describes existing phenomenon as stipulated in Mugenda and Mugenda (2003), by asking individuals about their perception, attitudes, behaviour and values. Survey is a descriptive research. For a researcher interested to collect data that was original, as it was the case in this study, then survey was the most appropriate design to undertake the study.

3.3 Population

The population for the study was for the 42 commercial state corporation in Kenya whereby a selection of five officers comprising an administrator , public relations officer, accountants, chief financial officers and internal auditors will be the respondents of the study. These are the people who directly deal with the day to day operations and governance in the commercial state Corporation.

3.4 Sampling Technique

Stratified sampling technique was used to select the sample. The technique will produce estimates of overall population parameters with greater precision. The study grouped the population into four strata that is administrators public relations officers accountants chief finance officers and internal auditors. From each stratum the study will used simple random sampling to select 27 respondents.

3.5 Data collection

The study used questionnaire to collect the primary data from the chief finance officers. The primary data was useful to the research because it was reliable and accurate. However, some qualitative data were also collected to support the quantitative data. The researcher collected secondary data from the ministries . The researcher administered the questionnaires to the respondents through drop and pick method giving the respondents a period of one week to respond to the questionaires.

3.5.1 Validity and Reliability

Piloting was carried out to test the validity and reliability of the instruments. Validity indicates that degree to which the instrument measures the constructs under investigation (Mugenda and Mugenda, (2003). There were three types of validity test which include content, criterion and related construct validity. This study used content validity because it measured the degree to which the sample of the items represents the content that the test will be designed to measure.

A pilot study was conducted by the researcher taking some questionnaires to the selected ministries filled by some respondents at random. From this pilot study the study was able to detect questions that needed editing and those that were ambiguous. The final questionnaire was then printed and used to collect data to be used for analysis.

Reliability was synonymous with repeatability or stability and a measurement that yields consistent results over time was said to be reliable (Kothari, 2008). The test retest method was used to ascertain the reliability. Cronbach's alpha formula was used in calculating the reliability of data coefficient of 0.8 was accepted (Mugenda and Mugenda, 2003). Reliability was obtained by correlating the scores of each questionnaire for each variable. Pearson product moment correlation coefficient (r) was used to test reliability of the questionnaire. The correlation coefficient of the halves was corrected by Spearman Brown Prophesy formula

$$\text{Re} = \frac{2r}{1+r} \quad \text{.......................... Equation (2)} \quad \text{(Tuckman, 1972)}$$

The questionnaires was considered reliable if the value for Re was closer to1.0 getting consistent responses when the same question is posed to the same respondent more than once.

3.6 Data Analysis

The data was edited, coded and classified so as to present the results of the data analysis in a systematic and clear way. The primary data collected through the questionnaire was analysed using descriptive statistics such as measures of central tendency which include mean, median and mode using SPSS version 17.5 and Microsoft excel. Pie charts, tables and graphs were used to present the data collected for ease of understanding and analysis. A multiple regression analysis was used to find out whether independent variables predict a given dependent variable.

3.6.1 Model Specification

Since the efficiency and effectiveness of the financial performance measures using by a firm had direct effect on its performance, profitability was used to quantify the financial performance measures. The study used natural logarithm of the previous years profit while the corporate government elements (Split Chairman/CEO Roles, Board Size, Independence of Committees and Independent Directors) was quantified using a Likert scale scores whose means was computed for each factor within the element. Regression model to the study that was used is:

$$LnPROF = \beta_0 + \beta_1 RP + \beta_2 BP + \beta_3 CP + \beta_4 DP + \varepsilon_{it}$$

Whereby β_0 is constant of the model while β_1, β_2, β_3 and β_4 are the coefficients of the independent variables

Ln PROF = natural logarithm of the previous years profit

RP = total mean scores for the factors within the Split Chairman/CEO Roles perspective

BP = total mean scores for the factors within the Board Size perspective

CP = total mean scores for the factors within the Committees Independence perspective

DP = total mean scores for the factors within the Independent Directors perspective

ε_{it} = an error term for the model

CHAPTER FOUR:

DATA ANALYSIS, INTERPRETATION AND PRESENTATION

4.1 Introduction

This chapter presents the data analysis, interpretation and presentation there-to on the study to determine corporate governance practices and the effect of corporate governance on financial performance of broadcasting Ministry in Kenya. The study had targeted 30 respondents out of which 30 respondents filled and returned their questionnaire constituting 100 % response rate. Data analysis was done through Statistical Package for Social Scientists (SPSS) version 17. Frequencies, percentages and mean were used to display the results which were presented in tables and graphs.

4.2 Data Analysis

Respondent profile

Respondent's position

The study sought to investigate respondents' position in the corporation. Form the findings, all of the respondents indicated that they were administrator , public relations officer , accountants, chief financial officers and internal auditors, This implied that the information was collected from the relevant respondnets who were in a better position to offer relevant information on effects of corporate governance practices on financial performance in the goverment ministries.

Table 1: Respondent Level of education

	Frequency	Percent
Secondary	3	10.0
College	9	30.0
University degree	12	40.0
Masters	3	10.0
Others	3	10.0
Total	30	100.0

(Source-Researcher 2011)

On the respondent level of education the study found that 40% of the respondents had university degree, 30% of the respondent had attained colleges education, those who had secondary education, master and profession qualification were shown by 10% in each case. This information shows that employees at the ministries were well educated.

Table 2: Length of work

	Frequency	Percent
1 to 5 years	18	60.0
6 to 10 years	12	40.0
Total	30	100.0

(Source-Researcher 2011)

From the findings in the table the study found that majority of the respondent had worked with state owned enterprises for 1 to 5 years and 40% had worked in the state owned enterprise for 6 to 10years. This information shows that most of the respondents were in the state owned enterprises for long enough to give credible information to the study.

Table 3: Rating the effectiveness of governance systems in public sectors

	Mean	Std Dev
Limited partnership agreements at the top level that prohibit headquarters from cross- subsidizing one division with the cash from another	1.5667	0.458
High-equity ownership on the part of managers and board members; board members who in their funds directly represent a large fraction of the equity owners of each subsidiary company	1.9333	0.823
Small boards of directors, typically consisting of not more than eight people	2.4667	0.427
CEOs who are typically the only insiders on the board	2.2000	0.416
CEOs who are seldom the chairman of the board	1.9667	0.580

(Source –Researcher 2011)

The study sought to know the respondent rating of the various governance systems, from the findings the study found that most the respondent indicated the following as effective, they include Limited partnership agreements at the top level that prohibit headquarters from cross-subsidizing one division with the cash from another as shown by mean 1.5667, High-equity ownership on the part of managers and board members; board members who in their funds directly represent a large fraction of the equity owners of each subsidiary company as shown by mean of 1.933, CEOs who are seldom the chairman of the board as shown by mean of 1.9667, CEOs who are typically the only insiders on the board as indicated by mean of 2.20 and Small boards of directors, typically consisting of not more than eight people as shown by mean of 2.4667. This shows that governance systems that were effective include Limited partnership

agreements at the top level that prohibit headquarters from cross- subsidizing one division with the cash from another.

On who incorporate corporate governance system in the respondent firm the study found that they were board of directors, partners, department heads, directors who own the company and top management. The study further revealed that majority of state owned enterprises house regularly review and collected data on customer feedback for services provided. The methods used were SMS line, phone line, through emails, online interview, questionnaires, interview guide, and interview and through survey and shows. This implies that the incorporation of corporate governance system in the firm is by various players and state owned enterprises regularly review and collected data on customer feedback for services provided using SMS line, phone line, through emails and online interview, questionnaires.

Table 4: Respondent level of agreement on corporate governance

	Mean	Std Dev
Good corporate governance approach aims at performing the main function of separating the firm's principals and agents.	1.0000	0.549
Corporate governance themes in your Ministry separates management from the board	2.3333	0.217
Corporate governance systems are mechanisms for establishing the nature of ownership and control of organizations within an economy.	1.7667	0.305
Agency problem arises as a result of the relationships between shareholders and managers	1.7667	0.940
Corporate governance would not apply to the sector since the agency problems are less likely to exist.	2.2667	0.850

(Source –Researcher 2011)

Table shows that most of the respondent strongly agreed that good corporate governance approach aims at performing the main function of separating the firm's principals and agent as shown by mean of 1. Respondent agreed that Agency problem arises as a result of the relationships between shareholders and managers and Corporate governance systems are mechanisms for establishing the nature of ownership and control of organizations within an economy as shown by mean of 1.7667 in each case, Corporate governance would not apply to the sector since the agency problems are less likely to exist as shown by mean of 2.2667 and Corporate governance themes in your Ministry separates management from the board as shown by mean of 2.333. This implies that good corporate governance approach aims at performing the main function of separating the firm's principals and agent.

Table 5: Rating the determinants of strong corporate governance

	Mean	Mean
Split Chairman/CEO Roles	1.9333	0.983
Board Size	2.7333	0.792
Independence of Committees	1.6333	0.692
Independent Directors	1.8333	0.480
Any other	1.5667	0.938

(Source –Researcher 2011)

On the respondent rating the determinant of strong corporate governance the study found that most of the respondent indicated the following were significant other factors as shown by mean of 1.5667, Independence of Committees as shown by mean of 1.6333,

Independent Directors as indicated by mean of 1.8333 and Split Chairman/CEO roles as indicated by mean of 1.9333. Board Size was rated as significant as shown by mean of 2.7333. This implies that determinant of strong corporate governance were independence of committees, independent directors and split chairman/CEO roles.

Table 6: Respondent level of agreement on various aspects of corporate governances that enhances financial performance

	Mean	Std dev
Good corporate governance shields the ministries from vulnerability to future financial distress	1.7000	0.893
Governance structure of the Ministry affects the firm's ability to respond to external factors that have some bearing on its financial performance	2.1667	0.815
Good governance generates investor goodwill and confidence	2.4667	0.681
Better corporate framework benefits the Ministry through greater access to financing and lower cost of capital	2.0000	0.794
Good corporate governance is important for increasing investor confidence and market liquidity	2.0333	0.640
Companies with better corporate governance guarantee, the payback to the shareholder and limit the risk of the investment	2.5000	0.539
Better corporate governance is correlated with better financial performance and market valuation	2.3000	0.615
Corporate governance mechanisms assure investors in corporations that they will receive adequate returns on their investments	2.3667	0.479
Good corporate governance will lead to lower firm risk and subsequently to a lower cost of capital.	2.0333	0.419
Good corporate governance increases firm valuation and reduces the financial fraud	2.0000	0.630
There is no relation between the proportion of outside directors and various financial performance measures	2.2667	0.918
There is a significant relationship between board composition and financial performance.	2.5000	0.562
Percentage of outside directors significantly affects firm financial performance	2.3667	0.529
Good corporate governance increase investor trust and subsequently lower corporate risk and a lower expected rate of return	1.9333	0.620

From the findings in table the study found that most of the respondent agreed that Good corporate governance shields the Ministry from vulnerability to future financial distress

as shown by mean of 1.7, Good corporate governance increase investor trust and subsequently lower corporate risk and a lower expected rate of return as shown by mean of 1.933, Good corporate governance increases firm valuation and reduces the financial fraud and Better corporate framework benefits the Ministry through greater access to financing and lower cost of capital as shown by mean of 2.0 in each case, Good corporate governance will lead to lower firm risk and subsequently to a lower cost of capital And Good corporate governance is important for increasing investor confidence and market liquidity as indicated by mean of 2.0333 in each case, Governance structure of the *Ministry affects the firm's ability to respond to external factors that have some bearing on* its financial performance as shown by mean of 2.1667,.

There is no relation between the proportion of outside directors and various financial performance measures as shown by mean of 2.2667, Better corporate governance is correlated with better financial performance and market valuation as indicated by mean of 2.3, Corporate governance mechanisms assure investors in corporations that they will receive adequate returns on their investments and Percentage of outside directors significantly affects firm financial performance as shown by mean of 2.3667 in each case and Good governance generates investor goodwill and confidence as shown by mean of 2.4667. Respondent moderately agreed that there is a significant relationship between board composition and financial performance as shown by mean of 2.5. These findings show that Good corporate governance shields the Ministry from vulnerability to future financial distress, increase investor trust and subsequently lower corporate risk and a lower expected rate of return and increases firm valuation and reduces the financial fraud.

Table 7: Rating various aspects of board size and composition affecting the financial performance

	Mean	Std dev
Splitting of the roles of chairman and chief executive	1.4000	0.723
Number of non-executive directors	2.0000	0.457
Executive remuneration	1.9667	0.684
Optimal mix of inside and outside directions	1.8000	0.638
Participation of outside directors	2.3667	0.800
Proportion of outside directors	1.9000	0.211
Number board of directors	2.4667	0.566

(Source –Researcher 2011)

On rating of various aspects of board size and composition affecting the financial performance, the study found that most of the respondent rated Splitting of the roles of chairman and chief executive to very great extent as shown by mean of 1.4. Those rated to great extent optimal mix of inside and outside directions as shows by mean of 1.8, Proportion of outside directors as shown by mean of 1.9, Executive remuneration as shown by mean of 1.9667, Number of non-executive directors as shown by mean of 2.0, Participation of outside directors as shown by mean of 2.3667and Number board of directors as indicated by mean of 2.4667. This implies that splitting of the roles of chairman and chief executive affect the financial performance to a very great extent.

Table 8: Rating effects of corporate governance on financial performance

Financial performance Measure	Mean	Std Dev
Turnover	1.4000	0.534
Disbursement	1.9000	0.792
Surplus Or Net Profit	1.9667	0.769
Market share Price	1.9000	0.457
Return on assets	1.6000	0.251
Stock returns	1.8000	0.773
Dividend payout	1.7333	0.449

(Source –Researcher 2011)

The study sought to establish the effect of corporate governance on various aspect of financial performance from the findings, most of the respondent rated Turnover to very great extent as shown by mean of 1.4. Those rated to great extent were Return on assets *as shown by mean of 1.6, Dividend payout as shown by mean of 1.7333,* Stock returns as shown by mean of 1.8, Market share Price and Disbursement as shown by mean of 1.9 in each case and Surplus Or Net Profit as indicated by mean of 1.9667. This implies that corporate governance affect turnover, return on assets, dividend payout, stock returns, market share price, disbursement and surplus or net profit.

4.3 Model analysis

The study used the natural logarithm of the previous year's profit while the corporate government elements (Split Chairman/CEO Roles, Board Size, Independence of Committees and Independent Directors) were quantified using a Likert scale scores whose means was computed for each factor within the element. Regression model to the study that was used is:

$LnPROF = \beta_0 + \beta_1 RP + \beta_2 BP + \beta_3 CP + \beta_4 DP + \varepsilon_{it}$

Whereby β_0 is constant of the model while β_1, β_2, β_3 and β_4 are the coefficients of the independent variables

Ln PROF = natural logarithm of the previous years profit

RP = total mean scores for the factors within the Split Chairman/CEO Roles perspective

BP = total mean scores for the factors within the Board Size perspective

CP = total mean scores for the factors within the Committees Independence perspective

DP = total mean scores for the factors within the Independent Directors perspective

ε_{it} = an error term for the model

Table 9: Coefficient Table Results

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	19.298	14.04		1.374	0.400
Split Chairman/CEO Roles	0.743	0.186	0.919	3.9897	0.156
Board Size	-2.53	-2.865	-0.545	0.886	0.539
Board Composition	2.645	19.81	0.099	0.133	0.915
Committees Independence	4.643	8.572	0.483	0.540	0.684

(Source –Researcher 2011)

The established regression equation was:

LnPROF = β + β Split Chairman/CEO Roles + β Board Size + β Board Composition + β Committees Independence

Whereby Ln PROF was natural logarithm of the previous year's profit, RP was total mean scores for the factors within the Split Chairman/CEO Roles perspective, BP was total mean scores for the factors within the Board Size perspective, CP was total mean scores for the factors within the Committees Independence perspective and DP was the total mean scores for the factors within the Independent Directors perspective. The study thus determined the regression equation to be:

LnPROF = 19.298+0.743 Split Chairman/CEO Roles - 2.532 Board Size + 2.645Board Composition + 4.643407 Committees Independence

The regression results shows that when value of the corporate governance indicators/measures used in the study (Split Chairman/CEO Roles ,board size, composition, Committees Independence) are zero, the financial performance of ministry will be becomes19.298. The results also show that board size negatively affects firm's financial performance while board composition, spilt of chairman/CEO role and committee independence affects financial performance positively. Unit increase in splitting chairman/CEO role leads to increase in financial performance by a factor of 0.743, unit increase in board composition leads to increase on financial performance by factors of 2.645 and a unit increase in committee independence leads to increase in financial performance by factor of 4.643. A unit increase in board size would lead to decrease in financial performance by a factor of 2.53

4.4 Discussion of Findings

The study found that Limited partnership agreements at the top level, High-equity ownership on the part of managers and board members; board members who in their funds directly represent a large fraction of the equity owners, CEOs who are seldom the chairman of the board and Small boards of directors were effective in the Ministries. The study also found that the board of directors, partners, and department heads, directors and top management were responsible for incorporate corporate governance system. From the study findings, majority of state owned enterprises regularly review and collected data on customer feedback for services provided.

The study established that good corporate governance approach aims at performing the main function of separating the firm's principals and agent and corporate governance themes separates management from the board, Agency problem arises as a result of the

relationships between shareholders and managers and Corporate governance systems are mechanisms for establishing the nature of ownership and control of organizations within an economy and Corporate governance would not apply to the sector since the agency problems are less likely to exist. The determinants of strong corporate governance are independence of committees, independent directors and split chairman/CEO roles and board size. Good corporate governance shields the Ministry from vulnerability to future financial distress, increase investor trust, increases firm valuation and reduces the financial fraud. There is no relation between the proportion of outside directors and various financial performance measures, better corporate governance is correlated with better financial performance and market valuation, corporate governance mechanisms assure investors in corporations that they will receive adequate returns on their investments and percentage of outside directors significantly affects firm financial performance and good governance generates investor goodwill and confidence. Governance structure of the Ministry affects the firm's ability to respond to external factors that have some bearing on its financial performance.

On rating of various aspects of board size and composition affecting the financial performance, the study found that Splitting of the roles of chairman and chief executive was rated to very great extent. The study established that corporate governance affect turnover to very great extent. Those rated to great extent were Return on assets, Dividend payout, Stock returns, Market share Price, Disbursement and Surplus or Net Profit.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary

The results showed that board size negatively affects firm's financial performance while board composition, spilt of chairman/CEO role and committee independence affects financial performance positively. The model summary shows that the relationship between corporate governance and financial performance was strong. The corporate governance indicators/measures used in the study (Split Chairman/CEO Roles, board size, composition, Committees Independence), committee independence had the strongest relationship with financial performance of the firm.

From the study it was found that Limited partnership agreements at the top level that prohibit headquarters from cross-subsidizing one division with the cash from another, High-equity ownership on the part of directors and board members; board members who in their funds directly represent a large fraction of the equity owners of each subsidiary company. The study also found that board size and composition, splitting of the roles of chairman and chief executive, optimal mix of inside and outside directions and number board of directors affected the financial performance of the government ministries.

5.2 Conclusions

From the findings the study concludes that Limited partnership agreements at the top level that prohibit headquarters from cross-subsidizing one division with the cash from another, High-equity ownership on the part of managers and board members; board

members who in their funds directly represent a large fraction of the equity owners of each subsidiary company, CEOs who are seldom the chairman of the board, CEOs who are typically the only insiders on the board and Small boards of directors, typically consisting of not more than eight people were very effective systems of corporate governance.

The study also concludes that Good corporate governance approach aims at performing the main function of separating the firm's principals and agent and corporate governance themes in your Ministry separates management from the board. The study concludes that board size and composition, Splitting of the roles of chairman and chief executive, optimal mix of inside and outside directions, proportion of outside directors, executive remuneration, number of non-executive directors, participation of outside directors and number board of directors affected the financial performance of the ministries .

The study further concluded that corporate governance affect turnover, Return on assets, Dividend payout, Stock returns, Market share Price, Disbursement and Surplus or Net Profit. It also concludes that there exist relationship was strong as the R square value was 0.95 between corporate governance and the financial performance of broadcasting Ministry in Kenya

5.3 Policy Recommendations

The study found out that the corporations qualify as having very strong corporate governance principles. The study further revealed that there is a positive correlation

between performance and corporate governance. Based on the study findings and conclusion, the study recommends that there should an increase meetings frequency if the situation requires a high quality supervision and control. This will allow for consultations and discussions on the direction the company is to take to counter the changes in the operating environment.

The board should balance the costs and benefits of meetings frequency given that the study established that if the board increases the frequency of its meetings, the recovery from poor performance is faster.

Since it was clear from the study that the companies with a small board size had greater performance, the study recommends that board size should be maintained as small as possible as an increase in board size leads to decrease in financial performance of the company. However, the management should ensure that the board size is optimal as a very small board can also be redundant and may not be efficient in governing the company.

The study also recommends that state owned enterprises should adopt good governance systems as they enhance the financial performance these state owned enterprises. This include optimal mix of inside and outside directions with a small proportion of outside directors and splitting of the roles of chairman and chief executive roles.

The study therefore recommends that policy makers for state owned enterprises should take serious notice of these findings to implement policies that sustain the already existing strong corporate governance structures.

The study also recommends to the management of state owned enterprises and other organizations to use the findings of this study to upgrade their corporate governance practices and structure so as to remain profitable in this competitive sector.

5.4 Limitations of the Study

The main limitation of study is its inability to include more corporations. This is a case study focusing on the selected corporations. The study would have covered more institutions across all sectors so as to provide a more broad based analysis. However, time and resource constraints placed this limitation. The study may also encounter unwillingness by respondents to reveal information which may be classified as confidential. This will be mitigated by the ensuring the respondents understand that the information they give will not be use to victimize them but it will be of benefit to them all.

5.5 Areas for further Research.

The relationship between corporate governance practices and financial performance of non commercial state corporations.

What other factors apart from finance that affect corporate governance performance.

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APPENDICES

Appendix I: Questionnaire

Questionnaire for the Study of the Relationship between Corporate Governance Practices & Financial Performance of commercial state corporations.

PART A: GENERAL INFORMATION

1. Your designation...

2. What is your highest level of education?

   Secondary ( ) Masters degree ( )

   College diploma ( ) Others (please state)

   ....

   University degree ( )

3. How many years have you worked in this institution?

   1-5 years [ ] 6-10 years [ ]

   11-15years [ ] 16-20 years [ ]

   21-25 years [ ] 26-and above [ ]

PART B: CORPORATE GOVERNANCE AND GOVERNANCE SYSTEMS

4. Effective governance systems in public sector are characterized by the following factors, how effective are they in your institution? Please rate your response in a scale of 1 – 5 where 1 = Very Effective and 5 = Very ineffective.

	1	2	3	4	5
Limited partnership agreements at the top level that prohibit headquarters from cross- subsidizing one division with the cash from another					
High-equity ownership on the part of managers and board members; board members who in their funds directly represent a large fraction of the equity owners of each subsidiary company					
Small boards of directors, typically consisting of not more than eight people					
CEOs who are typically the only insiders on the board					
CEOs who are seldom the chairman of the board					

5. To what extent do you agree with the following statements that relate to corporate governance at your organisation? Use a scale of 1 – 5 where 1 = strongly agree and 5 = strongly disagree.

	1	2	3	4	5
Good corporate governance approach aims at performing the main function of separating the firm's principals and agents.					
Corporate governance themes in your Ministry separates management from the board					
Corporate governance systems are mechanisms for establishing the nature of ownership and control of organizations within an economy.					

Agency problem arises as a result of the relationships between shareholders and managers					
Corporate governance would not apply to the sector since the agency problems are less likely to exist.					

PART C: Good Corporate Governance and Financial Performance

6 The following are the determinants of strong corporate governance, how significant is each of the factors in your institution's performance?

	Very significance	Significant	Moderatel y significant	Slightly significant	Insignific ant
Split Chairman/CEO Roles					
Board Size					
Independence of Committees					
Independent Directors					
Any other (specify………………… …….)					

Splitting of the roles of chairman and chief executive					
Number of non-executive directors	Very	Great	Moderate	Little	Not at
Executive remuneration	great	extent	extent	extent	all
Optimal mix of inside and outside	extent				

directions					
Participation of outside directors					
Proportion of outside directors					
Number board of directors					

7. To what extent do the following aspects of board size and composition affect the performance of your organization?

8. To what extent does corporate governance affect the following aspects of financial performance of your firm?

Financial performance measure	Very great extent	Great extent	Moderate extent	Little extent	Not at all
Turnover					
Disbursement					
Surplus Or Net Profit					
Market share Price					
Return on assets					
Stock returns					
Dividend payout					

Appendix 2: Table showing the Commercial State Corporations in Kenya

1. New Kenya Co-operative Creameries
2. Nyayo Tea Zones Development Corporation
3. Kenya Railways Corporation
4. Kenya National Shipping Line
5. Kenya Power and Lighting Company

6. South Nyanza Sugar Company
7. Kenya Ports Authority
8. School Equipment Production Unit
9. Kenya Pipeline Company
10. Pyrethrum Board of Kenya
11. Kenya Literature Bureau
12. Postal Corporation of Kenya
13. Kenya Electricity Generating Company
14. Nzoia Sugar Company
15. Kenya Broadcasting Corporation
16. Numerical Machining Complex
17. Kenya Airports Authority
18. Jomo Kenyatta Foundation
19. National Oil Corporation of Kenya
20. Kenya Postal Corporation of Kenya
21. National Housing Corporation
22. East African Portland Cement Company
23. National Cereals and Produce Board
24. Kenya Seed Company Limited
25. Kenyatta International Conference Centre
26. Kenya Meat Commission
27. Kenya Wine Agencies