IMPACT OF CORPORATE GOVERNANCE PRACTICES ON OPERATING PERFORMANCE OF THE UNLISTED FINANCIAL INSTITUTIONS IN KENYA

BY

ANTONY OPONDO
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DECLARATION

This is to declare that this research project is my original work and has not been presented for an award of any degree or any other certificate in any other institution of higher learning other than the University of Nairobi.

Signed: ………………………… Date: ……………………………

Name: **ANTONY OPONDO**

Reg. No: **D61/61692/2010**

This is to declare that this research project has been submitted for examination with my approval as the university supervisor.

Sign: ………………………… Date: ……………………………

Name: **J. BARASA**

SENIOR LECTURER

SCHOOL OF BUSINESS, UNIVERSITY OF NAIROBI

DEDICATION

To

My beloved children

Victory Joy Opondo   Grace Joy Opondo

Emmanuel Otieno Opondo

Faith Atieno Opondo

That you may excel far beyond this.

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I take this opportunity to express my sincere gratitude and deep regards to my project moderator and chairman to the department of finance and accounting, Dr. Josiah Aduda for his exemplary guidance, monitoring and constant critiques during the development of this project. The help and guidance given by him time to time shall carry me a long way in the journey of life on which I am about to embark.

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ABSTRACT

The study sought to determine the impact of corporate governance practices on the operating performance of the unlisted insurance companies and banks in Kenya. The study had five objectives. The first objective sought to determine the extent of corporate governance adoption by unlisted insurance companies and banks in Kenya. The second objective sought to determine levels of adoption of foreign countries corporate governance codes by the unlisted insurance companies and banks in Kenya. The third objective sought to determine the extent of vacuum in the Kenya Corporate Governance provisions in the unlisted and private companies. The fourth objective sought to determine the impact of corporate governance practices on the corporate investment decisions of the unlisted insurance companies and banks in Kenya. In the fifth objective the study sought to determine the impact of corporate governance practices on the corporate performance of the unlisted insurance companies and banks in Kenya.

To achieve the objectives a descriptive research design was adopted. The study conducted a census of all unlisted insurance companies and banks operating in Kenya. Primary data was collected from senior managers in these firms using a structured questionnaire which aided in construction of corporate governance indices used in the analysis. The study used descriptive statistics, ANOVA and pooled multivariate regression analysis. The findings were presented in figures, tables and were beefed up by a narrative explanation.

The study found that none of the unlisted firms had achieved 100% compliance with the governance mechanisms. The study found that firm with the lowest corporate governance index had an index of 30% while the highest had 96%. The study further found that mean index was 68% with a deviation of 14% indicating that most of the firms had just above average compliance rates with the governance mechanisms. The study found that the unlisted firm had adopted most of the corporate governance requirements of the CMA as these are regulatory requirements in Kenya while some firms had also adopted the foreign ones. The study also found that governance did not significantly influence corporate investment decisions as the relationship was positive but insignificant at 5%. The study found that the effect on firm value as well as the effect on firm performance, corporate governance index did not have a significant effect on either Tobin's Q or on ROA.

The study makes a number of recommendations. First, unlisted firms should strive to adopt more corporate governance codes as the level of adoption is still relatively low compared to their listed peers. It is therefore important that the boards of financial institutions adopt stringent corporate governance mechanisms. The study also recommends that the Central Bank of Kenya and the Insurance Regulatory Authority should find other ways of ensuring that the firms conform to the minimum requirements of the governance codes in Kenya arising from regulatory lapse. More stringent regulations should be adopted to ensure strict adherence to the guidelines. In as much as corporate governance was not found to influence firm performance, the study recommends that firms keep adopting more of the governance guidelines as this has been found to positively impact on firm performance.

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ABBREVIATIONS AND ACRONYMS

CBK	Central Bank of Kenya
CG	Corporate Governance
CEO	Chief Executive Officer
CFO	Chief Finance Officer
CIFE	Centre International De Formation European
CMA	Capital Markets Authority
IAS	International Accounting Standards
IAS	International Auditing Standards
IFC	International Finance Corporation
IRA	Insurance Regulatory Authority
ISDA	International Swaps and Derivatives Association
NSE	Nairobi Securities Exchange
OECD	Organization for Economic Co-Operation and Development
PWC	Price Water-house Coopers
SPSS	Statistical Package for Social Sciences

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CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

The term corporate governance since 1970s has been featuring in public and academic debates. N.R. Narayana Murthy, the Chairman, Committee on Corporate Governance, Securities and Exchange Board of India, 2003 gave a broad definition of corporate governance. He noted that the term corporate governance is susceptible both to broad and narrow definitions. In fact, many of the codes do not even attempt to articulate what is encompassed by the term. The important point is that corporate governance is a concept, rather than an individual instrument. It includes debate on the appropriate management and control structures of a company. Further it includes the rules relating to the power relations between owners, the Board of Directors, management and, last but not least, the stakeholders such as employees, suppliers, customers and the public at large (N.R. Narayana Murthy Committee, 2003).

As the names of several top corporations have become synonymous with corporate misconduct and financial scandal, a call for more effective corporate governance has been raised worldwide from financial reporting and internal controls to how a corporation selects, trains, and evaluates its board of directors. This has also inspired a close look at a range of issues associated with corporate governance and how some companies are responding to those issues and using compliance efforts to build greater business value (PWC, 2010). Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance 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 (2004). These are the structures and processes for the direction and control of companies. Finance executives are looking carefully at the cost-benefit of compliance to determine if sound corporate governance can reduce market volatility, encourage investment and promote sustainable productivity and growth, including a combination of internal controls, explicit businesses processes and growth, including a combination of internal control, explicit businesses processes and systems for corporate governance that can also build business value (Bhagat and Black, 2002).

Although corporate governance has largely been portrayed as an issue of compliance, analysts and business leaders increasingly are seeing good governance as good business (Cadbury, 1992). Uddin and Choudhury (2008) corporate governance provides the structure through which the company objectives and strategy are set, and the means of attaining those objectives and monitoring performance. Corporate governance is concerned with holding the balance between economic and social goals and between individual and common goals. The corporate governance framework is there to encourage efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society.

OECD (2005) defines a non listed company as closely held companies whose shares unlike those of publicly held companies, do not trade freely in impersonal markets, either because shares are held by a small number of persons or they are subject to restriction that limit their transferability. Non listed firms employ different legal business forms to structure their organization, varying from partnership firms, to limited liability companies and joint stock companies. Uddin and Choudhury (2008) argues that in some instance the choice of legal business firm allows for a governance structure in which the owners have joint management and control rights without a board. Thus, the large varieties of non listed companies with the preponderance of non listed companies are being family owned.

In most countries round the world including Kenya both listed and non listed companies operate as closely held companies with concentrated ownership. Therefore the need to consider the relevance of OECD principles of Corporate Governance in countries like Kenya where non listed and often family / founder owned companies play a pivotal economic & social role (OECD, 2005). Most non listed companies rely on family and bank financing for expansion and growth. However those that are unable to obtain bank finance, usually attract private equity to develop their plans (venture capital). There are many challenges and opportunities for non listed companies in search of external capital (Kula, 2005). The best way to ensure effective access to external capital is to decrease the risks posed to creditors and providers of external equity by enacting investor protection laws and enforcing them, and also to introduce effective corporate governance. Banks & financial institutions should consider improving their monitoring of Corporate Governance in non listed companies (IFC, 2008).

The controlling shareholders close levels of monitoring and cheaper intervention in the event of management failure, seem to entail better performance in non listed companies. The financing structure of non listed companies can bring benefits. Large controlling shareholders in non listed companies prefer to fiancé business development with internal funds and tend to use bank fiancé for expansion and growth. The repayment requirements give managers a strong incentive to ensure the company's success (Cadbury, 1992). Any default can deprive the managers and shareholders interest. The policy implication is stronger creditor right. Banks & credit rating agencies can help to implement good governance practices by demanding that non listed companies comply with best practice norms as part of risk assessment process (Zaheer, 2006).

Zaheer (2006) is critical that having separate Corporate Governance codes or guidelines for non listed companies could have a possible counterproductive effect on the development of a good Corporate Governance system. They further argue that to improve corporate Governance non listed companies should address improving transparency of decision making process, as well as training for managers and shareholders. IFC (2008) maintains that an effective company law framework for non listed companies is the most important source of Corporate Governance. The most pressing matter involves the abuse of minority interests by controlling shareholders. McCahery and Vermeulen (2008) there interests can be protected by rules that restrict managers' power to act in response to directions gives by controlling shareholders. There effective lock in rules, squeeze out regulations, are highly important for promoting share transfers and investment in these companies. Kula (2005) argues that to achieve continued investment and minority protection, it is desirable to devise clear and precise valuation method and procedures that are not cumbersome. He further points out that although the importance of clear and simple company law rules is desirable, one legal framework suitable for non listed companies across the board will be difficult to achieve. Company rules need to be flexible to enable these companies to contract into the desired organizational structure.

Zaheer (2006) the OECD principles of Corporate Governance primarily meant for listed companies provide guidelines in the non listed company context but optional guidelines inform of advice could be implemented to supplement the existing legal framework, that are a must for adoption by all firms. These guidelines to preferably contain

recommendation on different ownership & control structures of non listed companies, composition of the board of management, transparency requirements, accessing outside capital and strategies for succession planning and conflict resolution. McCahery and Vermeulen (2008) maintains that the central reason for analyzing the corporate governance of non-listed companies is that the subject begin to play a pivotal role in policy discussions around the world on the non-listed companies that receive less attention than their public counterparts. Mueller (2006) they have encouraged an analytical approach and future orientation to corporate governance, notably by bringing into proper focus the realm of the non-listed company, as a legitimate and important perspective for policy makers and lawmakers to think about when undertaking legislative reforms.

1.1.1 The Corporate Governance Characteristics of Non-Listed Companies

McCahery and Vermeulen (2008) it's important to create effective internal and external mechanisms for non-listed companies and the need for improved institutions to stimulate social welfare and economic growth. The governance features and mechanisms that are characteristic of non-listed companies include: ownership and control; the role of professional management; transparency; and education and awareness. Naturally, corporate governance issues vary not only from business to business, but also across countries (Cadbury, 1992). For example, in the field of enforcement, some participants identified in itself is a good opportunity to improve corporate governance, this point will not be taken up in this synthesis note as it is one of the central issues of OECD's programme on privatization and corporate governance of state-owned enterprises.

1.1.2 Significance of Corporate Governance

Berglof and Claessens (2004) policymakers around the world acknowledge that corporate governance reform is vital for developing countries seeking to attract investment and thereby strengthen their economies. The World Bank (2002) in a report on deliberations by heads of state from the developed and developing worlds observed that private international capital flows are vital complements to national and international development efforts. The report further noted that to attract and enhance inflows of productive capital, countries need to continue their efforts to achieve a transparent, stable and predictable investment climate (Claessens, 2006). Special efforts are required in priority areas such as corporate governance. 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 (IFC, 2008). Thus, for financial sector (insurance companies and banks) it could well mean enhanced company image before investors who expect shareholder rights, board of directors, accountability, transparency and disclosure.

According to the Wajeeh and Muneeza (2012), recent corporate governance scandals in the United States and Europe – some of which have triggered the largest insolvencies in history – have caused a crisis of confidence in the corporate sector. As a result, corporate governance has entered the vocabulary not only of financial economists but also of day traders, pension fund beneficiaries, employees of all ranks, chief executive officers, and prime ministers, during the wave of financial crisis of 1997 – 98 in Asia, Russia and Latin America, the behaviour of the corporate sector affected entire economies. Deficiencies in corporate governance endangered the stability of the global financial system. Improving corporate governance is now recognized in most countries and policy circles to have first – order macroeconomic consequences and have become a mainstream concern. Beyond the scandals and crises, the World Bank points out, other several structural reasons explaining why corporate governance has become more important for economic development and well-being. The private, market-based investment process is now much more important for most economies than it used to be. Wanyama et al (2009) that process is underpinned by better corporate governance. With the size of firms increasing and the role of financial intermediaries and institutional investors growing, decisions about mobilizing capital are now one step removed from the principal/owner. At the same time, the opening up and liberalization of financial and real markets have broadened investment choices and made decisions about the allocation of capital more complex.

Berglof and Claessens (2004) argues that structural reforms, including price deregulation and increased competition, have increased companies' exposure to risk from market forces. These developments have made monitoring the use of capital more complex in certain ways, enhancing the need for good corporate governance.

1.1.3 Corporate Governance and Unlisted Companies

Unlisted companies make a major contribution to economic growth and employment in all EU member states. However, the corporate governance needs of such companies have hitherto been relatively neglected by governance experts and policy-makers alike (Foley

and Lardner 2006). IFC, (2006) argues that the debates on corporate governance has mostly focused on listed companies particularly in countries with developed capital markets and companies with dispersed shareholdings. OECD (2004) points out that leading corporate governance issue concerns the appropriate design of a legal, institutional and regulatory framework that helps to align the interests of shareholders and managers. Policy makers worldwide have looked to advise an effective framework that supplies proper incentive for the board and management to act in the interest of the company and its shareholders; and furnish investors with sufficient monitoring information. Foley and Lardner (2006) one of the primary risks that non-controlling shareholder face- in both private and publicly listed companies-is that will end up in a situation where the controlling shareholders of influence over major decisions; and/ or any significant distribution of the business earnings. Many jurisdictions have legislation that can prevent abuse of non-controlling shareholders in both circumstance, and typically these measures apply to both non-listed companies and public companies (McCahery and Vermeulen, 2008)

OECD (2005) observes that in most countries around the world, both listed and non-listed firms typically operate as a closely held company with concentrated ownership. While there are substantial similarities in the problems and solutions devised for both types of companies, the typical organizational structure of non-listed companies seems to demand, in some instances, an approach different from the one used for listed firms. OECD (2004) points out that shareholders in publicly held companies unlike those in unlisted firms are protected by mechanisms to constrain large shareholders, due to presence of a market for transferable shares and by reputation agents (accountants, rating agencies, and stock exchange watchdogs) who play an important role in both reducing information asymmetries and detecting fraud. In the absence of the above external mechanism an alternate framework is needed to improve the performance of unlisted companies.

Foley and Lardner (2006) argues that active investors clearly value good corporate practices, as a better expectation of development and the creation of value and, accordingly, are prepared to pay a premium for the listing of securities of better governed companies. Mainstream corporate governance appears to have little concern in understanding the organization and structure of non-listed companies and the conflicts arising within such firms. McCahery and Vermeulen (2008) the non-listed category of

companies represents a broad church of organizations, activities and ownership patterns. The non-listed sector includes family-controlled and government-owned but profit focused companies which have remained prominent in many economic sectors and countries and for such organizations. They question the applicability of the traditional principal-agent theory. McCahery and Vermeulen (2008) argue that there is a three-way conflict between majority shareholders, managers and minority shareholders and that principal-agent mechanisms used to address opportunistic behaviours by management is less useful in such circumstances. However, survival studies and studies on the development of family businesses exist, whose protagonists believe that Good Governance practices are a determining factor in their shareholding stability and long term success, and positively contribute, in cases of access to capital, towards alliances or purchase or merger operations. OECD (2005) argues that in this type of companies, the shareholders are frequently specific individuals, with significant holdings, and it is possible to explicitly ascertain their expectations. Their good management and the transparency of governance and management are of utmost importance. The necessary initiative and impulse by owners and directors, when implementing good governance practices are, if possible, even greater than in listed companies, because, in these, the presence and demands of regulatory entities are lower.

Zaheer (2006) points out that the universe of unlisted companies covers a wide spectrum, with vast differences regarding size, shareholding structure, management model and, obviously, corporate governance practices, in parallel, the concept of "Good Governance" include diverse aspects, whose application frequently implies significant changes in the behaviour of companies. The adaptation process must be approached stringently, but also with realism, bearing in mind that the starting point for these aspects will condition both priorities and the rhythm of changes to be made.

In most non listed companies controlling shareholders retain the power to appoint and dismiss both the Board and the management of the company. In such cases where, the board remains exposed to the controlling shareholders influence, the effectiveness of adopting independence rules or independent Directors is likely to yield few benefits. Corporate Governance problems could be minimized by appointment of competent rather than independent professional outside directors (McCahery and Vermeulen, 2008). A way to foster professionalism and competency is to provide training and support to

incumbent Directors. Professionalized companies, in which communication channels between shareholders are clear, need to create by adoption of professional training in Corporate Governance (Cadbury, 1992). Zaheer (2006) points out that there is need to build up on knowhow on corporate governance in the courts. Giving non-controlling shareholders full and timely access to information enhances the governance of both listed and unlisted companies. The controlling shareholder generally has much better information than the non-controlling investors. McCahery and Vermeulen (2008) unlisted companies are of particular importance in countries with less developed capital markets, where the vast majority of companies are not listed on a stock exchange or regulated market. But even in more developed economies, most small and medium-sized enterprises are not publicly listed on regulated equity markets. Furthermore, there exist many notable large corporations that have chosen for a variety of reasons to forego public listing. Gonencer (2008) is critical that mandatory disclosure for non listed companies generates more costs than benefits due to loss of personal privacy, loss of competitive position, undermining of private property rights, direct compliance and administrative costs. He also adds that the usefulness of disclosed information often depends on the experience and quality of auditors.

1.1.4 Corporate Governance and Financial Performance

A properly defined and functioning corporate governance system helps a company to attract investor funding, investment and strengthen the foundation for company financial performance. Good corporate governance shields a company from vulnerability to future financial distress (Demsetz and Villalonga, 2002). The argument has been advanced time and time again that the governance structure of any corporate entity affects the company'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 company's financial performance and performance.

Corporate governance has dominated the policy agenda in developed market economies for sometime especially among very large firms. This is gradually warming up, to the top of policy agenda in the African continent. It is believed that good governance generates investor goodwill and confidence. Again, poorly governed firms are expected to be less profitable (Berglof and von Thadden, 1999). Claessens et al (2002) points out 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 observe that weak corporate governance does not only lead to poor company 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). Roe (2003) argues that a country's political framework forms the basis for its corporate governance practices.

1.1.5 Unlisted Financial Institutions in Kenya

According to OECD, non-listed entities (Appendix III) encompass a wide variety of corporate ownership, financing and management structures which renders the applicability of a standard code intricate. This study examines how non-listed insurance companies and banks in Kenya respond to the publication of a code of corporate governance in the context of developing economy. We draw on annual report disclosures to measure the extent of adoption local code of best practice (CMA Code 2002) in relation to foreign ones since its inception. OECD (2005) proves that evidence shows that all requirements are being ignored by at least half of the surveyed companies in the UK (representing developed economies).

Studies argue that a "borrowed" code is not always suited to non-listed companies of an emerging nation. This study will bring empirical evidence to support the development of more appropriate mechanisms of corporate governance for non-listed companies. It may propose possibilities for research in corporate governance among an untraditional category of companies: the unlisted. This study will also offer insights to policy makers to enhance codes of corporate governance to accommodate the specifics of non-listed entities. Moreover, the findings could be useful to international bodies and agencies who advocate the adoption of borrowed corporate governance models for emerging nations.

1.1.6 Corporate Governance and Code of Practice

The most famous definition of corporate governance was provided in 1992 by Sir Adrian Cadbury in the Report on Financial aspects of Corporate Governance in the United Kingdom. Adrian defined corporate governance as the system by which companies are directed and controlled. Here corporate governance is defined as a set of mechanisms

through which firms operate when ownership is separated from management. However, one definition does not fit all, and other definitions of corporate governance may be used. But whether a broad or a narrow definition of corporate governance is chosen, it is important that the fundamental values of transparency, accountability, fairness, and responsibility be respected in order for firms to build and sustain the confidence of investors, stakeholders, and society as a whole. OECD defines corporate governance as involving a set of relationships between a company’s management, its board, its shareholders and other stakeholders. Corporate governance 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, 2004).

Commonwealth defines corporate governance as essentially about leadership: - leadership for efficiency; leadership for probity; leadership with responsibility; leadership which is transparent and which is accountable (Commonwealth Association for Corporate Governance, Guidelines, 1999). In Kenya corporate governance can be defined as the manner in which the power of a corporation is exercised in the stewardship of the corporation's total portfolio of assets and resources with the objective of maintaining and increasing shareholder value with the satisfaction of other stakeholders in the context of its corporate mission (Private Sector Corporate Governance Trust, 2002). While for India, corporate governance is the acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, about ethical business conduct and about making a distinction between personal and corporate funds in the management of a company (Securities and Exchange Board of India, 2003).

1.2 Statement of the Problem

Corporate governance based on the Anglo-American model has received much attention in the accounting literature, with studies focusing on the impact of corporate governance and the financial performance of entities. However, an assertion is that the Anglo-American model does not appear to be suited for non-listed entities in developing countries (Berglof and Claessens, 2004; Singh and Zammit, 2006; McCahery and Vermeulen, 2008). Non-listed entities encompass a variety of corporate ownership, financing and management structures which do not reflect a situation that is symptomatic of the principal-agent problem. At the same time there is increasing awareness that

specific corporate governance practices could be effective in regulating contractual arrangements between parties e.g. between joint-venture partners, family factions or between venture capitalists and entrepreneurs. In longer term, a non-listed entity that adopts better corporate governance structures and improves its transparency and disclosure of information could become a more attractive investment for a merger or takeover. Countries have slowly started to acknowledge the need for a separate code for non-listed entities (4 countries as reported by McCahery and Vermeulen, 2008, p. 212-213). Furthermore, there is scant empirical evidence of how non-listed companies have adopted corporate governance codes (e.g. Kula, 2005; Foley and Lardner, 2006). They propose that the adoption of a borrowed model is not well suited for non-listed companies of a developing economy.

Kula (2005) finds evidence that the resource role of the board is positively related to performance rather than the service and control roles. Jensen and Meckling (1976) prove that better-governed firms might have more efficient operations, resulting in a higher expected future cash flow stream. Klapper and Love (2003) that use return on assets as measure for performance found evidence that firms with better governance have higher operating performance. Contrast results are seen in Gompers *et al* (2003) who found no significant relationship between firm's governance and operating performance, fiisenberg et al(1998) also find negative correlation between board size and profitability when using sample of small and midsize Finnish firms. Mak and Yuanto (2003) supports the above findings in firms listed in Singapore and Malaysia when they found that company valuation is highest when a board has five directors, a number considered relatively small in those markets. Even though corporate governance principles have always been important for getting good rating scores for large and publicly held firms, they are also becoming much more important for investors, potential investors, creditors and governments (Gompers *et al,* 2003). Because of all of these factors, corporate governance receives high priority on the agenda of policymakers, financial institutions, investors, firms and academics (Heracleous, 2001).

Locally, Mbola (2005); Kihara (2006); Nambiro (2008); Manyuru (2005); Maina (2002); Okin (2006); Ngugi (2007); Malulu (2005); Maina (2007); Njuguna (2006); Ng'ang'a (2007); Mutisya (2006); Maina (2011) and Mwangi (2006) in Appendix IV conducted a study on the relationship between corporate governance mechanisms on the Kenyan

companies. They all focused on separation of ownership and control, agency problem, control of shareholders opportunism and creating incentives for listed companies which are a characteristic corporate governance problem for listed companies - None of these scholars focused on the three-way conflict of major share holders, managers and minor shareholders which is a corporate governance problem for non listed companies as argued by Doidge et al, 2004; Clacher et al, 2005 and Zaheer (2006). Furthermore, they established conflicting findings on the relationship between different corporate governance mechanisms and corporate performance of quoted companies on NSE. However, they established that the responsibility placed on the quoted companies by law, compelled them to follow the laid down rules and procedures pertaining to corporate governance. For example, while Maina (2005); Manyuru (2005) and Okin (2006) finds evidence that the role of the board is positively related to corporate performance Mbola (2005) and Ng'ang'a (2007) finds no evidence that the role of the board is positively related to performance but rather to control roles.

Manyuru (2005); Gatauwa (2008) and Tokei (2007) prove that better-governed firms might have more efficient operations, resulting in a higher expected future cash flow stream. Gatauwa (2008) by use of return on assets as measure for performance found evidence that firms with better governance have higher operating performance. Contrast results are seen in Mugwang'a (2008) who found no significant relationship between firm's governance and operating performance. Maina (2002) also find negative correlation between board size and profitability when using sample of quoted companies in Kenya. Their methodology focused on separation of ownership and control and agency problem without addressing other corporate governance principles like internal control environment, transparency and disclosure; treatment of minority shareholders and control of shareholders opportunism. Malulu (2005) supports the above findings. He did a study on the relationship between board activity and firm performance: the case of firms listed on NSE. The methodology focused on separation of ownership and control and agency problem. He found out that those firms with the highest level of corporate governance reported high performance and was more stable compared to those with weak corporate governance.

From the literature reviewed above, it is clear that there exists a gap in the non listed entities in Kenya. Mukiiri (2008); Wasike (2006); Kibet (2008); Ngumi (2008); Owuor

(2008); Gitari (2008) and Gathika (2006) in Appendix IV did a study on corporate governance practices in state corporations in Kenya. Their focus was state corporations with a corporate governance framework based on the social and economic needs. They found out that in state corporations that conformed to high corporate governance measures reported high performance and motivation to their employees compared to those corporations that reported low corporate governance. However, a comparative sector with a more different and diverse ownership structure like family owned enterprises while focusing on the three-way conflict between majority shareholders, managers and the minority shareholders that is a characteristic of corporate governance problem for non listed companies in developing and emerging economies like Kenya was not considered.

This study therefore sought to fill this research gap by; first, determining the extent of corporate governance codes from foreign countries adoption like the Combined Code (2003) of UK and SOX Code (2002) of US by the unlisted financial institutions in Kenya; and two, apply a study methodology that focuses on the three way conflict between majority shareholders, managers and the minority shareholders that is a characteristic of corporate governance problem for non listed companies in developing and emerging economies like Kenya (Doidge et al2004; Clacher et al2005 and Zaheer (2006). The study findings will be invariable to the entire unlisted entities in particular to insurance companies and banks in Kenya, as it will provide a benchmark on the effect of good corporate governance on the corporate performance, corporate valuation and corporate investment decisions.

1.3 Objectives of the study

The study was guided by broad and specific objectives.

1.3.1 General Objectives

The broad objective of this study was to determine the impact of corporate governance practices on the operating performance of the unlisted insurance companies and banks in Kenya.

1.3.2 Specific Objectives of the Study

The specific objectives of this study were;

i. To determine the extent of corporate governance adoption by unlisted insurance companies and banks in Kenya.
ii. To determine levels of adoption of foreign countries corporate governance codes by the unlisted insurance companies and banks in Kenya.
iii. To find out whether there are differences in adoption of corporate governance codes between unlisted banks and unlisted insurance firms in Kenya
iv. To determine the impact of corporate governance practices on the firm value of the unlisted insurance companies and banks in Kenya.
v. To determine the impact of corporate governance practices on the firm performance of the unlisted insurance companies and banks in Kenya.
vi. To determine the impact of corporate governance practices on the institutional shareholding of the unlisted insurance companies and banks in Kenya.
vii. To determine the impact of corporate governance practices on the corporate investment decisions of the unlisted insurance companies and banks in Kenya.

1.4 Justification of the study

This study presents seven major contributions to the existing corporate governance literature that are aimed at addressing the identified gaps in the previous local studies in corporate governance (Appendix IV). The gaps were in terms of presented study methodology (such as focus and analysis), scope of respondent, target of study, and findings (such as conflict in findings).

First, the study develops a broad firm level corporate governance index for a sample of large Kenyan unlisted financial institutions (insurance companies and banks). Second, the study index was based on whether the firm complied with the provisions set out in the CMA Code (2002) or foreign codes like the Combined Code (2003) of UK and SOX Code (2002) of US. This was followed by an empirical examination of the relationship between governance and firm value, performance and investment decisions.

Third, this study provides a critical analysis of the aggregate and disaggregates impact of different governance mechanisms on firm valuation and performance. Using a combination of several internal and external governance mechanisms; we examined the interaction between internal and external governance mechanisms and whether they

add value to the firm. This area of research had received little attention in prior studies that analysed Kenyan corporate governance.

Fourth, the study extends the current literature by providing an analysis of the ability of large and external shareholders, and in particular institutions, to influence the level of governance in firms under the prevailing legal and regulatory framework in Kenya. The function of institutions in Kenya corporate governance has received much attention since existing governance codes actively emphasize the role of institutions in ensuring good governance.

Fifth, the study of corporate governance framework considered the social and economic needs of the non listed companies since the majority of firms are family owned that are characterized by the three-way conflict between majority shareholders, managers and the minority shareholders – a corporate governance problem for non listed companies in developing and emerging economies like Kenya.

Sixth, this study also targeted employees who make major contributions in corporate governance today, as part of the study target of respondents. This respondent target has received little attention in previous studies reviewed by the researcher.

Seventh, the study assessed whether the quality of firms' corporate governance determines the investment decisions within the unlisted corporate in Kenya.

1.5 Importance of the Study

This study is important as it provides an empirical evidence to support the development of more appropriate mechanisms of corporate governance for non-listed companies. It proposes possibilities for research in corporate governance among an untraditional category of companies: the unlisted. This study offers insights to policy makers to enhance codes of corporate governance to accommodate the specificities of non-listed entities. Moreover, the findings could be useful to international bodies and agencies who advocate the adoption of borrowed corporate governance models for emerging nations.

The industry regulator will also find the results of this study very invaluable, as it ascertains the corporate governance practices that enhance financial performance to

an individual company and as so determines whether such practices adopted in the industry conform to the guidelines provided for the industry by the government.

The researchers and academic community could use this study as a stepping stone for further studies on corporate governance in Kenya and around the world. The students and academics will use this study as a basis for discussions on corporate governance and financial performance.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter summarizes the information from other researchers who have carried out their research in the same field of study. The specific areas covered here are corporate governance, determinants of good corporate governance, importance of good corporate governance, corporate governance and company performance, corporate governance and financial performance and the empirical review.

2.2 Theoretical Review

2.2.1 Corporate Governance Models

There are a number of models which have been used by scholar and practitioners to help explain various issues related to corporate governance. Gonencer, (2008) noted that reporting requirements for large private companies vary widely across the major industrial economies. The two largest industrialized economies, USA and Japan, do not require large private companies to disclose publicly their financial accounts. On the other hand, the three other members of the G5 Germany, France and the UK, do require large private companies to disclose publicly their accounts. In those countries that require disclosure by private companies, alternative legal structures are often available that permit enterprises or their owners to avoid public financial disclosure, albeit at a cost in terms of the compliance or restructuring costs incurred (Gonencer, 2008, p. 13).

The study discussed two corporate governance models. On one hand, the so-called shareholder-oriented "outsider model" (2.2.1.1), which prevails mostly in Anglo-Saxon countries, and on the other hand, the stakeholder-oriented "insider model" (2.2.1.2), that can be found in most of the other countries in the world. The latter is sub-categorized into the Germanic model (2.2.1.2.1), the family/state-based model (2.2.1.2.2) and the Japan-based model (2.2.1.2.3).

2.2.1.1 The Outsider Model

This is also known as “Anglo-American model”, “shareholder model” or “dispersed ownership model.” The idea behind this model is that shareholder wealth maximization is

the dominant and sole function of corporations, because shareholders (principal) are the rightful owners of a company. Consequently the role of the managers, as the agents of shareholders, is to serve the interests of the shareholders and to maximize the market price of the shares of the company. This model, mostly seen in UK, Ireland and the US, is characterized by a widely dispersed shareholder ownership structure with shareholders not being affiliated with the corporation (called as "outside shareholders" or "outsiders") and by a well-developed legal framework defining the rights and responsibilities of the three key players (management, directors and shareholders). This model provides the following features: Recognized primacy of shareholders interests in the company law; dispersed equity ownership; most of the shares are in the hands of dispersed groups of the individuals and especially institutional investors; separation of owners and management; strong emphasis on the protection of minority rights in securities regulations; preference for the use of public capital and high disclosure standards (Gonencer, 2008, p.15).

"….The separation of owners and managers and the dispersed ownership, providing that no single shareholder owns more than a small portion of the firm's shares, causes the so-called "principle-agent problem". Because of the existence of asymmetric information, managers may pursue objectives and strategies which suit them the most and maybe not in favour of the "principle". For instance managers may prefer to have goals such as over-investment or unsustainable growth in pursuit of their power and prestige, rather than maximizing the profit of the company leading to a conflict of interest (Abor and Adjasi 2007). Yeoh (2007) notes that to reduce the effects of the principle-agent-problem, the model provides mechanisms such as incentive-based payment and stock-option remuneration for the board members and the thread of hostile takeovers in case of poor management. This model is based on strong and liquid capital markets with high market transparency and low debt/equity ratios, as it is the case in the New York Stock Exchange (NYSE) and the London Stock exchange (LSE) and banks having an arm's length relationships with corporations due to the restrictions of the legislation of Anglo-American countries. The highly dispersed ownership structure requires that the shareholders receive adequate and on-time information in order to make rational investment decisions. Gonencer, 2008) further argues that the disclosure requirements of publicly listed companies and the related liability of the board members are high in Anglo-American countries. This is due to the characteristics of the "common law" legal system, which generally provides a higher degree of shareholder protection compared to the "civil law"

system of Continental Europe. This has been underlined by the US “Sarbanes-Oxley Act” providing civil and criminal penalties for filing misleading financial reports, regulating the oversight of the accounting profession and determine the roles and duties of the audit committee and auditors, as well as of directors, including even foreign companies with 300 or more individual shareholders based in the US and foreign public accounting firms preparing audit report for US companies.

Another feature of the outsider model is the dominance of institutional investors such as insurance companies and pension funds among the shareholders. These institutional investors, whose number is increasing in the UK and the US, are seen as the key actors of corporate governance and have an active role in fostering corporate governance standards. The National Association of Pension Funds (NAFT) in the UK and the California Public Employees' Retirement System (CalPERS) in US are prominent examples of active investors, who as a result of their fiduciary responsibilities closely monitor the management of the corporations that they invest in and also list their own governance requirements (Yeoh, 2008).

Discrepancies between UK and US

Although UK and US share many common features of corporate governance structures, there are divergence areas as well. The most significant divergence is that while the US has a rules-base approach, rigidly defining exact provisions that must be adhered to, the UK has a principles-based approach in the sense that it provides general guidelines of best practice and is founded on self-regulation backed by codes and guidelines. The first recognized set of corporate governance principles in UK the Cadbury Code based on the Cadbury Report were developed in 1992 and resulted in the Combined Code and are used as a benchmark for many countries, especially in Continental Europe. The Combined Code firstly introduced that public listed companies should disclose if they have complied with the code, and provide a reason if they have not applied the code, the so-called “comply or explain” approach. Although the compliance to the code is voluntary, the disclosure of the statement of compliance to be included in each annual report is required by the Listing Rules under the UK Financial Services and Market Act of 2000. Thus, in contrast to the statuary regime of the US Sarbanes-Oxley Act, UK approach considers that it is the best to leave some flexibility to the companies (Bhasa, 2004; Abor and Adjasi, 2007).

Other differences lie in the role of the CEO and the chairman of board. While in US companies the CEO is usually the full time manager with a seat on the board and at the same time also its chairman. However, in UK, the functions of CEO and member or Chairman of the Board are separated. Besides, shareholders in the UK, to the contrary of US shareholders, have extensive rights and can for example demand an extraordinary general meeting or vote on the dividend proposed by the board. This leads UK to stronger institutional investors and more active takeover market (Dewing, 2003; Denis and McConnell, 2003; Young, 2009)

2.2.1.2 Insider Model

Gonencer (2008) equates the insider model to stakeholder model or social model of corporate governance. The basic idea behind the insider model is that the corporation must be run not only in the interest of the shareholders, but for all stakeholders of the company (e.g. creditors, employees, unions, and governments), because the stakeholders participate in the production or the finance of the company and the company therefore has a social responsibility towards them. The insider model is prevalent mainly in Continental Europe and in Japan as well as in many developing and transition countries. This model has three sub-categories: the Germanic model based on a bank-centred system (prevalent in Germany, Austria, Switzerland, Netherlands and partly in France, Belgium and some Scandinavian countries as well as in Korea and Taiwan); the Japanese Model which is also bank-centred, but control is provided through a keiretsu structure; and the family-based (prevalent in Sweden, Denmark, Greece, Italy, Turkey)/state-based (prevailing in France) model. This model provides the following features: Concentrated ownership; a "relationship-based" system; interlocking networks and committees; different form of pyramidal structures; weak securities markets; low transparency and disclosure standards; and high debt/equity ratios, with a higher rate of bank credits. Groups of "insiders" include family and industry interests, as well as banks and holding companies. Contrary to the outsider model, corporations can also play a key role in corporate governance, because they can have shares in other corporations and hence a long-term relation with that corporation. Because of the better communication flow between "insiders", they are considered to ensure the monitoring of the corporate management. Therefore agency costs are reduced in this model (OECD, 2005).

Contrary to the outsider model; due to the concentration of ownership in the hands of a family, the state, banks, other industrial firms or a few shareholders; block holders (controlling shareholder) control the company and at the same time monitor the management. A conflict of interest between dominant shareholders and minority shareholders is therefore possible and is referred to as the "expropriation problem" by the means of pyramidal ownership structures, multiple classes of shares and or shareholders. The most frequently used indicator for comparing of corporate governance systems is the "minority shareholders protection index" (MSP Index,) because high levels of MSP correlate with shareholder concentration. If minority shareholder rights are protected, which means a higher level of MPS, shareholder diffusion will occur, investment will be higher and capital markets will be deeper. Finally, the capital markets of countries using the insider model are relatively less developed and less liquid with lower market capitalization compared to Anglo-American countries (Yeoh, 2008). Gonencer (2008) further points out that for each type of ownership structure and its represented model; a certain type of remedies and disciplinary mechanisms are suggested for the different problems arising for each specific pattern. Suehireo (1993) dispersed shareholder ownership as a feature of the outsider model implies a weak shareholders' voice when important decisions are taken by the managers. Allowing voting by mail or electronic means, and the provision of proxy voting are effective tools to deal with this problem. For the problem of uncountable boards and CEO carrying out visionary projects such as massive acquisition programs, the standard remedies suggested for the outsider model are: increasing the autonomy of the board from the CEO , appointment of independent and non-executive directors , increasing ,increasing directors liability, establishing committees consisting of independent directors for the remuneration , audit and nomination of the board members, accelerating hostile takeovers and introducing a market for corporate control. On the other hand, the insider model faces the problem of the block holding shareholders using their power at the expense of minority shareholders. For this the OECD principles recommend the appointment of the independent directors. One-share-one vote rules or voting right ceilings together with minority shareholder approval for the removing of directors are the possible disciplinary devises (OECD, 2005).

2.2.1.2.1 Germanic Model

Germanic model is a bank-based, as the banks play a key role in this type of corporate governance model. The Germanic corporate governance system deals with the firm as

an autonomous economic entity which may benefit the shareholders and stakeholders in the firm. Countries which implement this system use a two board system consisting of a supervisory board and managing board. A supervisory board appoints the managing dismissal board and evaluates management performance. A Germanic corporate governance system considers the bank as the main source of finance. Therefore, the bank has a significant voting right in the shareholder's assembly as well as representing the shareholders' interest in a supervisory board (Odenius, 2008). Contrary to the Anglo-American model which has a "single board" system, the Germanic model has a "two-tiered board" structure, used in Germany and also in Austria, the Netherlands, Switzerland and France: supervisory board and management board. The management board is responsible for daily management of the corporation and composed of "insiders", while the supervisory board consists of directors elected by shareholders and representatives of employees and unions as well as the banks, similar to the "outsiders" in Anglo-American boards. Supervisory board members are responsible for appointing and dismissing the management board, as well as approving major decisions such as dividend proposals, company's accounts and major capital investment decisions, including decisions on acquisitions and major capital investment decisions, including decisions on acquisitions and plant closings (Bauer et al, 2004).

Suehireo (1993) points out the following further features for Germanic model: co-deterministic approach providing that in corporations with 2,000 or more employees, representatives of the shareholders and employees must have (held of the total number) equal seats; interests of employees are seen as important as the ones of shareholders cross-shareholdings between companies are common stock and bond markets are not well developed and non-financial enterprises such as other corporations are an important group of shareholders and shareholder rights such as the right of proposal or counter-proposal are common.

Within the last decade, a number of reforms has been introduced in Germany including the modernization of the corporate law in 1998, the takeover law in 2001 and finally the introduction of the German corporate governance code in 2002, with the aim to make Germany's corporate governance rules transparent for both national and international investors, thus strengthening confidence in the management of German corporations (Gonecher, 2008).

2.2.1.2.2 Family/State Based Model

The family based model mainly prevails in East Asia and many emerging and developing countries including turkey. This model also dominates the Latin American countries such as Mexico, Brazil, Argentina, and can be found in some EU countries such as Italy, Spain and France (to a certain extent) (Aguilera and Ermoli, 2005). Family business is defined by Suehireo (1993) as "a form of enterprise in which both management and ownership are controlled by a family kinship group, either nuclear or extended and the fruits that which remain inside that group, being distributed in some way among its members.

Lieu et al (2008) notes that this system can be characterized by several features such as relationship-based institutions, concentration of ownership (pyramid structures and cross-holdings), dominant shareholdings by families, conflict of interest between dominant shareholders, managers and minority shareholders; multiple voting rights and lack of transparency. Gonecher (2008) noted that founding families and their affiliates usually control the network of listed and non-listed companies. Le Breton-Miller and Miller (2008) argued that family-owned business usually lacks a separation of ownership and management as well as a separation of directors and managers so that a real system of checks and balances does not exist within the corporation. As the family as a block holder controls the managing and the board and dismiss board members or managers, the concept of independent directors can therefore not be applied efficiently. Further disadvantages are the high risk of expropriation, related-party transactions on non-commercial terms, the possible transfer of the company's assets to other companies owned by the family and finally the succession problematic

However, Amran and Ahmad (2009) noted that the family-owned system is considered to also have some advantages, such as a stable ownership, a long-term commitment of the shareholders, high degree of re-investment of earnings, from-specific investments by stakeholders contributing to high rates of growth and lower agency costs.

2.2.1.2.3 Japan Based Model

According to Gonencer (2008) Japan has a bank-centred system and stakeholder oriented corporate governance framework and resembles the Germanic model, nevertheless there are also some unique elements different than both the Germanic and

the Anglo-American model. In the Japanese model, interests of stakeholders such as employees and clients tend to come before the interests of shareholders. Key characteristics of the Japanese system are: Unlike the Anglo-American model, several companies are linked together though interlocking directorships. These intertwined groups of firms are called keiretsu. A main bank as well as several other banks or financial institutions hold shares of the group companies, creating a network of financial and industrial firms.

The board of directors in Japanese system comprises a board of directors, an office of representative directors and an office of auditors. The president is the rarely the chairman of the board. Banks have high influence on the decision making of the management in the Japanese system (Allen and Zhao, 2007).

Suehireo (1993) the main bank and/or other financial institutions also have representatives on the supervisory board of these companies and the main bank is usually the major shareholder in the corporation. Thus, Japanese keiretsu provides a multidirectional control and the average board contains up to 50 members. On contrary to the Anglo-American model, non-affiliated shareholders are weak to have an effect on board and company decisions and there are almost no "outsiders" in the board. Governmental ministries traditionally have a strong regulatory control in Japan, thus the main bank, the management and the government has a stronger relationship which characterizes the Japanese model. Unlike the Germanic system, Japan has a single board of directors dominated by managers. Consequently, there is a tendency of conflict between shareholders and management, and board members can hardly protect shareholder rights.

2.2.2 Is There A Convergence In Corporate Governance Models?

Debate is still on the two main models of corporate governance whether one of them prevail the other or if there will be a convergence in the future. Most of the debates are focused on as Albert (1993) and Hall and Saskice (2001) discussed in their studies whether the changes and developments of EU regulations in the scope of the corporate law and corporate governance implies a convergence of Rhenish capitalism on the Anglo-Saxon model, or as Cernat (2004) and Reberioux (2002) discussed in their studies whether it is true that we are witnessing is a new "hybrid" form of European corporate governance. Due to the globalization in general and recent corporate scandals

and the pressure coming from the institutional domestic and foreign investors in particular, convergence seems to be a reaction. Nevertheless, both the two models have weaknesses and strengths and according to the institutional and legal structure of the regions or national countries and nature of their business, each model has its own precedence over the other together with its unique governance mechanism and tools. On the hand, it is important to say that convergence must not be perceived as it means a victory of one system over another. It must not be perceived as unification of the national legislation, either. What is important is the possibility and flexibility of the firms to move from one regime to another as their needs and constituencies change. Convergence means also the positive reception of a common understanding regarding policy direction (Gonencer, 2008).

There are some commentators and researchers who predict a shift of European and Asian countries towards the Anglo-American corporate governance model, due to the stronger capital markets, higher disclosure and efficient mode of finance and governance (Hansmann and Kraakerman 2001; Mc Cahery et al 2002). Nevertheless, it can be stated that there is a tendency of convergence in many aspects manly focusing on increasing the shareholder rights and transparency due to the globalization of the capital and product market. Preliminary data and anecdotal evidence also suggests that European corporate governance has been shifting towards the outsider model during the last decade. Some significant reforms and changes are also examined in national level such as Germany, France and Sweden. The amendment of German corporate law in 1998 included the protection of shareholder value as a corporate objective. Germany also look important steps to facilitate takeovers, and eliminated voting right restrictions and some cross-shareholdings involving banks. In Italy, Draghi Law of 1997 increased the shareholder rights. In Spain and France, the privatization process has accelerated the decline of the state control. The reform of the French company law based on the Marini Report of 1997 gave firms more liberties concerning the way they shape their financial structures. Sweden which is an example of traditionally family-based ownership system started to contain some elements of the outsider model besides the existing insider model through evolution over time.

Denis and McConnell (2003) note that there is also convergence area in corporate governance concerns the International Financial Reporting Standards (IFRS). IFRS

have already been enacted by the EU and oblige all EU Companies listed on EU Exchanges to prepare their financial reports under the principal based IFRS as of 2005. The EU has made considerable progress in harmonizing accounting, auditing and corporate governance within the context of EC's Financial Service Action Plan (FSAP). Some non European countries also converge their national standards partially or completely with IFRS such as Australia, Hong Kong, Israel, Canada, New Zealand and Turkey…However, US apply its own US GAAP which is grounded on rules based approach and has chosen not to recognize IFRS or other international standards equivalent to its own standards in US listing requirements. Nevertheless, according to Gonencer (2008) international accounting standards board (ISBE) of the EU and Financial Accounting Standards Board (FASB) of US, as the enforcement bodies of these financial reporting standards, announced a memorandum of understanding- the Norwalk Agreement- pledging their best efforts to: Make their existing financial reporting standards fully compatible as soon as it is practicable and to coordinate their future work, programmes to ensure that once achieved, compatibility is maintained.

2.3 Principles of Good Corporate Governance Practices

In Kenya, Capital Markets Authority (CMA), 2002 in recognition of the role of good governance in corporate performance, capital formation and maximization of shareholders value as well as protection of investors' rights; CMA developed guidelines for good corporate governance practices for public listed companies in Kenya. This is in response to the growing importance of governance issues both in emerging and developing economies and for promoting growth in domestic and regional capital markets and to help shareholders realize long-term value while taking into account the interest of other stakeholders. The guidelines have been developed taking into account the work which had been undertaken extensively by several jurisdictions through many task forces and committees including but not limited to the United Kingdom, Malaysia, South Africa, Organization for Economic Cooperation and Development (OECD) and the Commonwealth Association for Corporate Governance. CMA has also supported development of a code of best practice for corporate governance in Kenya issued by the Private Sector Corporate Governance Trust, Kenya, whose efforts have also been useful in the development of these guidelines and are supplementary thereto. Whilst the guidelines have been developed for public listed companies and issuers of fixed income securities and debt instruments in Kenya's capital

market, companies in the private sector are also encouraged to practice good corporate governance (CMA, 2002).

According to CMA (2002), Combined Code (2003) and SOX Code (2002) there are a number of principles that are essential for good corporate governance practices of which the following have been identified as representing critical foundation and virtues of good corporate governance practices as discussed below:

Directors

Every public listed company should be headed by an effective board to offer strategic guidance, lead and control the company and be accountable to its shareholders. This does not compel unlisted companies to comply with these corporate governance requirements.

The Board and Board Committees

The board should establish relevant committees and delegate specific mandates to such committees as may be necessary. The board shall specifically establish an audit and nominating committee to ensure independence in performing their functions.

Directors Remuneration

The directors' remuneration should be sufficient to attract and retain directors to run the company effectively and should be approved by shareholders. The executive director's remuneration should be competitively structured and linked to performance. The non-executive directors' remunerations should be competitive in line with remuneration for other directors in competing sectors and companies should establish a formal and transparent procedure for remuneration of directors, which should be approved by the shareholders.

Supply and Disclosure of Information

The board should be supplied with relevant, accurate and timely information to enable the board discharge its duties. Every board should annually disclose in its annual report, its policies for remuneration including incentives for the board and senior management, particularly the following: First, quantum and component of remuneration for directors including non executive directors on a consolidated basis in the following categories; executive director's fees; executive director's emoluments; non executive director's fees and non executive director's emoluments. Second, a list of ten major shareholders of the company, third; share options and other forms of executive compensation that has to be made or have been made during the course of the financial year; and last, aggregate directors' loans.

Board Balance

The board should compose of a balance of executive directors and non-executive directors (including at least one third independent and nonexecutive directors) of diverse skills or expertise in order to ensure that no individual or small group of individuals can dominate the boards' decision-making processes.

Independent director

This refers to a director who has not been employed by the company in an executive capacity within the last five years; is not associated to an adviser or consultant to the company or a member of the company's senior management or a significant customer or supplier of the company or with a not-for-profit entity that receives significant contributions from the company; or within the last five years, has not had any business relationship with the company (other than service as a director) for which the company has been required to make disclosure; has no personal service contract(s) with the company, or a member of the company's senior management; is not employed by a public listed company at which an executive officer of the company serves as a director; is not a member of the immediate family of any person described above; or has not had any of the relationships described above with any affiliate of the company.

Non-Executive Director

This refers to a director who is not involved in the administrative or managerial operations of the company.

Appointments to the Board

There should be a formal and transparent procedure in the appointment of directors to the board and all persons offering themselves for appointment, as, directors should disclose any potential area of conflict that may undermine their position or service as director.

Multiple Directorships

Every person save a corporate director who is a /director of a listed company shall not hold such position in more than five public listed companies at any one time to ensure effective participation in the board and in the case where the corporate director has appointed an alternate director, the appointment of such alternate shall be restricted to three public listed companies, at any one time, subject to the requirements under the Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations, 2002.

Re-election of Directors

All directors except the managing director should be required to submit themselves for re-election at regular intervals or at least every three years. Executive directors should have a fixed service contract not exceeding five years with a provision to renew subject to: Regular performance appraisal; and shareholders' approval. Disclosure should be made to the shareholders at the annual general meeting and in the annual reports of all directors approaching their seventieth (70th) birthday that respective year.

Resignation of Directors

Resignation by a serving director should be disclosed in the annual report together with the details of the circumstances necessitating the resignation.

Role of Chairman and Chief Executive

There should be a clear separation of the role and responsibilities of the chairman and chief executive, which will ensure a balance of power of authority and provide for checks and balances such that no one individual has unfettered powers of decision making. Where such roles are combined a rationale for the same should be disclosed to the shareholders in the annual report of the Company. Every person who is a Chairperson of a public listed company shall not hold such position in more than two public listed companies at any one time, in order to ensure effective participation in the board, subject to the requirements under the Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations, 2002.

Shareholders

Approval of Major Decisions by Shareholders

There should be shareholders participation in major .decisions of the Company. The board should therefore provide the shareholders with information on matters that include but are not limited to major disposal of the Company's assets, restructuring, takeovers, mergers, acquisitions or reorganization.

Annual General Meetings

The board should provide to all its shareholders sufficient and timely information concerning the date, location and agenda of the general , meeting as well as full and timely information regarding issues to be decided during the general meeting; The board should make shareholders expenses and convenience primary criteria when selecting venue and location of annual general meetings; and the directors should provide sufficient time for shareholders questions on matters pertaining to the Company's performance and seek to explain to the shareholders their concern.

Accountability and Audit

Annual Reports and Accounts

The board should present an objective and understandable assessment of the Company's operating position and prospects. The board should ensure that accounts are presented in line with International Accounting Standards.

Internal Control

The board should maintain a sound system of internal control to safeguard the shareholders investments and assets.

Independent Auditors

The board should establish a formal and transparent arrangement for shareholders to effect the appointment of independent auditors at each annual general meeting.

Relationship with Auditors

The board should establish a formal and transparent arrangement for maintaining a professional interaction with the Company's auditors.

General

Public disclosure

There shall be public disclosure in respect of any management or business agreements entered into between the Company and its related companies, which may result in a conflict of interest.

Chief Financial Officers of Public Listed Companies

The Chief Financial Officers and persons heading the accounting department of every issuer shall be members of the Institute of Certified Public Accountants established under the Accountants Act. Where the persons referred to in paragraph (i) are members of other internationally recognized professional bodies and are yet to register as the members of the Institute of Certified Public Accountants such persons shall register as members of the Institute within a period of twelve months from the date of appointment to such position, subject to requirements under the Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations, 2002.

Company Secretaries of Public Listed Companies

The Company Secretary of every public listed company shall be a member of the Institute of Certified Public Secretaries of Kenya established under the Certified Public Secretaries of Kenya Act.

Auditors of Public Listed Companies

The auditor of a public listed company shall be a member of the Institute of Certified Public Accountants and shall comply with the International Auditing Standards.

2.4 Empirical Review

According to Clacher et al (2007) a number of recent studies have found a link between corporate governance measures adoption and firm performance. These studies showed that governance quality was higher when firm performance was stronger. Both the legal and governance systems in Kenya place a high degree of emphasis protecting shareholders' interests. We would therefore expect that firms with higher governance quality to have higher performance. In this case, better governance acts as a disciplining mechanism on managers with poor performance.

Further, as noted in the Combined Code (2003), the 'comply or explain' approach results in considerable variation in governance across firms, making it difficult to identify a specific set of governance structures and practices within firms that are related to improved performance. Most empirical research has focused on links between specific governance mechanisms, such as corporate boards, with performance. Yermack (1996) and Eisenberg, Sundgren and Wells (1998) find that board size is inversely related to firm performance and value. Board composition measured as the ratio of outsiders to insiders, and board independence, have been found to be positively related to firm performance (Rosenstein and Wyatt, 1990).

A number of empirical studies provided the nexus between corporate governance and firm financial performance (Gompers et al2003; Black et al2003 and Sanda et al (2003) with inconclusive results). Other scholars like 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 chairman. In the recent past, some empirical papers appear to focuses on the relationship between corporate governance ratings and firm financial performance: Gompers et al (2003), Brown and Caylor (2004), for the USA; Drobetz et al (2003) and Bauer et al (2004) for Europe; Forester and huen (2004) for Canada.

Ricart et al (2005) considered the relationship between corporate governance systems and sustainable development of DJSI leading companies. Bauer et al (2004) argued whether good corporate governance leads to higher common stock returns, firm value or operating performance using a sample of 269 firms from the FTSE Eurotop 300 over the period 2000-2001. The authors used Deminor's corporate governance ratings in order to measure the firms' quality of corporate governance. Deminor's rating can be attributed to four categories: shareholder rights, takeover defences, disclosure on corporate governance and board structure and functioning. They point out that good corporate governance will increase investor trust and subsequently lower corporate risk and a lower expected rate of return; furthermore a lower expected rate of return leads to a higher firm valuation. However, they found an insignificant relationship between corporate governance and firm valuation. Finally, the relationship between corporate governance and firm performance is statistically negative.

Empirical evidence on the association between outside independent directors and firm financial performance is mixed. Studies have found that having more outside independent directors on the board improves financial performance (Daily and Dalton, 1994), while other studies have not found a link between independent NEDs and improved firm financial performance (Hermalin and Weisbach, 1991). The point that can be made from these studies is that there is no clear benefit to firm financial performance provided by independent NEDs. Petra (2005) argues that the mixed results may be reflective of a corporate culture wherein corporate boards are controlled by management and the presence of independent NEDs has no discernable impact on management decisions. As for the association between role duality and financial performance, Abdul and Haniffa (2003) documented that Malaysian companies with role duality seem not to perform as well as their counterparts with separate board leadership based on accounting performance measurement.

According to Cho and Kim (2003), company would enhance their corporate governance when the company's performance is poor because changes in corporate governance structure are expected to bring out positive result on their performance. Claessens et al (2003) believes that good governance generates investor goodwill and confidence. Again, poorly governed firms are expected to be less profitable.) 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.

Freeman (1984) reveals that greater disclosure enhances stock market liquidity, thereby reducing the cost of capital. The commitment of management teams to increase the level of disclosure should lower the information asymmetry between managers and shareholders and lower the cost of capital. As a result of a reduced cost of capital, firm valuation will increase. If these relationships hold, greater disclosure of financial information and corporate governance topics will reduce information asymmetry and thereby lowering uncertainty and reducing the cost of capital. 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. 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.

Locally several studies have been done on the effect of corporate governance on financial performance. For example Muriithi (2004) studied the relationship between corporate governance mechanisms and performance of firms quoted on the NSE and found that the size and the composition of the board of directors together with the separation of the control and the management have the greatest effect on the performance. Ngugi (2007) did a study on the relationship between corporate governance structures and the performance of insurance companies in Kenya and found that inside directors are more familiar with the firm's activities and they can act as monitors to top management especially if they perceive the opportunity to advance into positions held by incompetent executives. The study also found that the effectiveness of a board depends on the optimal mix of inside and outside directors concluding that an optimal board composition lead to better performance of the companies.

Gatauwa (2008) studies the relationship between corporate governance practices and stock market liquidity for firms listed on the Nairobi Stock Exchange. The study found that greater disclosure enhances stock market liquidity, thereby reducing the cost of

capital. The commitment of management teams to increase the level of disclosure also lower the information asymmetry between managers and shareholders and lower the cost of capital. Matengo (2008) also conducted a study on the relationship between corporate governance practices and performance the case of banking industries in Kenya. The study found that good corporate governance will lead to lower firm risk and subsequently to a lower cost of capital. The study also found that adoption of corporate governance measures increases firm performance and attraction of financial resources from potential investors. Lang‘at (2006) conducted a study on corporate governance practices and performance in firms quoted at the NSE. The study found that good corporate governance will lead to lower company risk and subsequently to a lower cost of capital. The study also found that separation of ownership and control maximizes shareholders wealth.

2.5 Importance of Good Corporate Governance

IFC (2005) corporate governance is a priority because it presents opportunities to manage risks and add value to clients. In addition to the benefits to individual client companies, working to improve corporate governance it contributes more broadly to the company's mission to promote sustainable public private sector investment in developing countries. It is also in the company's interest to reduce the risk of investments by improving the governance of investee companies. In the worst corporate governance environments, poor standards and weak enforcement continue to be a barrier to investment even for firms with its mandate to work in frontier markets. Thus, improving the corporate governance of investee companies allows the firm to work in higher risk environments. It should also bring an increase in the market valuation of companies and attract more investors, which together increase the opportunities for a firm (Gonencer, 2008).

In recent years, IFC has worked with some of our highest-profile clients to improve their governance and to better communicate the quality of their governance to markets. Establishing best practices among high-profile clients has a positive demonstration effect that benefits other companies. By working with individual clients, a company helps to increase the investment flows to developing countries. However, if the company does not work to improve the corporate governance of client companies, then the company takes on not only investment risk, but also a reputational risk for involvement with companies with poor governance or, in the worst cases, corporate scandals. This reputational risk is particularly serious where stakeholders in addition to equity investors stand to lose from

governance abuses, such as, banks and insurance companies, where depositors and policyholders are vulnerable (IFC, 2008).

Gonecher (2008) in addition, improving corporate governance contributes to the development of the public and private capital markets. Poor governance undermines the integrity of publicly traded securities and discourages the use of public markets as a means to intermediate savings. Poor standards of governance, particularly in the area of transparency and disclosure have been a major factor behind instability in the financial markets across the globe. This was seen in the case of the East Asian financial crisis of 1997, where so called "crony capitalism" combined with macroeconomic imbalances to interrupt decades of outstanding economic growth. Most recently, poor corporate governance contributed to the spread of corruption and fraud that led to the dramatic corporate failures in United States and Western Europe.

2.6 Corporate Governance and Firm Performance

According to Clacher et al (2007) a number of recent studies have found a link between corporate governance and firm performance. These studies showed that governance quality was higher when firm performance was stronger. Both the legal and governance systems in Kenya place a high degree of emphasis protecting shareholders' interests. We would therefore expect that firms with higher governance quality to have higher performance. In this case, better governance acts as a disciplining mechanism on managers with poor performance. Further, as noted in the Combined Code (2003), the 'comply or explain' approach results in considerable variation in governance across firms, making it difficult to identify a specific set of governance structures and practices within firms that are related to improved performance. Most empirical research has focused on links between specific governance mechanisms, such as corporate boards, with performance. Yermack (1996) and Eisenberg, Sundgren and Wells (1998) find that board size is inversely related to firm performance and value. Board composition measured as the ratio of outsiders to insiders, and board independence, have been found to be positively related to firm performance, (Rosenstein and Wyatt (1990)).

According to Clacher et al (2007) the relationship between corporate governance and firm valuation has also been examined in many prior studies; the findings of these studies however are mixed. An important factor in whether governance impacts upon firm value

is the relation between internal and external governance mechanisms. If corporate governance is important in firm valuation we would expect that firms with higher quality governance to receive a higher valuation than those with lower governance quality holding all else constant.

Despite the consensus on the relationship between governance and firm value, the interaction between internal and external governance mechanisms is still subject to much debate. Black, Jang and Kim (2006) suggest that markets incorporate information on good governance by valuing firms with reference to the quality of internal and external governance mechanisms. Cremers and Nair (2005) find that internal and external governance mechanisms are complementary and associated with higher long term abnormal returns and profitability. However, Weir, Laing and McNight (2002) noted that despite the emphasis UK governance codes place on internal governance structures, there is little empirical evidence to support performance improvements.

A number of other papers have found no relationship between corporate boards and performance. Using accounting performance measures, Hermalin and Weisbach (1991), Aggrawal and Knoeber (1996) and Bhagat and Black (2000) report no link between the proportion of outside directors and Tobin's Q. Further, Bhagat and Black (2000) examine the effect of board composition on long-term stock market performance and report no relation between board composition and firm performance. Therefore, the empirical evidence on the effectiveness of the board of directors is rather very mixed. We therefore follow a broader approach to proxy the relationship between governance and firm value allowing us to assess internal and external governance together according to Clacher et al (2007).

2.7 Corporate Governance and Investment Expenditure

According to Clucher et al (2007) empire building is one of the most common forms of agency problems within firms. Management may undertake projects that are not necessarily in the interest of shareholders in order to achieve growth in the size of the firm and their own personal power. Consequently, management can become entrenched. As a result of investment decisions within the firm being taken by management, where there are weaker governance structures there is greater potential for empire building to occur. Jensen (1986) proposed that executives in well governed firms would choose investments that add value to the firm i.e. shareholder wealth maximising. This relation has been shown to hold in prior studies. From the investors' point of view, corporate governance is a way of minimising the

level of risk on their investment and provides the means to safeguard returns (Shleifer and Vishny, 1997). We therefore expect firms with higher quality governance to make better decisions regarding capital expenditure and invest in shareholder wealth maximising projects.

2.8 Challenges of Corporate Governance in Unlisted Companies in Kenya

OECD points out several comparative studies on the challenges and opportunities for corporate governance of non-listed companies, and distinguishes a variety of non-listed companies, such as family-owned companies, state-owned companies, group-owned companies, private investor- owned companies, joint ventures, and mass-privatised companies. The most peculiar of non-listed companies is family-owned; these businesses attract the most attention in the discussions. These firms are characterised by a smaller number of shareholders, no free market for the companies' shares, and substantial majority shareholder participation in the management, direction and operation of the company. Nevertheless, they do not fit into a single mould.

According to OECD, it is clear that non-listed companies avail themselves of different internal and external corporate governance mechanisms. Non-listed firms employ, for example, different legal business forms to structure their organisation, varying from partnership forms to limited liability companies and joint stock companies. They also note that the choice of organisation defines and determines to a large extent the internal corporate governance mechanisms. In some instances, the chosen legal business form allows for a governance structure in which the owners have joint management and control rights without a board. Other business forms require companies of a certain size to have a two-tiered system, consisting of a management board and a supervisory board. Again, this varies from country to country, as does the relationship between the two boards. It is also argued that effect of internal mechanisms, such as ownership and compensation regimes, also depend on how the business is financed. Most non-listed companies rely on family and bank financing for expansion and growth. However, companies that are unable to obtain bank finance because of the high risk they present, must usually attract private equity to develop their plans. Venture capital funds are a very important source of private equity capital. OECD maintains that the legal and non-legal mechanisms that venture capitalists usually employ align the interests of investors, fund managers and entrepreneurs (OECD, 2005).

2.9 Chapter Summary

The subject matter of corporate governance refers to the manner in which the power of a company is exercised in the stewardship of the company's total portfolio and resources with a view of obtaining increasing stakeholders value and also to satisfy other stakeholders within an individual company's corporate mission and vision. The main corporate governance themes that are currently receiving attention are adequately separating management from the board to ensure that the board is the top most decision making organ and the management of a three-way conflict between major shareholders, managers and minor share holders to enhance firm growth and attract more capital. It directs and supervises management, including separating the chairperson and chief executive roles. Thus, this is enhanced by ensuring that the board has an effective mix of independent and non-independent directors or board members; and establishing the independence of the auditor and therefore the integrity of financial reporting, including establishing an audit committee of the board. Good Corporate Governance aims at increasing financial performance, profitability, sound investment decision making of firms. It also enhances the ability to create wealth for shareholders, increased employment opportunities with better terms for workers and benefits to the stakeholders.

The research conducted on company level data of corporate governance ratings reveals that better corporate governance is correlated with better operating performance and market valuation. Corporate governance mechanisms assure investors in corporations that they will receive adequate returns on their investments evidence suggests that corporate governance has a positive influence over corporate performance. The literature also establishes that good corporate governance results in a lower cost of funds. One explanation is that good corporate governance will lead to lower company risk and subsequently to a lower cost of funds. Good governance is a signal or symptom of lower agency costs; an indicator not properly incorporated in firm's visibility and market prices.

Several mechanisms can be used to overcome the problems associated with separation of ownership and control. These include alignment of members' or shareholders' interest with managerial interests, board monitoring by investors, large shareholders, lenders and legal protection of minority investors and shareholders from managerial expropriation through members or shareholder rights and the community or market for corporate

control respectively. The number board of directors is assumed to have an influence on performance. The board is vested with responsibility for managing the company and its activities. The studies cited in the literature mostly concentrate on the developed countries whose strategic approach and corporate governance systems are not similar to that of Kenya.

The studies have also been done on other firms other than the insurance and banks. To the best of the researchers' knowledge, no study has been done on the impact of corporate governance adoption on non listed entities in Kenya. This study seeks to fill this gap by investigating the impact of corporate governance on non listed entities in Kenya while comparing insurance industry to banking industry.

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 and finally the pilot study.

3.2 Research Design

In this study, the researcher applied a descriptive research design. A descriptive study is concerned with determining the frequency with which something occurs or the relationship between variables. According to Cooper and Schindler (2003), a descriptive study is one that finds out the what, where and how of a phenomenon. Thus, this approach is appropriate for this study, since the researcher intended to collect detailed information through descriptions and is useful for identifying variables and hypothetical constructs.

3.3 Target Population

The study focused generally on all insurance companies and banks that are by choice unlisted but have financial stakeholders besides the controlling shareholders. All the managers in the thirty seven unlisted insurance companies and the thirty three unlisted banks of the financial industry in Kenya formed the target population. This is because managers are the people directly responsible for implementing corporate policies formulated by their respective board of directors and also understand the effects of corporate governance. Therefore, they are better placed to provide information pertaining to corporate governance practices which they have adopted to manage and achieve financial performance and competitiveness in their market. The study conducted a census as the sample was small and accessible. All the thirty two unlisted insurance companies and the thirty three unlisted banks of the unlisted financial institutions in Kenya formed the study sample population. To get the corporate indices one respondent (senior management level) was purposively selected from each organization to participate in the study.

3.4 Data Collection

The study used both primary and secondary data. The researcher collected primary data to determine a corporate governance index through a semi structured questionnaire with a "Yes" and "No" questions. Secondary data on financial reports and financial Statements were obtained from the financial institutions' industry regulators - Central Bank of Kenya (CBK) and Insurance Regulatory Authority (IRA).

3.5.1 Data Analysis and Presentation

The study analysis considered the interdependence of governance mechanisms. Therefore, in addition to the study corporate governance index, the analysis also considered institutional block holdings, board size and composition, and leverage. To analyse the impact of corporate governance mechanisms on various dependent variables the researcher applied a pooled multivariate regression analysis in a model specification as shown below:

$y = a + \sum pit\ V + \sum \beta iC + e$

Where; y = dependant variable (firm's performance),

a= the constant term for the Governance Variables,

V = Governance Variables; Board size, Board Composition, Audit Independence, Independent Committees),

C = Controls and

e = Error Term.

This model is in line with Gompers, Ishii and Metrick (2003), and Clucher et al (2007) where the relationship between the corporate governance index, institutional shareholdings, Tobin's Q, ROA and investment expenditure is analysed. The dependent variables were measured at time *t*; whereas the independent variables were used as the average over the 2007 to 2011 sample period. The calculation of the average value over the sample period was applied to reduce the problem of short term fluctuations in our sample years. Tobin's Q was applied to measure the effect of corporate governance mechanisms on firm value. To measure the impact of corporate governance mechanisms on firm performance, the researcher calculated an adjusted return on assets (ROA) in the same way industry adjusted Tobin's Q was calculated.

3.5.2 Developing the Corporate Governance Index

To construct the study index, the researcher asked a list of seventy questions (see Appendix III) relating to the level of compliance in the firm with the corporate governance provisions outlined in the CMA Code (2002), SOX (2002) and the Combined Code (2003). These are grouped under six main categories namely; board structure, Disclosure, Accountability & Audit, ownership structure, shareholders & their voting rights, compensation policy and general policy issues. To construct the index, 1 point is awarded where compliance with the spirit of the CMA Code (2002), SOX (2002) or the Combined Code (2003) is observed and 0 for non-compliance or absence of satisfactory procedure(s) relating to the specified governance mechanism.

The study basis for the construction of the index considers full acceptance of the recommendations of the CMA Code to reflect high quality governance. The higher the score awarded to a firm then the higher the level of governance in the firm. The study final index is calculated as the average total points scaled by the number of questions. This avoids overweighting one specific component in the study index. Here, the researcher records 1 for firms which adhere to the governance provision set out in the CMA Code and 0 for those that did not adhere or elected to explain instead of comply. For example, where a company fails to split the roles of Chairman and CEO but elects to explain the researcher will record a zero. Lastly the study changed its index into percentages and so 0% indicates a lower level of adherence or non-adherence to the code.

A corporate governance index as developed by Gompers, Metrick and Ishii (2003) and Gonecher (2008) was constructed to proxy for the level of shareholder rights within Kenyan unlisted firms. The study developed this methodology to jointly analyse the relationship between firm level governance and market value, operating performance and investment on a sample of Kenyan financial sector firms.

3.5.3 Data Analysis and Models

The study analysis considered the interdependence of governance mechanisms. Therefore, in addition to the study corporate governance index, the analysis also considered institutional block holdings, board size and composition, and leverage. To

analyse the impact of corporate governance mechanisms on various dependent variables the study applied a pooled multivariate regression as shown below:

$$Y_{it} = a + \Sigma\beta_i V_{it} + \Sigma\beta_i C + \varepsilon_i$$

Where; Y=Dependable Variable,

a= Constant Term for the Governance Variables,

V= Governance Variables,

C=Controls such as Transparency, Accountability and Disclosures,

β= Regression coefficient of the Independent Variable,

ε=Error Term which is usually equated to 0 value for convenience computation purposes and values in parenthesis are t-statistics.

This was applied following Gompers, Ishii and Metrick (2003); Cremers and Nair (2005) and Gonecher (2008) the study that analysed the relationship between the corporate governance index, institutional shareholdings, Tobin's Q, ROA and investment expenditure in UK and US applying the Combined Code and SOX Code respectively. The dependent variables were measured at time *t*; whereas the independent variables were used as the average over the 2007 to 2011 sample period. The calculation of the average value over the sample period was applied to reduce the problem of short term fluctuations in the study sample years.

Tobin's Q: Firm Valuation

Tobin's Q was applied to measure the effect of corporate governance mechanisms on firm value as shown below:

$$\text{Tobin's } Q = a + \beta_1 I + \Sigma_{j=1}\beta_j S_{ij} + \beta_7 T + \beta_8 U + \beta_9 V + \beta_{10} W + \varepsilon_{it}$$

Where; a= Constant Term for the Governance Variables,

I= Governance Index,

S= Other Governance Mechanism such as board size, outsiders, leverage and institutional ownership,

T= Firm's Total Assets Employed,

U= Firm's Age,

V=Growth,

W= Industry Dummy which relates to the dummy variables in the industries according to NSE industrial classification,

ε = Error Term which is equated to 0 value for computation purposes and values in parenthesis are t-statistics.

To take account of industry effects the study applied an industry adjusted Q subtracting the industry median Tobin's Q from our initial measure of Tobin's Q.

Adjusted ROA: Firm Performance

To measure the impact of corporate governance mechanisms on firm performance, the study calculated an adjusted return on assets in the same way an industry adjusted Tobin's Q was calculated as shown below:

$$Y = a + \beta_1 I + \Sigma_{j=1} \beta_j S_{ij} + \beta_7 T + \beta_8 U + \beta_9 V + \beta_{10} W + \varepsilon_{it}$$

Where; Y=ROA (Return on Assets),

a= Constant Term for the Governance Variables,

I= Governance Index,

S=Other Governance Mechanism such as board size, outsiders, leverage and institutional ownership,

T= Firm's Total Assets Employed,

U= Firm's Age,

V=Growth,

W= Industry Dummy which relates to the dummy variables in the industries according to NSE industrial classification,

ε=Error Term which is equated to 0 value for computation purposes and values in parenthesis are t-statistics.

Institutional Shareholding Measurement

For the percentage of institutional shareholding, the average institutional shareholdings for the period 2007-2011 were used. The ownership structure was assumed to be relatively stable in most of the study sample firms. Percentage of Institutional Shareholding is the percentage of ownership by institutions based on common equity shares held under voting control as shown below:

$$Y = a + \beta_1 I + \Sigma_{j=1} \beta_j S_{ij} + \beta_7 T + \beta_8 U + \beta_9 V + \beta_{10} W + \varepsilon_{it}$$

Where; Y= Percentage of Institutional Shareholding,

a= Constant Term for the Governance Variables,

I= Governance Index,

S=Other Governance Mechanism such as board size, outsiders, leverage and institutional ownership,

T= Firm's Total Assets Employed,

U= Firm's Age,

V=Growth,

W= Industry Dummy which relates to the dummy variables in the industries according to NSE industrial classification,

ε=Error Term which is equated to 0 value for computation purposes and values in parenthesis are t-statistics.

Level of Investment Measurement

To measure the level of investment within the firm capital expenditure was scaled by total assets employed (Richardson, 2004) as shown below:

$Y = a + \beta_1 I + \beta_2 \text{Inverse } Q + \beta_3 U + \beta_4 T + \beta_5 L + \beta_6 Ca + \beta_7 W + \varepsilon_{it}$

Where; Y= Investment Expenditure,

a= Constant Term,

I= Governance Index; Inverse Q is the inverse of Tobin's Q,

U= Firm's Age,

T= Firm's Total Assets Employed,

L=Firm's Leverage,

W= Industry Dummy which relates to the dummy variables in the industries according to NSE industrial classification,

ε = Error Term which is equated to 0 value for convenience computation purposes and values in parenthesis are t-statistics.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter presents the results of the study. Data was collected from a number of sources as outlined in chapter three on all the unlisted financial institutions. Of the 65 firms, 33 were commercial banks while 32 were insurance firms. Secondary data was obtained from filled up the questionnaires which were then coded into the SPSS and analysed using both descriptive and multiple regression analysis.

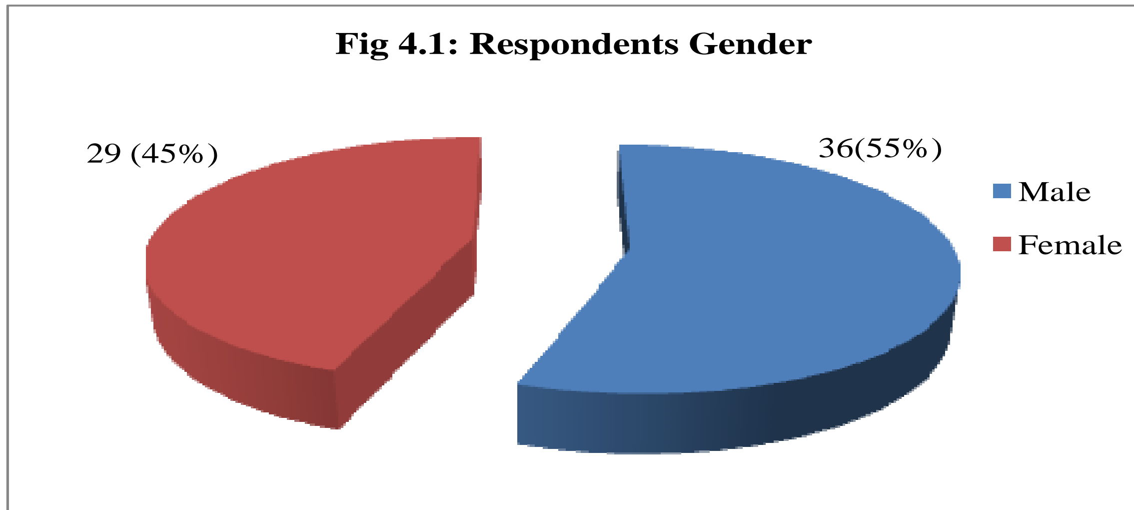
Data on all the dependent and independent variables of the study were found from various secondary sources. These were Tobin's Q, total assets employed, ROA, Board size, outsiders, institutional shareholders, leverage, age, growth, and industry. Only the data for free cash flow as a percentage of shares was not found for all the firms hence the variable was dropped from model 4 of the study.

This chapter is organized as follows: section 4.2 gives the characteristics of the respondents who filled the questionnaires. Section 4.3 presents the descriptive analysis results where minimum, maximum, mean, and standard deviations are shown in a table. This section also presents the results of the differences in adoption levels of banks and insurance firms on various indices. The section further presents an ANOVA analysis to establish whether such differences are significant. Section 4.4 presents the multiple regression results where results for specific models as were outlined in chapter 3 are presented in tables under sections 4.4.1, 4.4.2, 4.4.3, and 4.4.4. Section 4.5 then presents the discussion of results where the results of the study are compared with the previous results from the literature review.

4.2 Characteristic of the Respondents

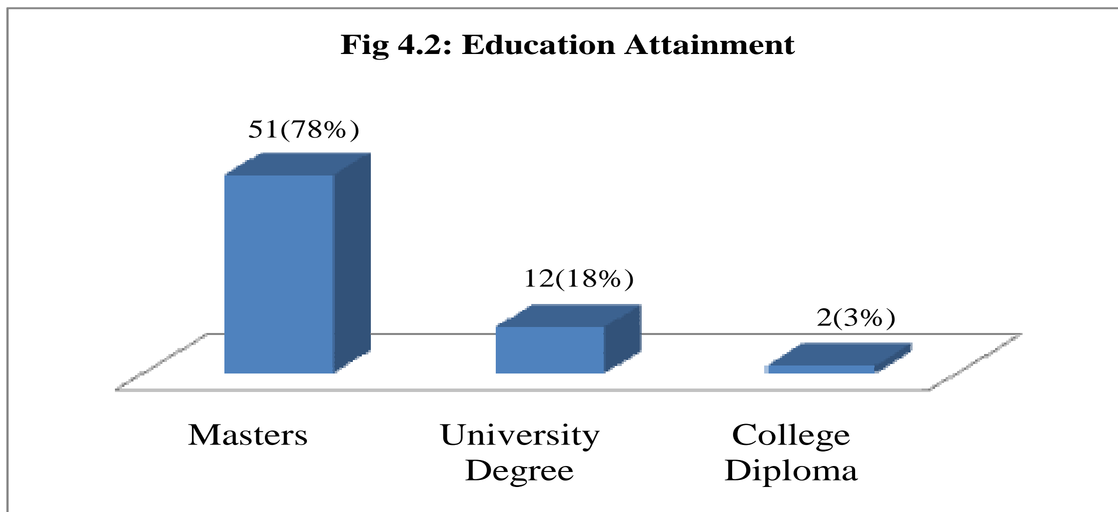
The study had sought first sought to find out the characteristics and general information of the respondents to ensure credibility of the data obtained and used in the study. The information sought included designation, gender, level of education and duration of service.

Figure 1 below, shows the gender distribution of the respondents.



Source: Author (2012)

The results show that the respondents were fairly distributed across both genders with 55% being male while 45% being female. This shows that there is no gender bias.
The study also sought to find out the highest level of education attained by the respondents. Figure 2 shows the results obtained.



Source: Author (2012)

The results show that 78% of the respondents had a Masters degree; 18% had a university degree while 3% had college diplomas. These results show that the respondents were well informed on the subject of study and thus appropriate for the study.

The study also asked the respondents the departments they were working in. Table 4.1 shows the results.

Table 4.1: Departments where respondents were based

Department	Frequency	Percent
Administration and HR	34	52
Finance and Accounting	12	18
Legal	8	12
Marketing	4	6
Communications	3	5
Corporate Affairs	2	3
Credit Management	2	3
Total	65	100

The results show that the majority (52%) of the respondents were drawn from the Administration and HR department. Other respondents were drawn from finance and accounting, legal, marketing, communications, corporate affairs and credit management departments.

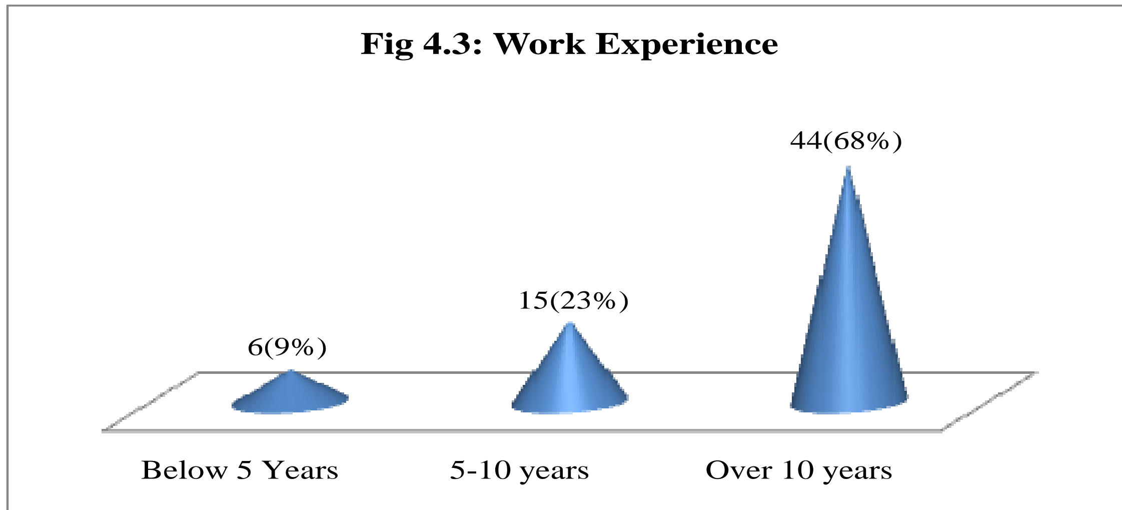
The study also sought to find out the designation of the respondents and the results are shown in table 4.2.

Table 4.2: Respondents' designation

Department	Frequency	Percent
Chief Executive Officers	4	6
Chief Operation Officers	6	9
Deputy CEOs	9	14
Credit, Marketing, Finance and Accounting Managers	15	25
Administration and HR directors	15	23
Communications/Corporate Affairs Directors	5	8
Legal and Corporate Affairs Directors	10	15
Total	65	100

The results show that the respondents held various senior management positions and thus were qualified and appropriate for the subject under study and their responses would lead to credible results.

The study then sought to find out the number of years which the respondents had worked in their respective firms. The results are shown in figure 3,



Source: Author (2012)

The results show that 68% had worked in their respective firms for over 10 years; 23% had worked for between 5 and 10 years while the rest 9% had worked less than 5 years. The results show that the respondents had a proper understanding of the firms operations and issues related to corporate governance and thus information they provided were reliable and credible in calculating the corporate governance indices for use in the analysis models.

4.3 Descriptive Analysis Results

Table 4.3 presents the results of the descriptive analysis on all the dependent and independent variables in the study.

Table 4.3: Descriptive results on dependent and independent variables

Variables	Minimum	Maximum	Mean	Std. Dev
Governance Index	.30	.96	.6815	.14405
Tobin's Q	.41	.96	.7254	.13669
Inverse Q	1.04	2.44	1.4368	.32530
ROA	.01	.40	.1371	.08021
Board Size	5.00	12.00	9.1692	1.77279
Outsiders	1.00	4.00	1.9385	.96626
Instit. Shareholders	.00	5.00	1.7231	1.09698
Leverage	.09	.26	.1389	.04150
Age	4.00	52.00	29.4923	12.88546
Total Assets	1,023,546	14,445,821	5,364,707	2,944,073

Source: Author (2012)

The results in table 4.3 show that the firm with the lowest corporate governance index had an index of 30% while the highest had 96%. This means that no firm had achieved 100% compliance with the corporate governance standards. The mean index was 68% with a deviation of 14% indicating that the firms had just above average compliance rates with the governance mechanisms.

On other corporate governance issues, it was noted that the firm with the least board members had 5 members while the highest number was 12 with a mean of 9 members and a standard deviation of 2 members. This means therefore that all firms met the minimum requirements for board memberships. The least number of outsiders in the board was 1 member while the highest was 4 members. The mean outsiders were 2 members. Thus all firms had at least one outsider on the board. Some of the firms did not have an institutional shareholder while the highest number of institutional shareholders in a firm was 5 with a mean of 2.

The results also show that the firm with the least firm value as measured by Tobin's Q had a value of 41% while the highest had 96%. The mean firm value was 72% with a standard deviation of 13%. These results show that most firms had higher firm values and were therefore performing well above the industry average.

Another performance variable, ROA, shows that the firm with the least performance had an ROA of 1% while the highest ROA was 40%. The mean ROA was 13% with a standard deviation of 8%. This means that most firms in the financial sector have very low ROAs.

Table 4.4 shows the results of the analysis on the corporate governance codes adoption levels among the financial firms surveyed. The mean values are shown.

Table 4.4: Corporate Governance Adoption Levels in Kenya

Indices	Banks (%)	Insurance (%)	All (%)
Board sub-index	0.78	0.76	0.77
Disclosure sub-index	0.57	0.50	0.54
Ownership sub-index	0.72	0.75	0.74
Shareholder rights sub-index	0.67	0.65	0.66
Compensation sub-index	0.60	0.61	0.61
General	0.78	0.75	0.77
Overall governance index	**0.69**	**0.67**	**0.68**

Source: Author (2012)

As regards the board sub-index, the banks had a score of 78%, insurance firms had a score of 76% while the mean score for the index was 77%. The results show that banks had adopted board level governance mechanisms more that insurance firms.

On the disclosure sub-index, the results show that the banks had a score of 57% while the insurance firms had a score of 50%. The overall index for the firms was 54%. This shows that banks had adopted more disclosure level corporate governance mechanisms that the insurance firms.

On ownership sub-index, table 2 reveals that banks had a score of 72% while insurance firms had a score of 75%. The overall index for the firms was 74%. These results indicate that insurance firms had adopted ownership codes more than the banks.

On shareholder rights, banks had a score of 67% while insurance firms had a score of 65%. Overall, the firms had a score of 66%. The results therefore show that banks had adopted more of these shareholder rights guidelines more than the insurance firms.

On compensation, banks had a score of 60% while insurance firms had a score of 61%. Overall, the firms had a score of 61%. This means that insurance firms had adopted more compensation level corporate governance codes than the banks.

On the general guidelines which were specifically Kenyan guidelines, the results show that banks had a score of 78% while insurance firms had a score of 75%. Overall, the firms had a score of 77%. This means that banks had adopted these guidelines more than the insurance firms.

Overall, the results reveal that banks had an index of 69% while the insurance firms had an index of 67%. All the firms combined had an index of 68%. Thus generally the banks had adopted more governance codes than the insurance firms but the difference was very minimal. The index that had the highest adoption therefore was board sub-index followed by the general guidelines at 77%. The least adopted was disclosure sub-index with 54%.

Table 4.5 shows a one-way ANOVA analysis for the differences between the corporate governance adoption levels in banks and insurance firms. This test was done in order to establish whether the differences in adoption levels were statistically significant. The test of significance was done at 5% level of confidence.

Table 4.5: Differences in Governance Adoption between Banks and Insurance Firms

	Sum of Squares	df	Mean Square	F	Sig.
Between Groups	.007	1	.007	.318	.575
Within Groups	1.321	63	.021		
Total	**1.328**	**64**			

Source: Author (2012)

The results show that the F statistic was 0.318 and the p-value was 0.575. This means that the difference in adoption levels of corporate governance codes between the banks and insurance firms was not significant at 5% level of confidence.

4.4 Multiple Regression Results

This section shows the multiple regression results. Section 4.4.1 presents the results on the effect of corporate governance mechanisms on firm value. Section 4.4.2 shows the results on the effect of corporate governance mechanisms on firm performance. Section 4.4.3 presents the results on the effect of corporate governance mechanisms on institutional shareholding, while section 4.4.4 presents the results on the effect of corporate governance mechanisms on the level of investment.

4.4.1 Effect of Corporate Governance Mechanisms on Firm Value

The results in table 4.6 show the effect of corporate governance mechanisms on firm value as shown by Tobin's Q. The results indicate that governance index (β = -.173, p=.155), board size (β = -.002, p=.878), institutional shareholding (β = -.002, p=.920), and leverage (β = -.490, p=.249), had a negative effect on firm value while outsiders (β = .033, p=.103), age (β = .001, p=.521), growth (β = 259, p=.144), total assets employed (β = .002, p=.989), and industry (β = .029, p=.429), had a positive effect on firm value. However, at 5% confidence level, none of the variables had a significant effect on firm value. This therefore means that corporate governance mechanisms do not have a significant effect on firm value as shown by Tobin's Q.

The R value of 0.415 shows that there was a moderate correlation between the dependent and independent variables in the study. Further, the R^2 indicates that the model explained 17.2% of the variance in firm value. Thus the model did not account for much of the variance in firm value. The F statistic was also insignificant at 5% level of confidence suggesting that the model was not fit to explain the relationship between firm value and corporate governance.

Table 4.6: Effect of Corporate Governance on Firm Value

Independent variables	Tobin's Q
Constant	.755 (.000)
Governance Index	-.173 (.155)
Board size	-.002 (.878)
Outsiders	.033 (.103)
Institutional	-.002 (.920)
Leverage	-.490 (.249)
Age	.001 (.521)
Growth	.259 (.144)
Industry	.029 (.429)
Total assets employed	.002 (.989)
R	.415
R^2	.172
F statistic	1.268 (.275)

Source: Author (2012)

Tobin's Q = 0.755 - 0.173 Index - 0.002 Board + 0.033 Outsiders - 0.002 Inst - 0.490 Leverage + 0.001 Age + 0.259 Growth + 0.029 Industry + 0.002 Assets

4.4.2 Effect of Corporate Governance Mechanisms on Firm Performance

The results in table 4.7 show the effect of corporate governance mechanisms on firm performance as shown by ROA. The results indicate that governance, board size, age, growth, and total assets employed had a positive effect on performance while outsiders, institutional shareholding, leverage, and industry had a positive effect on firm performance. However, at 5% confidence level, only growth was significant ($p = 0.005$) as the rest of the variables had an insignificant effect on firm performance. This therefore means that corporate governance mechanisms do not have a significant effect on firm performance as shown by ROA.

There was a moderate correlation between the dependent and independent variables as shown by the R value of 0.430. Further, the R^2 indicates that the model explained 18.5% of the variance in firm performance. Thus the model did not account for much of the variance in firm performance. The F statistic was also insignificant at 5% level of confidence suggesting that the model was not fit to explain the relationship between firm performance and corporate governance.

Table 4.7: Effect of Corporate Governance Mechanisms on Performance

Independent variables	ROA
Constant	.090
Governance Index	.069 (.324)
Board size	.003 (.571)
Outsiders	-.009 (.426)
Institutional	-.001 (.912)
Leverage	-.223 (.366)
Age	.000 (.623)
Growth	.298 (.005)
Industry	-.026 (.228)
Total assets employed	.014 (.911)
R	.430
R^2	.185
F statistic	1.387 (.217)

Source: Author (2012)

ROA = 0.090 + 0.069 Index + 0.003 Board - 0.009 Outsiders - 0.001 Inst - 0.223 Leverage + 0.000 Age + 0.298 Growth - 0.026 Industry + 0.014 Assets

4.4.3 Effect of Corporate Governance Mechanisms on Institutional Shareholding

The results in table 4.8 show the effect of corporate governance mechanisms on institutional shareholding. The results indicate that governance, board size, leverage, growth, and industry had a negative effect on institutional shareholding while outsiders, age, and total assets employed had a negative effect on institutional shareholding. However, at 5% confidence level, only board was significant (p = 0.022) as the rest of the variables had an insignificant effect on institutional shareholding. This therefore means that corporate governance mechanisms do not have a significant effect on institutional shareholding.

There was a moderate correlation between the dependent and independent variables as shown by the R value of 0.425. Further, the R^2 indicates that the model explained 18.0% of the variance in institutional shareholding. Thus the model did not account for much of the variance in institutional shareholding The F statistic was also insignificant at 5% level of confidence suggesting that the model was not fit to explain the relationship between institutional shareholding and corporate governance.

Table 4.8: Effect of Corporate Governance on Institutional Shareholding

Independent variables	Institutional shareholding
Constant	.496 (.001)
Governance Index	-.073 (.495)
Board size	-.021 (.022)
Outsiders	.011 (.511)
Leverage	-.214 (.571)
Age	.001 (.381)
Growth	-.197 (.204)
Industry	-.039 (.236)
Total assets employed	.020 (.872)
R	.425
R^2	.180
F statistic	1.541 (.164)

Source: Author (2012)

Inst = 0.496 - 0.073 Index - 0.021 Board + 0.011 Outsiders - 0.214 Leverage + 0.001 Age - 0.197 Growth – 0.039 Industry + 0.020 Assets

4.4.4 Effect of Corporate Governance Mechanisms on the Level of Investment

The results in table 3.9 show the effect of corporate governance mechanisms on the level of investment. The results indicate that governance, inverse of Tobin's Q, and growth had a positive effect on the level of investment while leverage, age, and industry had a negative effect on the level of investment. However, at 5% confidence level, none of the variables had a significant effect on the level of investment. This therefore means that corporate governance mechanisms do not have a significant effect on the level of investment.

There was a very low correlation between the dependent and independent variables as shown by the R value of 0.155. Further, the R^2 indicates that the model explained 2.4% of the variance in institutional shareholding. Thus the model did not account for much of the variance in institutional shareholding The F statistic was also insignificant at 5% level of confidence suggesting that the model was not fit to explain the relationship between institutional shareholding and corporate governance.

Table 4.9: Effect of Corporate Governance on Level of Investment

Independent variables	Level of Investment
Constant	14.659 (.098)
Governance Index	.179 (.905)
Inverse Q	.412 (.861)
Leverage	-516 (.898)
Age	-.002 (.603)
Growth	1.364 (.318)
Industry	-.126 (.680)
R	.155
R^2	.024
F statistic	.237 (.963)

Source: Author (2012)

LN_Assets (Investment) = 14.659 + 0.179 Index + 0.412 Inverse Q - 0.516 Leverage - 0.002 Age + 1.364 Growth – 0.126 Industry

4.5 Discussion of Findings

The study found that governance had a negative and insignificant effect on firm value as measured by Tobin's Q. These results are inconsistent with those of Clacher et al (2007) who found that governance index had a positive and significant effect on firm value in the UK. These results show that unlisted firms with better quality governance structures in Kenya do not necessarily have a higher market value.

On the effect of corporate governance on firm performance, the study found a positive but insignificant effect of corporate governance index. This is inconsistent with the findings of Clacher et al (2007) who noted that firms with better quality governance structures also performed better. However, the study revealed that growth of a firm had a positive and significant effect on firm performance. Therefore, high growth firms also perform better in terms of ROA.

The results on the effect of corporate governance mechanisms on institutional shareholding reveal that governance index negatively but insignificantly influenced institutional shareholding in unlisted firms. As far as the direction of this relationship is concerned, the results are consistent with prior empirical studies which suggest that institutions are not effective monitors of the companies in which they invest. Further, it indicates that higher institutional ownership increases agency costs to the firm relative to any benefits that can be derived from the presence of institutions.

The study also tested the effect of corporate governance mechanisms on the level of investment. The study found that governance index was positively but insignificantly related to investment expenditure. These results are inconsistent with those of Clacher et al (2007) who found significant and negative coefficients.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the summary of the study, conclusions of the study, recommendations, limitations of the study, and suggestions for further research.

5.2 Summary of the Study

This study was designed to determine the impact of corporate governance practices on operating performance of the unlisted financial institutions in Kenya. The specific objectives were: to determine the extent of corporate governance adoption by unlisted insurance companies and banks in Kenya; to determine levels of adoption of foreign countries corporate governance codes by the unlisted insurance companies and banks in Kenya; to determine the extent of vacuum in the Kenya Corporate Governance provisions in the unlisted and private companies; to determine the impact of corporate governance practices on the corporate investment decisions of the unlisted insurance companies and banks in Kenya; and to determine the impact of corporate governance practices on the corporate performance of the unlisted insurance companies and banks in Kenya.

This study was designed as a descriptive design where the researcher intended to collect detailed information through descriptions in order to identify variables and hypothetical constructs. The population of the study was unlisted financial institutions in Kenya. All the firms were targeted in the study. Primary data was collected through a semi-structured dichotomous questionnaire. These data were also available from the financial reports of the firms. Financial data was collected from 2007-2011 from the financial records and these averages used in the analysis. Various models were developed for analysis and regression analysis used to perform the data analysis. Descriptive analysis was also used to perform data analysis.

The results showed that none of the unlisted firms had achieved 100% compliance with the governance mechanisms. The firm with the lowest corporate governance index had an index of 30% while the highest had 96%. The mean index was 68% with a deviation of 14% indicating that most of the firms had just above average compliance rates with the governance mechanisms.

The results showed that unlisted firms had adopted most of the corporate governance requirements of the CMA as these are regulatory requirements in Kenya while some firms had also adopted the foreign ones. It is important to note here that the CMA guidelines were adopted from the global best practices and therefore CMA guidelines conform to the global standards.

From the results of this study, there was no vacuum in the Kenya Corporate Governance provisions by the CMA as these met international best practices. From the results, it was clear that governance did not significantly influence corporate investment decisions as the relationship was positive but insignificant at 5%. As shown by the effect on firm value as well as the effect on firm performance, corporate governance index did not have a significant effect on either Tobin's Q or on ROA.

5.3 Conclusion

The study concludes that the level of adoption of corporate governance in Kenya by unlisted firms is very high provided that they are not bound by the CMA codes yet they have reached the levels of adoption noted. This can be attributed to the fact that the sample consisted of financial firms where banks are tightly managed by the CBK and hence there governance levels must reach a certain minimum in order to be allowed to operate. Same goes to the insurance firms in Kenya.

The study also concludes that the unlisted financial firms in Kenya have adopted to a large extent the foreign corporate governance mechanisms and this is because the ones issued in Kenya are borrowed heavily from other foreign developed nations and therefore the adoption of Kenyan corporate governance guidelines also means adoption of foreign ones.

The study further concludes that there is no vacuum as far as the Kenya corporate governance guidelines are concerned as the guidelines clearly stipulate the requirements that each firm must meet at minimum and these are also borrowed from the best practices around the world.

The study also concludes that firm performance of unlisted financial firm in Kenya is not influenced by corporate governance mechanisms. This can be attributed to the fact that

there is less variability in the application and adoption of corporate governance among unlisted financial firms in Kenya.

5.4 Recommendations

The study makes a number of recommendations. First, unlisted firms should strive to adopt more corporate governance codes as the level of adoption is still relatively low compared to their listed peers. It is therefore important that the boards of financial institutions adopt more stringent corporate governance mechanisms.

The study also recommends that the Central Bank of Kenya and the Insurance Regulatory Authority should find other ways of ensuring that the firms conform to the minimum requirements of the governance codes in Kenya. More stringent regulations should be adopted to ensure strict adherence to the guidelines.

In as much as corporate governance was not found to influence firm performance, the study recommends that firms keep adopting more of the governance guidelines as this has been found to positively impact on firm performance.

Majority of businesses fall outside the purview of the CMA & CBK hence gaps and loopholes in governance related reporting for such private companies not considered. This area should be explored.

The study suggests that unlisted firms should strive to adopt to corporate governance mechanisms that enhance employee motivation to improve firm performance. This is because employees are the implementers of the corporate governance codes that contribute to firm performance and profitability.

5.5 Limitations of the Study

The study was unable to get information on free cash flow for all the firms and therefore this variable was not included in the final analysis. This therefore limits the application of this specific model.

The study was unable to get information on market value of assets for the unlisted financial firms – banks and insurance firms. Therefore the book value of assets instead of market value of assets was used to measure market valuations.

This study focused on unlisted insurance companies and banks of the financial institutions sector in Kenya. Therefore, the actual degree of compliance to best practices of corporate governance guidelines of every non listed company or economic sector not presented.

This study focused on unlisted insurance companies and banks of the financial institutions sector in Kenya. Majority of businesses fall outside the purview of the financial institutions sector, hence gaps and loopholes in governance related reporting for such companies like the listed firms were not considered.

The study focused on the analysis of the ability of large and external shareholders, and in particular institutions, to influence the level of governance in firms under the prevailing legal and regulatory framework in Kenya.

5.6 Suggestions for Further Research

The study suggests that such a study should be undertaken in Kenya to draw a parallel between listed and unlisted firms in Kenya. This will help clear whether listed firms have adopted corporate governance guidelines more than the unlisted ones and whether such differences are statistically significant.

The study suggests that such a study should be undertaken in Kenya under the new regulatory framework - after the new company Act being developed is operationalised.

The study suggests that a study should be undertaken to determine the correlation between good governance and employee motivation within the financial sector in Kenya. This will help clear whether listed firms have adopted corporate governance guidelines more than the unlisted ones and whether such differences are statistically significant.

The study suggests that such a study should be undertaken in Kenya to measure the levels of interactions by corporate leaders in strategic change approach. This will help clear whether levels of interactions by corporate leaders in strategic change exist and whether such interactions are statistically significant.

Relationship between governance structures and other variables such as capital structure of corporations and market share not considered. The study suggests that a study in this area be conducted.

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APPENDICES

Appendix I: Letter of Introduction

TO WHOM IT MAY CONCERN

I am a postgraduate student at the University of Nairobi, currently undertaking a research on relationship between corporate governance and operating performance among non listed financial institutions in Kenya.

Your company is one of the firms selected for the study; I kindly request for your assistance; and the information that will be collected is solely for academic purpose and will remain confidential. A copy of the final report will be made available to you at your request.

Your assistance will be highly appreciated.

Yours sincerely,

Antony Opondo
Reg. No. D61/61692/2010

Appendix II: Research Questionnaire

This questionnaire consists of two parts; kindly answer all the questions by ticking in the appropriate box or fill in the space provided.

Part I: General Information

a) Please indicate your Gender. .

( ) Male ( ) Female

a) Your department...

b) Your designation..

c) What is your highest level of education?

Secondary ( ) College diploma ( ) University degree ( )

Masters degree ( ) Others (please state).......................

e) How many years have you worked in this institution?

Below 5 years ( ) 5-10 years ( ) Above 10 years ( )

Part II: Corporate Governance and Governance Systems

S/No	Part A: Board Structure	YES	NO
1	Does the firm have two-third or more of board members as independent non-executive directors?		
2	Is the board larger than average board sizes (of five) in NSE 20?		
3	Is the role of chairman and CEO split?		
4	Did the board conduct sufficient number of meetings?		
5	Did the board members attend sufficient number of meetings (75% or more)?		
6	Did the non-executive meeting in the absence of chairman takes place?		
7	Is the chairman independent?		
8	Does the board have sufficient number of independent non-executive directors?		
9	Did the non-executive directors attend relevant training programmes within the financial year?		
10	Does the company have a formal system to evaluate the board and individual directors?		
11	Does the board establish relevant committees and delegate specific mandates to such as may be necessary?		
12	Does the board specifically establish an audit and nominating committee?		
13	Does the board compose of a balance of executive directors and non executive directors (including at least one third independent and non executive directors) of diverse skills or expertise?		

14	Is a director, save for a corporate director allowed to act as a director in more than five public listed companies at any one time?		
15	Do directors other than the managing director submit themselves for election at regular intervals or at least every three years?		
16	Do executive directors enjoy a fixed service contract of five years with a provision to renew subject to regular performance review and shareholders' approval?		
17	Is a chairman allowed to hold such a position in more than two public listed companies at any one time?		
18	Does the nominating committee (if there is one) composed of persons of calibre, credibility and who have the necessary skills and expertise to exercise independent judgment on issues that are that are necessary to promote the companies objectives and performance in its areas of business?		
	Part B: Disclosure, Accountability and Audit		
19	Does the company disclose the audit fee paid?		
20	Does the company disclose the auditor independence in the annual reports?		
21	Does the company disclose chairman's performance report?		
22	Does the company disclose board's performance report?		
23	Is the audit committee independent?		
24	Does the member of audit committee have the experience and qualifications required?		
25	Does the company have formal internal governance guideline separate from the CMA Code (2002)?		
26	Does the company disclose the name of lender and percentage of debt owed to the company?		
27	Does the company disclose any transaction with related parties?		
28	Does the board present an objective and understandable assessment of the company's operation position and prospects?		
29	Does the board ensure that accounts are presented in line with International Accounting Standards (IAS)?		
30	Does the board maintain a sound system of internal control to safeguard the shareholders investments and assets?		
31	Does the board establish a formal and transparent arrangement for shareholders to effect the appointment of independent auditors at each annual general meeting?		
32	Does the company disclose the extent of non compliance of CMA Code 2002?		
33	Does the company establish a formal and transparent arrangement for maintaining a professional interaction with the company's auditors?		
34	Is the board supplied with relevant, accurate and timely information to enable the board discharge its duties?		

35	Does the board annually disclose in its annual reports, its policies for remuneration including incentives for the board and senior management?		
36	Does the board annually disclose in its annual reports a list of ten major shareholders of the company (as appropriate)?		
37	Does the board annually disclose in its annual reports aggregate directors' loans?		
38	Does the board annually disclose in its annual reports share options and other forms of executive compensation?		
39	Does the board annually disclose in its annual reports component of remuneration for directors on a consolidated basis (i.e. executive directors fees, executive directors emoluments, non executive directors fees and non executive directors emoluments)?		
40	Do directors on appointment disclose any potential area of conflict that may undermine their position or service as director?		
41	Are directors required to disclose to shareholders at the annual general meeting and in the annual reports of all directors approaching their seventieth (70th) birthday that respective year?		
42	Is resignation of a serving director disclosed in the annual report together with the details of the circumstances necessitating resignation?		
	Part C: Ownership Structure		
43	Do the board members own companies stock?		
44	Do the CEO own companies stock?		
45	Do the internal directors own stocks?		
46	Is there a guideline on stock ownership by internal executives?		
47	Is there a guideline on stock ownership for board members?		
	Part D: Shareholders and their Rights		
48	Does the company have appropriate technology to support electronic voting?		
49	Does the company allow shareholders to call a poll on all resolutions at the meetings?		
50	Does the company provide information on vote withheld?		
51	Does the company allow shareholders to participate in major decisions of the company e.g. disposal of company's assets, restructuring, takeovers, mergers, acquisitions or reorganization?		
52	Does the company's board provide to its shareholders sufficient and timely information concerning the date, location and agenda of the annual general meeting, as well as full and timely information regarding issues to be decided during the general meeting?		
53	Does the board make shareholders' expenses and convenience primary criteria when selecting venue and location of annual general meeting?		

54	Do directors provide sufficient time for shareholders questions on matters pertaining to the company’s performance and seek to explain the shareholders their concern?		
	Part E: Compensation Policy		
55	Are directors required to own stock?		
56	Is the CEO required to own shares?		
57	Is the committee's composition balanced and qualified?		
58	Is the committee comprising of all independent non-executives?		
59	Is the directors’ remuneration approved by shareholders and sufficient to attract and retain the directors to run the company effectively?		
60	Is the executive director’s remuneration competitively structured and linked to performance?		
61	Is the non executive directors’ remuneration competitive in line with remuneration for other directors in competing sectors?		
62	Does the company have a formal and transparent procedure for remuneration of directors, approved by the shareholders exists in your company?		
63	Does the board of directors developed appropriate staffing and remuneration policy including, the appointment of CEO and the service staff, particularly finance director, operations directors and corporation secretary as may be applicable?		
	Part F: General		
64	Does the company make a public disclosure in respect of any management or business agreements entered into between the company and its related companies, which may result in a conflict of interest?		
65	Are Chief Finance Officers (CFOs) and persons heading the accounts department of every issuer members of Institute of Certified Public Accountants of Kenya (ICPAK) under the Accountants Act?		
66	Where persons referred to in Question (65) are members of other internationally recognized professional bodies and are yet to register as members of ICPAK – Are they registered within twelve months (12) from the date of appointment to such position?		
67	Does the company require that corporation secretary must be a member of Institute of Certified Public Secretaries of Kenya (ICPSK)?		
68	Does the company require that Auditors must be members of ICPAK and comply with International Auditing Standards (IAS)?		
69	Does the company have a code of ethics?		
70	If yes, is the code developed and approved by the company’s board?		

Appendix III: Unlisted Insurance/Banking Companies in Kenya

1. African Merchant Assurance Company (AMACO)
2. APA Insurance Company
3. Apollo Life Assurance Company
4. Blue Shield Insurance Company
5. Cannon Assurance Company
6. Capex Life Assurance Company Limited
7. Chartis Kenya Insurance Company
8. Concord Insurance Company
9. Co-operative Insurance Company
10. Corporate Insurance Company
11. Directline Assurance Company Ltd
12. Fidelity Shield Insurance Company
13. First Assurance Company
14. Gateway
15. Geminia Insurance Company
16. GA Insurance Company
17. Heritage Insurance Company
18. Insurance Company of East Africa (ICEA)
19. Intra Africa Assurance Company
20. Kenindia Assurance Company
21. Kenyan Alliance Insurance Company
22. Kenya Orient Insurance Company
23. Lion of Kenya Insurance Company
24. Madison Insurance Company
25. Mayfair Insurance Company
26. Mercantile Insurance Company
27. Metropolitan Life Insurance Kenya Ltd.
28. Monarch Insurance Company
29. Occidental Insurance Company
30. Old Mutual Life Assurance Company
31. Pacis Insurance Company Ltd

32. Phoenix of East Africa Assurance Company
33. Pioneer Life Assurance Company
34. Real Insurance Company
35. Shield Assurance Company
36. UAP Insurance Company
37. UAP Life Insurance Company

Source: Insurance Regulatory Authority (2012)

Unlisted Banks in Kenya

1. ABC Bank (Kenya)
2. Bank of Africa
3. Bank ofBaroda
4. Bank of India
5. Chase Bank (Kenya)
6. Citibank
7. Commercial Bank of Africa
8. Consolidated Bank of Kenya
9. Credit Bank
10. Development Bank of Kenya
11. Dubai Bank Kenya
12. Ecobank
13. Equatorial Commercial Bank
14. Family Bank
15. Fidelity Commercial Bank Limited
16. Fina Bank
17. First Community Bank
18. Giro Commercial Bank
19. Guardian Bank
20. Gulf African Bank
21. Habib Bank
22. Habib Bank AG Zurich
23. I&M Bank
24. Imperial Bank Kenya
25. Jamii Bora Bank
26. K-Rep Bank

27. Middle East Bank Kenya
28. Oriental Commercial Bank
29. Paramount Universal Bank
30. Prime Bank (Kenya)
31. Trans National Bank Kenya
32. United Bank for Africa
33. Victoria Commercial Bank

Source: Central Bank of Kenya (2012)

Appendix IV: Financial Performance Data Inventory

PERFORMANCE MEASURES	YEAR 2011	YEAR 2010	YEAR 2009	YEAR 2008	YEAR 2007
Turnover					
Surplus/Net Profit					
Return on Assets (ROA)					
Stock Returns					
Dividend Payout					
Return on Capital Expenditure					

Appendix V: Table of Previous Local Studies in Corporate Governance

No	Local Scholar	Study Topic	Methodology
1.	Maina, A. M. (2011)	An analysis of CG reporting in companies listed at the NSE in Kenya	Focus was on CG reporting on insurance companies listed at the NSE in Kenya. Secondary data for 2010 analyzed through descriptive statistics. **Gaps:** (i) Adoption levels of updated CMA Code 2002 guidelines not studied (ii) No focus on the non listed companies.
2.	Mwangi, A. K.G. (2002)	A survey of CG practices among insurance companies in Kenya	Both primary & Secondary data used on measuring CG practices. Descriptive statistics and Ratio Analysis applied to measure financial performance. **Gap:** (i) This was just a survey whose finding might not be relied upon. (ii) Target respondents were only management i.e. Chief Operating Officer and Chief Finance Officers without members of the board and other employees who also contribute on CG practices today (iii) Ratio analysis is too simplistic and prone to error of original entry. (iv) Study conducted 10 years ago, things might have changed.
3.	Riro, G.K. (2005)	Audit committee and corporate governance in Kenya	Both primary & Secondary data used. Data analysis: Descriptive statistics and application of SPSS. **Gap:** (i) Audit committee is just one of the many independent CG measures which is affected by the other variables. (ii) A target of all firms in Kenya leaves the peculiar group of firms – “the unlisted” inadequately covered.
4.	Maina, A. W. (2005)	Board composition and performance in quoted companies in Kenya	Focus was on board composition (ownership and control aspects of the firm) which is just one of the various corporate governance mechanisms. Both primary and secondary data collected and analysed. Tobin’s Q and ROE models applied to measure market value and company performance of the firm. **Gap:** (i) CG problem for unlisted companies is the three-way conflict of major shareholders, managers and minor shareholders and not separation of ownership and control in the listed companies (ii) Other dimensions of CG not studied (iii) Non listed firms in Kenya not considered. (iv) Firm performance based on the above data is inadequate and elements of risk not provided for.
5	Mugwe , E. M. (2008)	CEO perception of critical success factors in corporate leadership in Kenya	All CEOs survey through a semi structured and likert scale questionnaire. **Gap:** (i) No model used (ii) Employees perception impact not considered (ii) Whether CEOs considered have different perceptions on other issues like critical success factors not captured. (iii) Non listed firms not specifically considered
6	Ng’ang’a, P. M. (2007)	Compliance with CMA corporate governance guidelines: a survey of companies listed at the NSE	This was just a survey with a Yes and No plus semi structured questionnaire and secondary data analysed. Focus was on listed companies only. **Gap:** (i) No model (ii) Non listed/private companies not considered. (iii) relationship between compliance with all the CMA guidelines and performance/market price not presented
7	Nyagari, P. M. (2008)	Control and enforcement of CG by the CMA	Focus was on the control and enforcement aspects of CG practices. Questionnaire and secondary data analysed through content analysis. **Gap:** (i) Actual degree of compliance to best practices of CG guidelines of every listed company or economic sector not presented (ii) Level of compliance for the main and alternative segments. (iii) Only listed firms are studied.
8	Gathika, L. K. (2006)	CG: the practices of the board of directors in Kenya Roads Board	Focus was on only one firm (KRB). Questionnaire and secondary data analysed through content analysis. **Gap:** (i) Kenya Roads Board was a young organization formed

			in 2000 hence a child of the reforms process in the roads sector (ii) Other dimensions of CG not considered except the board. (iii) Focus was on only one firm and all firms are different hence findings might not be relied upon without a comparative study.
9	Manyuru, P. J. (2005)	CG and Organ. Performance: the case of companies quoted on the NSE	Focus was quoted companies on NSE. Secondary data from NSE & CMA analysed using Excel. Pearson product moment correlation model also applied. **Gap:** (i) Measures of company performance not exhaustive. Different performance measures would either confirm or give different results. (ii) CG problem for unlisted companies is the three-way conflict of major shareholders, managers and minor shareholders and not separation of ownership and control in the listed companies.
10	Gitari J. M. (2008)	CG and the financial performance of state corporations: the case of New KCC	Focus was on one firm (KCC). Likert scale questionnaire used and data analysed using scorecard method. **Gap:** (i) Narrow scope that may not be representative enough for all state corporations in Kenya. (ii) Relationship between governance structures and other variables such as capital structure of corporations and market share not considered.
11	Mugwang'a, J. O. (2008)	CG in public hospitals in the coast province of Kenya	Focus was on public hospitals with a Yes and No plus Likert scale questionnaire;and secondary data analysed by SPSS software. **Gap:** (i) No model specified (ii) Response rate was 34% at the individual level due to lack of knowledge on the subject of study hence findings may not be relied upon.
12	Owuor, M. E. (2008)	CG practices in state corporations in Kenya	Focus was on corporate governance in state corporations in Kenya. Structured questionnaire and secondary data collected. **Gap:** (i) State corporation is just one of the categories of unlisted companies. Different categories have different ownership and other characteristics (ii) No specific model of analysis disclosed.
13	Ngumi, P. M. (2008)	CG practices in housing finance company of Kenya	Focus was on board composition (ownership and control aspects of the firm) which is just one of the various corporate governance mechanisms. Likert scale questionnaire and secondary data from HFCK. **Gap:** (i) Correlation between good governance and employee motivation at HFCK. (ii) Narrow scope that may not be representative enough. (iii) No model of analysis disclosed thus findings might not be relied upon for comparison.
14	Lang'at, R. K. (2006)	CG practices and performance in firms quoted at the NSE	Both primary and secondary data utilized. Natural logarithm model applied to measure performance **Gap:** (i) Non listed firms not considered. (ii)Family ownership structure and how it impacts on firm value not presented.
15	Ng'ang'a, A.G. (2007)	CG structure and performance of manufacturing firms listed on the NSE	Focus was on non listed companies only. Both primary and secondary data utilized. Tobin's Q used to measure market valuations, ROE, ROE and Price/Earnings ratios used to measure other firm performances. **Gap:** (i) Non listed firms with performance that is not market based e.g. ROA & ROE (ii) Non listed firms in other sectors not considered.
16	Nderu, S.C. (2005)	Corporate leaders perceived and actual roles in strategic change: study of CEOs of firms listed at the NSE	Census research design on corporate leaders using semi structured questionnaires. **Gap:** (i) CG study findings based on censures cannot be relied upon (ii) No model specified (iii) Levels of interactions by corporate leaders in strategic change approach not captured. (iv) Only listed firms NSE analysed (v) Firm's CG needs not determined
17	Mwangi, M.W. (2004)	Determinants of corporate board	Focus was on board composition (ownership and control aspects of the firm) which is just one of the various corporate

		composition in Kenya: an agency theory perspective	governance mechanisms. Structured questionnaire and secondary data collected and analysed using Excel. **Gap:** (i)No specific model adopted (ii) Other dimensions of CG not considered except the board (iii) Almost 10 years ago things might be different today.
18	Kiamba, J.M.(2008)	The effects of CG on financial performance of local authorities in Kenya	Questionnaire and secondary data analysed by use of SPSS. **Gap:** (i) Focus was on local authority which is just one category in the non listed companies. (ii) Level of compliance by each local authority and corresponding financial impact and compare with other government departments/sectors
19	Tokei, J.C. (2007)	Use of CG as a post liberalization strategy by SACCOs in Nairobi area	Focus was on CG as a post liberalization strategy by SACCOs in Nairobi. Yes and No plus Likert scale questionnaire and secondary data analysed by SPSS software. **Gap:** (i) Different firms have different characteristics and corporate governance problems, hence findings from SACCOs might not be representative for other sector firms (ii) No model specified (iii) Response rate was low due to lack of knowledge on the subject of study interview questions check list was not well pretested.
20	Kibet, P.K.K. (2008)	A survey on the role of internal audit in promoting good corporate governance in state owned enterprises	A survey focusing on role of internal audit on promoting CG in state owned enterprises. Both primary and secondary data was collected and analysed. **Gap:** (i) The study was a survey that focused only one aspect of corporate governance principles whose findings would differ is other principles and methodology was used. (ii) Actual degree of internal audit impact on good CG vis a viz different firm ownerships and control not presented (ii) Non listed firms like family owned firms not considered for study.
21	Maina, A. (2007)	A survey on CG practices in insurance industry in Kenya	Yes and No plus Likert scale questionnaire and secondary data analysed by SPSS software. Responded were CEOs **Gap:** (i) No model specified (ii) Members of the board not interview for their views on CG practices.
22	Naibo, L. (2006)	A survey of C.G. structures and practices in the insurance underwriting sector in Kenya	Questionnaire and secondary data analysed through content analysis. **Gap:** (i) Actual degree of compliance to best practices of CG guidelines in the insurance sector not captured (ii) Non listed firms have peculiar characteristics but not studied specifically.
23	Wanjau, J.N. (2007)	A survey on the relationship between CG and performance in micro finance institutions in Kenya	Questionnaire and secondary data analysed by use of Excel. **Gap:** (i) Actual degree of compliance to best practices of CG guidelines in the insurance sector not captured (ii) Non listed firms have peculiar characteristics but not studied specifically. (iii) Excel may not capture exactly the degree of error in data analysis.
24	Mwirichia, G.M. (2008)	A survey of corporate governance disclosures among Kenyan firms quoted at the NSE	Yes and No plus semi structured questionnaire and secondary data analysed. Multiple regression models applied. **Gap:** (i) Majority of businesses fall outside the purview of the CMA & CBK hence gaps and loopholes in governance related reporting for such private companies not considered.
25	Mwakanongo, G.S.(2007)	A survey of CG practices in shipping companies operating in Kenya	Yes and No plus semi structured questionnaire and secondary data utilized. **Gap:** (i) No model specified
26	Ademba, C.O. (2006)	A survey of CG systems in SACCO front office savings entities (FOSA)	Questionnaire with open and closed ended questions; and secondary data utilized through descriptive analysis. **Gap:** (i) No model (ii) No clear framework to capture intended sample.
27	Mugambi, L.B. (2006)	A survey of CG practices of banks in Kenya	Structured Questionnaire and secondary data used. Study showed awareness and existence of CG practices in the banking sector, however does not show extent of such practices and extent of adoption of local or foreign codes of CG.

			Gap: (i) No model (ii) No clear framework to capture intended sample.
28	Wang'ombe, J.G.(2003)	A survey of CG practices in cooperative SACCO societies in Nairobi	Questionnaire used and data analysed by SPSS software. **Gap:** (i) No model specified (ii) Study focused on SACCOs leaving out other cooperative societies.
29	Mutisya, J.N. (2006)	A study of the relationship between CG and financial performance of companies listed on the Nairobi stock exchange	Yes/No and semi structured questionnaire and secondary data analysed. Multiple regression model applied. **Gap:** (i) Majority of businesses fall outside the purview of the CMA & CBK hence gaps and loopholes in governance related reporting for such private companies not considered.
30	Wasike, W.S. (2006)	An investigation of the nature of the agency relationship in public universities in Kenya	Structured questionnaire with closed and open ended questions analysed through simple content analysis. **Gap:** (i) No model specified (ii) Basis of legal framework not presented.
31	Njuguna, C.M. (2006)	The extent of compliance with CMA's guidelines on CG practices among companies listed at NSE	Questionnaire used and data analysed by SPSS software. **Gap:** (i) No model specified (ii) Study focused on listed companies leaving out the majority businesses – "the non-listed companies".
32	Mwangi, J.K. (2006)	Integrated governance and provision of quality health care in nonprofit institutions: a case of Gertrude's children's hospital	Both primary & Secondary data used on measuring CG practices. Data analysis and presentation: Descriptive statistics. **Gap:** (i) Risk component ignored/ not explained (ii) No model specified.
33	Mukiiri, M.M. (2008)	An investigation into the role of KENAO in ensuring good corporate governance in state corporations through audit	Secondary data from Kenya National Audit Office (KENAO) used for analysis and presentation of results using SPSS. **Gap:** (i) No specific model defined (ii) Questionnaire not developed to construct the CG index
34	Wasike, W.S. (2006)	An investigation of the nature of the agency relationship in public universities in Kenya	Structured questionnaire with closed and open ended questions analysed through simple content analysis. **Gap:** (i) No model specified (ii) Basis of legal framework not presented.
35	Mbola, W.K. (2005)	Ownership structures and chief executive turnover: evidence from companies listed on the NSE	No questionnaire used. Logic model used to analyze CEOs turnover. **Gap:** (i) CEOs turnover under different policy regimes not captured to determine whether such policy changes such as entry of foreign investors affect turnover. (ii) Non listed firms not considered
36	Maina, R. N. (2002)	Ownership structure, CG and company performance: the case of the Kenyan quoted companies	Yes/No and semi structured questionnaire and secondary data analysed using SPSS software. **Gap:** (i) Majority of businesses fall outside the purview of the CMA & CBK hence gaps and loopholes in governance related reporting for such private companies not considered. (ii) This study is of over 10 years – things could be different today.
37	Mutiga, J.K. (2006)	The perceived role of the external auditor in CG	Survey through open and closed ended and structured questionnaire. **Gap:** (i) No model used (ii) Risk based auditing on CG and other CG variables. (iii) Non listed firms not given adequate attention.
38	Mululu, A.K. (2005)	The relationship between board activity and firm performance: a study of firms on the NSE	Secondary data from NSE & CMA analysed using Excel. Pearson product moment correlation model also applied. **Gap:** (i) Measures of company performance not exhaustive. Different performance measures would either confirm or give different results. (ii) Study concentrated on board activity as

			measured by board meetings frequency as a CG mechanism but issues of quality of such meetings not considered.
39	Okin, K. O. (2006)	The relationship between board size and board composition on firm performance: a case study of quoted companies at the NSE	Both primary and secondary data utilized. Tobin's Q used to measure market valuations. **Gap:** (i) Non listed firms with performance that is not market based e.g. ROA & ROE (ii) Non listed firms not considered. (iii) Inadequate questionnaire on CG with only one Yes/No question.
40	Ngugi, B.K. (2007)	Relationship between CG structures and performance of insurance companies in Kenya	Both primary and secondary data utilized. Multiple regression models. **Gap:** (i) Non listed firms not adequately considered due to their peculiar characteristics (ii) Less control variables as well as performance trends. (iii) Study focused on stock market liquidity
41	Gatauwa, J.M. (2008)	The relationship between CG Practices and stock markets liquidity for firms listed on the NSE	Yes and No plus Likert scale questionnaire and secondary data analysed by SPSS software. Responded were CEOs **Gap:** (i) No model specified (ii) Members of the board not interviewed for their views on CG practices.
42	Matengo, M. (2008)	The relationship between CG practices and performance: the case study of banking industry in Kenya	Likert scale questionnaire and secondary data analysed by SPSS software. CAMEL model defined and applied. **Gap:** (i) Non listed banks not given adequate attention (ii) Model does not provide for adequate risk for the banking industry.
43	Nambiro, C.A. (2008)	Relationship between level of implementation of CMA guidelines on CG and profitability of companies listed at the NSE	Descriptive Survey method. Both primary and secondary data utilized. Analysis using SPSS. ROE, ROA and Price/Earnings ratios used to measure firm performances. **Gap:** (i) Firms with performance that is not market based e.g. ROA & ROE not considered (ii) Non listed firms not considered.
44	Kihara, M. N. (2006)	The relationship between ownership structures, governance structures and performance of firms listed at the NSE	Semi structured questionnaire and secondary data analysed. Multiple regression models applied on SPSS. **Gap:** (i) Majority of businesses fall outside the purview of the CMA & CBK hence gaps and loopholes in governance related reporting for such private companies not considered. (ii) Effects of insider trading not captured.
45	Opondo, A. (2012)	Impact of CG Practices on Operating Performance on Non Listed Financial Institutions in Kenya	The gaps identified above are in terms of study methodology (such as focus and analysis); scope of respondent; target of study and findings (such as conflict in findings). Thus, this study intends to fill these gap(s) as below:- ▪ First, the study develops a broad firm level corporate governance index for a sample of large Kenyan unlisted financial institutions (both insurance companies and banks). ▪ Second, the study index is based on whether the firm complies with the provisions set out in the CMA Code (2002) or foreign codes like the Combined Code (2003), SOX Code (2002). This is followed by an empirical examination of the relationship between governance index

			and firm value, performance and investment decisions. ▪ Third, the study provides a critical analysis of the aggregate and disaggregates impact of different governance mechanisms on firm valuation and performance. Using a combination of several internal and external governance mechanisms; the researcher examines the interaction between internal and external governance mechanisms and whether they add value to the firm. This area of research has received little attention in prior studies that analysed Kenyan corporate governance. ▪ Fourth, the study extends the current literature by providing an analysis of the ability of large & external shareholders, and in particular institutions, to influence the level of governance in firms under the prevailing legal and regulatory framework in Kenya. The function of institutions in Kenya corporate governance has received much attention since existing governance codes actively emphasize the role of institutions in ensuring good governance. ▪ Fifth, corporate governance framework considers the social and economic needs of the non listed companies since the majority of firms are family owned that are characterized by the three-way conflict between majority shareholders, managers and the minority shareholders – a corporate governance problem for non listed companies in developing and emerging economies like Kenya. ▪ Sixth, the study also targeted employees who make major contributions in corporate governance today, as part of the study target of respondents. This respondent target has received little attention in previous studies reviewed by the researcher. ▪ Lastly, the study assessed whether the quality of firms' corporate governance determines the investment decisions within the unlisted firm.

Source: Author (2012)

Appendix VI: Output

Descriptives

Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Corporate Governance Index	65	.30	.96	.6815	.14405
Tobin's Q	65	.41	.96	.7254	.13669
Inverse Q	65	1.04	2.44	1.4368	.32530
Total Assets Employed	65	1023546.00	14445821.00	5364707.9538	2944073.26248
ROA	65	.01	.40	.1371	.08021
ROE	65	.01	.41	.2180	.09177
Board Size	65	5.00	12.00	9.1692	1.77279
Outsiders	65	1.00	4.00	1.9385	.96626
Institutional Shareholders	65	.00	5.00	1.7231	1.09698
Leverage	65	.09	.26	.1389	.04150
Age	65	4.00	52.00	29.4923	12.88546
Growth	65	.01	.40	.1537	.10018
Industry	65	1.00	2.00	1.4923	.50383
Valid N (listwise)	65				

Output II: Regression

Variables Entered/Removed[a]

Model	Variables Entered	Variables Removed	Method
1	Total Assets Employed, Institutional Shareholders, Leverage, Board Size, Age, Corporate Governance Index, Growth, Industry, Outsiders[b]	.	Enter

a. Dependent Variable: Tobin's Q

b. All requested variables entered.

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.415[a]	.172	.036	.13418

a. Predictors: (Constant), Total Assets Employed, Institutional Shareholders, Leverage, Board Size, Age, Corporate Governance Index, Growth, Industry, Outsiders

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.206	9	.023	1.268	.275[b]
	Residual	.990	55	.018		
	Total	1.196	64			

a. Dependent Variable: Tobin's Q

b. Predictors: (Constant), Total Assets Employed, Institutional Shareholders, Leverage, Board Size, Age, Corporate Governance Index, Growth, Industry, Outsiders

Coefficients[a]

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.755	.171		4.423	.000
Corporate Governance Index	-.173	.120	-.182	-1.442	.155
Board Size	-.002	.010	-.020	-.154	.878
Outsiders	.033	.020	.230	1.659	.103
Institutional Shareholders	-.002	.016	-.013	-.101	.920
Leverage	-.490	.420	-.149	-1.166	.249
Age	.001	.001	.081	.647	.521
Growth	.259	.175	.190	1.483	.144
Industry	.029	.037	.108	.796	.429
Total Assets Employed	8.474E-011	.000	.002	.014	.989

a. Dependent Variable: Tobin's Q

Regression

Variables Entered/Removed[a]

Model	Variables Entered	Variables Removed	Method
1	Total Assets Employed, Institutional Shareholders, Leverage, Board Size, Age, Corporate Governance Index, Growth, Industry, Outsiders[b]	.	Enter

a. Dependent Variable: ROA

b. All requested variables entered.

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.430[a]	.185	.052	.07811

a. Predictors: (Constant), Total Assets Employed, Institutional Shareholders, Leverage, Board Size, Age, Corporate Governance Index, Growth, Industry, Outsiders

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.076	9	.008	1.387	.217[b]
	Residual	.336	55	.006		
	Total	.412	64			

a. Dependent Variable: ROA

b. Predictors: (Constant), Total Assets Employed, Institutional Shareholders, Leverage, Board Size, Age, Corporate Governance Index, Growth, Industry, Outsiders

Coefficients[a]

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.090	.099		.909	.367
Corporate Governance Index	.069	.070	.125	.995	.324
Board Size	.003	.006	.073	.570	.571
Outsiders	-.009	.011	-.110	-.802	.426
Institutional Shareholders	-.001	.009	-.014	-.111	.912
Leverage	-.223	.245	-.115	-.912	.366
Age	.000	.001	.061	.495	.623
Growth	.298	.102	.372	2.933	.005
Industry	-.026	.022	-.165	-1.219	.228
Total Assets Employed	3.854E-010	.000	.014	.112	.911

a. Dependent Variable: ROA

Regression

Variables Entered/Removed[a]

Model	Variables Entered	Variables Removed	Method
1	Total Assets Employed, Leverage, Age, Board Size, Industry, Corporate Governance Index, Growth, Outsiders[b]	.	Enter

a. Dependent Variable: Percentage of Institutional shareholding

b. All requested variables entered.

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.425[a]	.180	.063	.11984

a. Predictors: (Constant), Total Assets Employed, Leverage, Age, Board Size, Industry, Corporate Governance Index, Growth, Outsiders

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.177	8	.022	1.541	.164[b]
	Residual	.804	56	.014		
	Total	.981	64			

a. Dependent Variable: Percentage of Institutional shareholding

b. Predictors: (Constant), Total Assets Employed, Leverage, Age, Board Size, Industry, Corporate Governance Index, Growth, Outsiders

Coefficients[a]

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.496	.148		3.348	.001
Corporate Governance Index	-.073	.106	-.085	-.687	.495
Board Size	-.021	.009	-.298	-2.356	.022
Outsiders	.011	.017	.090	.661	.511
Leverage	-.214	.375	-.072	-.571	.571
Age	.001	.001	.108	.882	.381
Growth	-.197	.153	-.159	-1.284	.204
Industry	-.039	.033	-.159	-1.199	.236
Total Assets Employed	8.534E-010	.000	.020	.162	.872

a. Dependent Variable: Percentage of Institutional shareholding

Regression

Variables Entered/Removed[a]

Model	Variables Entered	Variables Removed	Method
1	Inverse Q, Industry, Age, Growth, Leverage, Corporate Governance Index[b]	.	Enter

a. Dependent Variable: Total Assets Employed

b. All requested variables entered.

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.155[a]	.024	-.077	3055422.54328

a. Predictors: (Constant), Inverse Q, Industry, Age, Growth, Leverage, Corporate Governance Index

ANOVA[a]

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	13259110747519.125	6	2209851791253.188	.237	.963[b]
Residual	541465201244286.060	58	9335606918004.932		
Total	554724311991805.200	64			

a. Dependent Variable: Total Assets Employed

b. Predictors: (Constant), Inverse Q, Industry, Age, Growth, Leverage, Corporate Governance Index

Coefficients[a]

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	5325387.394	3169457.445		1.680	.098
Corporate Governance Index	332503.782	2781043.771	.016	.120	.905
Leverage	-1234616.296	9575182.784	-.017	-.129	.898
Age	-15765.402	30174.947	-.069	-.522	.603
Growth	3943564.829	3914670.258	.134	1.007	.318
Industry	-319295.109	770335.909	-.055	-.414	.680
Inverse Q	222424.169	1264543.674	.025	.176	.861

a. Dependent Variable: Total Assets Employed