CORPORATE GOVERNANCE AND FINANCIAL PERFORMANCE OF COMPANIES QUOTED IN THE NAIROBI STOCK EXCHANGE

BY

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D61/P/7775/05

A MANAGEMENT RESEARCH PROJECT PROPOSAL SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR AWARD OF THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION (MBA), UNIVERSITY OF NAIROBI

NOVEMBER 2010

DECLARATION

This is to certify that this management research project has not been submitted for any degree in any other University or Institute of learning. Information from other sources have been duly acknowledged. No part of this work should be reproduced without the permission of the author.

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BONFACE OLUOCH ONG'WEN

Dated this............................Day of....................2010

This management research project has been submitted for examination with my approval as the University Supervisor.

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LECTURER

DEPARTMENT OF FINANCE AND ACCOUNTING

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Dated this............................Day of....................2010

DEDICATION

To my dear wife Beryne, my beloved children, daughter Abby, son Marcos, father John F. Ong'wen and to my mother Joyce for their love, care, sacrifices, support, understanding and encouragement during this long period of search for knowledge and study.

May God shower you all with his blessings in the long journey that life is.

ACKNOWLEDGEMENTS

This study in its present form was made possible by a number of people and institutions to whom I am greatly indebted and I would like to acknowledge their contribution.

To my supervisor, Mr. J. Baraza, I extend my most sincere thanks for his guidance, comments, suggestions and constant encouragement throughout the period of this research project. I wish also to acknowledge the inputs of M/s A. Kithinji, who was my moderator and to Dr. J. Aduda, chairman, Department of Finance and Accounting.

I am equally grateful to the Capital Markets Authority, the Nairobi Stock Exchange and to the companies which availed the data that I needed for the research.

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ABSTRACT

An effective system of corporate governance helps to facilitate decision making, accountability and responsibility within and outside a corporate entity. Good corporate governance ensures that the varying interests of stakeholders are balanced, decisions are made in a rational, informed and transparent fashion and that decisions contribute to the overall efficiency and effectiveness of the organization.

This study sought to establish whether listed firms which adopted corporate governance provisions which exceeded the minimum provisions significantly outperformed those which stuck to the minimum.

Data was obtained from 43 companies and analysed on a multiple linear regression model using SPSS version 17.0.The analysis included descriptive statistics, correlation coefficients, beta coefficients of the variables and the coefficient of determination.

The data analyzed showed that there was a positive relationship between corporate governance attributes which exceeded the minimum level prescribed by law and common practice, and firm performance. The relationship was found to be significant at the 95% level. It can therefore be concluded that it would be beneficial for a firm to institute corporate governance practices that exceed the minimum levels.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Corporate governance issues have recently received much attention from policy makers and the public due to globalization (such as the liberalization and internationalization of economies, developments in telecommunications, and the integration of capital markets) and transformations in the ownership structure of firms (due to the growth of institutional investors, privatization, and rising shareholder activism),which have increased the perceived need for more effective monitoring mechanisms and appropriate incentive schemes to improve corporate governance systems . (Aguilera and Cuervo-Cazurra, 2004)

Corporate governance concept first appeared in the 1930s, and was not broadly discussed until the outbreak of the Asian finance crisis in the 1990s. Various recent scandals around the world (e.g., the Enron case in the US in 2001 and the Procomp Informatics Ltd. case in Taiwan in 2004) caused many nations to aggressively mandate corporation governance to make sure that investors, vendors, creditors, and other stakeholders are treated fairly. (Huang *et al*. 2007)

Corporate Governance issues arise in an organization whenever there is an agency problem, or conflict of interest, involving members of the organization (owners, managers, workers or consumers). Second, transaction costs are such that this agency problem cannot be dealt with through a contract. Thus, corporate governance structures, consisting of a set of internal mechanisms (boards of directors, corporate charters) and external mechanisms (market for corporate control, legal and regulatory rules, investor monitoring, labor and product markets), arise to mitigate the agency conflicts. (Hart, 1995)

Corporate governance is the process and structure used to direct and manage business affairs of the company towards enhancing prosperity and corporate accounting with the ultimate objective of realizing shareholders long-term value while taking into account the interest of other stakeholders (CMA, 2002). It is a set of mechanisms that influence the decisions made by managers when there is a separation of ownership and control (Larcker *et al*., 2007); it is a set of relationships between a company's management, its board, its shareholders and other stakeholders; it also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders and should facilitate effective monitoring (OECD, 2004).

Corporate governance is affected by the relationships among participants in the governance system. Controlling shareholders, which may be individuals, family holdings, bloc alliances, or other corporations acting through a holding company or cross shareholdings, can significantly influence corporate behaviour. As owners of equity, institutional investors are increasingly demanding a voice in corporate governance in some markets. Individual shareholders usually do not seek to exercise governance rights but may be highly concerned about obtaining fair treatment from controlling shareholders and management. Creditors play an important role in a number of governance systems and can serve as external monitors over corporate performance. Employees and other stakeholders play an important role in contributing to the long-term success and performance of the corporation, while governments establish the overall institutional and legal framework for corporate governance. (OECD, 2004)

The presence of an effective corporate governance system, within an individual company and across an economy as a whole, helps to provide a degree of confidence that is necessary for the proper functioning of a market economy. As a result, the cost of capital is lower and firms are encouraged to use resources more efficiently, thereby underpinning growth. (OECD, 2004)

Good corporate governance contributes to sustainable economic development by enhancing the performance of companies and increasing their access to outside capital. For emerging market countries, improving corporate governance can serve a number of important public policy objectives. Good corporate governance reduces emerging market vulnerability to financial crises, reinforces property rights, reduces transaction costs and the cost of capital, and leads to capital market development. Weak corporate governance frameworks reduce investor confidence, and can discourage outside investment. Also, as pension funds continue to invest more in equity markets, good corporate governance is crucial for preserving retirement savings. (The World Bank, 2008)

On October 8, 1999, the Corporate Sector at a seminar organized by the Private Sector Initiative for Corporate Governance formally adopted a national code of best practice for Corporate Governance to guide corporate governance in Kenya, and mandated the Private Sector Initiative to establish the Corporate Sector Foundation, and collaborate with the Global Corporate Governance Forum, the Commonwealth Association for Corporate Governance, the African Capital Markets Forum, Uganda and Tanzania in promoting good corporate governance(PSCGT, 2002).

The Nairobi Stock Exchange began in the early 1920s while Kenya was considered a colony under British control. It was an informal marketplace for local stocks and shares. By 1954, a true stock exchange was created when the NSE was officially recognized by the London Stock Exchange as an overseas stock exchange. After Kenyan independence from Britain, the stock exchange continued to grow and become a major financial institution. The facilities have modernized since the original "handshake over coffee" method of trading. The NSE has recently adapted an automated trading system, to keep pace with other major world stock exchanges. (http://www.nse.co.ke/newsite)
For continued listing in the Nairobi Stock exchange, companies are required to establish audit committees and comply with guidelines on corporate governance issued by the Capital Markets Authority; disclose any management or business agreements entered into with related companies; every person save for a corporate director who is a director of a listed company is not required to hold such position in more than five listed companies at

any one time and in the case where the corporate director has appointed an alternate director, the appointment of such alternate shall be restricted to three listed companies. (http://www.nse.co.ke/newsite/pdf/nse_listing_manual)

Chairmen of listed companies should not hold such position in more than two listed companies at any one time, the chief financial officers and persons heading the accounting department of every issuer are required to be members of ICPA(K) and the company secretary is supposed to be a member of ICPS(K).Every issuer shall disclose in its annual reports a statement of the directors as to whether the issuer is complying with the guidelines on corporate governance issued by the Capital Markets Authority: Provided that where the issuer is not fully compliant with the guidelines, the directors shall indicate the steps being taken to adhere to full compliance. The auditor of a listed company shall be a member ICPA (K) and shall comply with the International Standards of Auditing. (http://www.nse.co.ke/newsite/pdf/nse_listing_manual)

The Capital Markets Authority was created pursuant to the Capital Markets Act, chapter 485a for the purpose of promoting, regulating and facilitating the development of an orderly, fair and efficient Capital Markets in Kenya. The authority has issued guidelines on corporate Governance practices for listed companies in Kenya. (CMA, 2002)

1.2 Statement of the Problem

A country's capacity to achieve sustainable prosperity, which is progressive economic growth and social development over a prolonged period of time, depends on decisions about the allocation, utilization and investment of resources. (CCGK, 2005)

Gompers *et al*. (2003) constructed a governance index based on 24 corporate governance attributes and found that an investment strategy that bought firms in the lowest decile of the index and sold firms in the highest decile of the index would have earned abnormal returns of 8.5% per year during the sample period. Bebchuk *et al*. (2009) used 6 of the 24 provisions and found that increases in the index are associated with economically significant reductions in firm valuation as well as negative abnormal returns during the sample period. Johnson *et al*. re-examined the evidence of long-term abnormal returns on portfolios of firms sorted on governance characteristics and found statistically zero abnormal returns for portfolios of firms sorted on Gompers *et al*. (2003) governance index entrenchment index. Chhaochharia and Laeven (2009) used data in a large cross section of countries, constructed a corporate governance index made of 17 out of the 24 attributes used by Gompers *et al*. (2003) and differentiated between minimally accepted governance attributes that are satisfied by all firms in a given country and governance attributes that are adopted at the firm level. The study found that the market rewards companies that are prepared to adopt governance attributes beyond those required by laws and common corporate practices in the home country.

Mwakanongo (2007) conducted a survey of Corporate Governance practices in shipping companies operating in Kenya, Nyagari (2008) studied the control and enforcement of corporate governance by the capital markets authority, Kiplagat (2008) surveyed the role of internal audit in promoting good corporate governance in state owned enterprises, Nambiro (2008) studied the relationship between the level of implementation of CMA guidelines on corporate governance and profitability of companies listed in the Nairobi Stock Exchange, Mwirichia (2008) conducted a survey of corporate governance disclosures among Kenyan firms quoted at the Nairobi Stock Exchange and Muriithi (2008) studied Corporate Governance and financial performance of state corporations, the case of new KCC.

There is a vast body of literature devoted to evaluating the relationship between corporate governance and performance, measured by valuation, operating performance, or stock returns. Most of the research to date suggests a positive correlation between corporate governance and various measures of performance. However, there are a number of studies that have questioned such a relationship. Furthermore this line of research is plagued by endogeneity problems, and resolving these has not been easy. (Love, 2010)

Studies conducted in Kenya have majorly described the corporate governance practices in various institutions and industries e.g. SACCOs, Insurance companies, banks and state corporations. Others have zeroed in on the role of internal audit. A sizeable number of studies have dealt with the relationship between corporate governance structures and firm performance and all such studies reviewed dealt with internal corporate governance mechanisms e.g. size and structure of the board, ownership structure, number and frequency of board meetings. None of the studies conducted in Kenya have differentiated between minimally accepted governance attributes that are satisfied by all firms in a given country and governance attributes that are adopted at the firm level. No study has been conducted in Kenya on the relationship between firm performance and corporate governance as measured by the 17 attributes which are majorly external governance mechanisms, which is the gap that this study seeks to fill.

1.3 Research Objective

The objective of this research is to assess whether performance of listed companies are more significantly related to governance attributes that are adopted at the firm level (firm level factors) or minimally accepted governance attributes that are satisfied by all firms in a given country(country level factors) .

1.4 Importance of the Study

For listed companies, this study will show the impact of internal governance practices on their performance. It will advise them on whether or not to revise their internal governance practices. The study will further point out to them whether or not to adopt corporate governance principles that exceed the ones prescribed by laws and norms in Kenya. Companies may also consider adopting more internal governance principals as opposed to the predominant external governance mechanisms.

The Capital Markets Authority, the Insurance Regulatory Authority, the Central Bank of Kenya and the SACCOs Regulatory Authority will find the results of this study useful. It will point out to them the adequacy of corporate governance disclosure requirements for the finance sector. This could be in terms of mandatory disclosure requirements and governance structures to put in place. From this study, the finance sector regulators will also consider whether or not to extend the corporate governance requirements to cover the microfinance sector and unlisted companies.

This study will be important to investors in making informed investment decisions. As a result of this study, choices about which shares to buy and sell may be made on the basis of the individual company's corporate governance index. Shareholders may also put pressure on directors to implement certain corporate governance principles. It will also advise shareholders on the optimal balance of power between the directors and the shareholders.

To academicians, this study will add to the existing body of knowledge, the area of the relationship between the internal governance mechanisms and firm valuation. The study will also attempt to find out whether there is causality between corporate governance and firm performance, and whether causality runs from corporate governance to firm performance or otherwise.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter discusses the various theories on the subject of corporate governance, prior research conducted on corporate governance and firm performance, both in Kenya and internationally. It concludes with the knowledge gap that this study seeks to fill.

2.2 Theoretical Framework of the Study

2.2.1 Agency Theory

Adam Smith (1776) explained that the directors of companies, however, being the managers of other people's money, cannot well be expected to watch over it with the same anxious vigilance with which the partners in a partnership frequently watch over their own. Negligence and profusion therefore prevail in the management of the affairs of such a company. Fama (1980) holds that separation of security ownership and control can be explained as a result of efficient form of economic organization within the set of contracts perspectives

Fama and Jensen (1983) argue that the separation of decision and risk bearing functions observed in large corporations is common to other organizations such as professional partnerships and non profits. They then contend that the separation of decision and risk bearing functions survives in these organizations in part because of the benefits of specialization of management and risk bearing but also because of an effective common approach to controlling the agency problems caused by separation of decision and risk bearing functions. They hypothesize that the contract structures of all these organizations separate the ratification and monitoring (control) of decisions from initiation and implementation (management) of the decisions.

Demsetz and Lehn (1985) note that large publicly traded corporations are frequently characterized as having highly diffuse ownership structures that effectively separate ownership of residual claims from control of corporate decisions. Vaninsky and Lauterbach (1999) observe that over the last century, a new form of business organization flourished as non concentrated ownership structure emerged and that the modern diverse ownership corporation has broken the link between the ownership and active management of the firm. Berle and Means (1932) explain that agency problems occur when the principals (shareholders) lack the necessary power or information to monitor or control the agent (managers) and when the compensation of the principal and agent is not aligned.

Jensen and Meckling (1976) define an agency relationship as a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent. They argue that since the relationship between the stockholders and manager of a corporation fit the definition of a pure agency relationship it should be no surprise to discover that the issues associated with the “separation of ownership and control” in the modern diffuse ownership corporation are intimately associated with the general problem of agency. It is generally impossible for the principal or the agent at zero cost to ensure that the agent will make optimal decisions from the principal’s viewpoint. In most agency relationships the principal and the agent will incur positive monitoring and bonding costs (non-pecuniary as well as pecuniary), and in addition there will be some divergence between the agent’s decisions and those decisions which would maximize the welfare of the principal.

Jensen and Murphy (1990) explain that the conflict of interest between shareholders of a publicly owned corporation and the corporation's chief executive officer (CEO) is a classic example of a principal-agent problem. If shareholders had complete information regarding the CEO's activities and the firm's investment opportunities, they could design a contract specifying and enforcing the managerial action to be taken in each state of the world. Managerial actions and investment opportunities are not, however, perfectly observable by shareholders; indeed, shareholders do not often know what actions the CEO can take or which of these actions will increase shareholder wealth. In these situations, agency theory predicts that compensation policy will be designed to give the manager incentives to select and implement actions that increase shareholder wealth. Specifically, agency theory is directed at the ubiquitous agency relationship, in which one party (the principal) delegates work to another (the agent), who performs that work.

Jensen (1986) argues that managers take wasteful, negative net present value investment projects because they derive private benefits from controlling more assets. This is overinvestment or empire-building. Alternatively, managers may forego some positive net present value investment projects because additional investments impose private costs on them. Because managers in general prefer to work less (i.e., they are inclined to shirk), and investing requires them to spend more time overseeing the firm’s activities, managers will underinvest. The optimal incentive contract for the manager ameliorates the over or underinvestment problem.

Eisenhardt (1989) explains that agency theory is concerned with resolving two problems that can occur in agency relationships. The first is the agency problem that arises when (a) the desires or goals of the principal and agent conflict and (b) it is difficult or expensive for the principal to verify what the agent is actually doing. The problem here is that the principal cannot verify that the agent has behaved appropriately. The second is the problem of risk sharing that arises when the principal and agent have different attitudes toward risk. The problem here is that the principal and the agent may prefer different actions because of the different risk preferences. He concludes that because the unit of analysis is the contract governing the relationship between the principal and the agent, the focus on the theory is on determining the most efficient contract governing the principal agent relationship given assumptions about people, (self interest, bounded rationality, risk aversion, organizations (e.g. goal conflict among members) and information (e.g. information is a commodity which can be purchased).The domain of agency theory is relationships that mirror the basic agency structure of a principal and an agent who are engaged in cooperative behavior, but have differing goals and differing attitudes toward risk.

According to Agrawal and Knoeber (1996), agency problems arise within a firm whenever managers have incentives to pursue their own interests at shareholder expense. Several mechanisms can reduce these agency problems. An obvious one is managerial shareholdings. In addition, concentrated shareholdings by institutions or by block holders can increase managerial monitoring and so improve firm performance, as can outsider representation on corporate boards. The use of debt financing can improve performance by inducing monitoring by lenders. The labor market for managers can motivate managers to attend to their reputations among prospective employers so improve performance. Finally, the threat of displacement imposed by the market for corporate control can create a powerful discipline on poorly performing managers.

Himmelberg et al. (1999) hold that when shareholders are too diffuse to monitor managers, corporate assets can be used for the benefit of managers rather than for maximizing shareholder wealth. It is well known that a solution to this problem is to give managers an equity stake in the firm. Doing so helps to resolve the moral hazard problem by aligning managerial interests with shareholders' interests.

Aggarwal and Samwick (2006) show that the optimal contract depends on the manager’s risk aversion, the variance of firm performance, the productivity of investment, and the magnitude of the private benefits or costs associated with investment, as well as other potential agency problems in the firm.

2.2.2 Inherent property rights theory

The inherent property rights conception is based on the view that private ownership is fundamental to a desirable social order and to the development of an efficient economy.

Thus, private ownership rights are inviolable in any way. This perspective was developed during the seventeenth and eighteenth centuries in corporate law theory. It was assumed that the right to incorporate is inherent in the right to own property and write contracts, and corporations should be regarded as legal extensions of their owners. (Allen, 1992)

When the modern corporation emerged, the inherence view of the corporation was further developed along with the aggregate theory which asserts that the corporation as a legal group is simply created by the state and is no more than a private association of shareholders. The new form of corporate property is the aggregation of individual property rights under a collective name, united by contract and protected by company law. Since shareholders are the owners of the corporation, the corporation has legitimate obligations and the managers have a fiduciary duty to act in the interest of the shareholders (Barker, 1958; Mayson *et al.* (1994).

Allen (1992) and Blair (1995) associate the modern Inherent property rights theory with the Chicago school of law and economics. Under this theory, assets of the corporation are the property of the shareholders, and directors and managers as agents of shareholders have no legal obligations to any other stakeholders. Hayek (1969) view individuals owning private property as pursuing their self-interests to ensure the most efficient economic activities and outcomes. Thus, the corporation that uses shareholders' capital must aim at maximizing profits to enhance shareholders' value. If a corporation uses profits for any social purpose beyond the shareholders' interest, this could be interpreted as managers' abuse of power and the allocation of corporate resources will not be efficient. Shareholders' property rights in the corporation must therefore be fully protected and shareholder control of the corporation must be strengthened.

Friedman (1962, 1970) asserts that the social responsibility of business is harmful to the foundations of a free society with a free-enterprise, private-property system. The function of a business in a society is to make profits in a free market for shareholders and should not be confused with other social functions performed by governments, institutions, and charities. Other stakeholders' interests are served by contract or through government regulation and should not be justified in corporate governance. Directors and managers are the agents of shareholders and are responsible for maximizing the shareholders' interest. If management is allowed or required to pursue any social purpose, managerial accountability to shareholders cannot be secured and shareholders' property rights will be damaged. Thus, the only social responsibility of a business is to increase its profits.

2.2.3 Stewardship theory

The stewardship theory claims that managers are good stewards of the corporation. Based on a traditional legal view of the corporation as a legal entity in which directors have a fiduciary duty to the shareholders, the stewardship theory argues that managers are actually behaving just like stewards to serve the shareholders' interests and diligently work to attain a high level of corporate profit and shareholder returns. Managers have a wide range of motives beyond a simple self-interest, such as achievement, recognition and responsibility needs, the intrinsic satisfaction and pleasure of successful performance, respect for authority, social status, and work ethics. Thus, the separation of ownership from control does not inherently lead to a goal and interest conflict between shareholders and managers. The separation actually promotes the development of managerial profession, which is certainly beneficial for corporate performance and shareholder wealth. In this regard, empowering managers to exercise unencumbered authority and responsibility is necessary for the maximization of corporate profits and shareholders' value. (Nichols, 1969; Etizioni, 1975).

2.2.4 The finance model

Manne (1965) refers to the finance model as the presupposed optimum of market-based governance and advocated the market for corporate control. Keasey et al., (1995) observes that the finance model can be incorporated into the agency theory as a principal-agent, or finance, model because both are concerned with the effectiveness of market governance in ensuring that managers will act to maximize shareholders' wealth. Thus, it is also called the 'efficient market model' (Blair, 1995,).

A theorem in financial economics is that the share price today fully reflects the market value of all future profits and growth that will accrue to the company. Believing in this assumption, the advocates of the finance model hold that shareholders' interests are best served by maximizing share price in the short run. The share price is an indicator of corporate performance and the stock market is the only objective evaluation of management performance. If a firm under-performs, its share price will be lower, which provides a chance for outsiders to buy the firm's stock and run the firm more efficiently in order to obtain a larger reward. The threat of a takeover provides management with an incentive to make efforts to perform better and maximize shareholders' return in order to make their firm bid-proof. Therefore, if the separation of ownership and control allows managers' behaviour to deviate from shareholders' value of profit maximization, the pressures of capital markets and takeovers are the most effective disciplines on managerial discretion (Alchian and Kessel, 1962).

Fama, (1980) argue that corporate governance failures are best addressed by removing restrictions on factor markets and the market for corporate control. Shareholders' residual voting rights on takeover should be enhanced. Hart (1995) reject any *ex post* external interventions and additional obligations imposed on corporations which may distort free market mechanisms. Keasey *et al.*, 1995 conclude that any measure to improve governance and to raise the value of the firm should be adopted without compulsion.

2.2.5 The myopic market model

The myopic market model shares a common view with the agency theory that the corporation should serve shareholders' interests only. However, the model criticizes the Anglo-American model of corporate governance as being fundamentally flawed by an over concern with short-term return on investment, short-term corporate profits, short-term management performance, short-term stock market prices, and short-term expenditures, due to huge market pressures. This model argues that the current corporate governance systems encourage managers to focus on short-term performance by sacrificing long-term value and competitive capacity of the corporation (Moreland, 1995).

One of the features of the system is that the evaluation of both corporate performance and managerial efforts is heavily reliant on short-term financial measurements, often judged on a 1 year basis, sometimes even on a quarterly basis. Managers are forced to pay more attention to short-term earning data and forecasts and less attention to long-term investment spending such as R & D. It is also argued that the stock market is not a good indicator of corporate performance because it is unable to cope with uncertainty and thus routinely misprices assets. The prices of shares often change without any corresponding change in the underlying fundamentals. Share prices may simply result from guesses about the behaviour and psychology of market participants and the changing moods and prejudices of investors, rather than from the estimations of corporate fundamental values (Keynes, 1936; Shiller, 1989).

The market for corporate control, therefore, is not an efficient disciplinary mechanism. The threat of a hostile takeover may distort and distract from true value creation as managers may be forced to act against the hostile takeover, which results in negative consequences. The myopic market model contends that corporate governance reform should encourage shareholders and managers to share long-term performance horizons. This includes increasing shareholders' loyalty and voice, reducing the ease of shareholders' exit, restricting the takeover process and voting rights for short-term shareholders, encouraging 'relationship investing' to lock financial institutions into long-term positions and empowering other groups such as employees and suppliers to form long-term relationships with the firm (Keasey *et al.*, 1997).

2.2.6 Social entity theory

The social entity conception of the corporation regards the corporation not as a private association united by individual property rights, but as a public association constituted through political and legal processes and as a social entity for pursuing collective goals with public obligations (Gamble and Kelly, 2001). This perspective view the corporation as a political tool for social purposes (Dine, 2000,) and argues that individual property rights are conditioned and restrained in a social context and in community (Warren, 2000).The social entity theory views the corporation as a social institution in society based on the grounds of fundamental value and moral order of the community.

Sacks (1997) suggests that human attachments and affiliations, loyalties and likes are both moral and fundamental, they enter into the identity and understanding of specific persons and cannot be reduced to contractual alliances for the temporary pursuit of gain. With the fundamental value of human rights and morality as a reference framework, the standard of a corporation's usefulness is not whether it creates individual wealth but whether it helps society gain a greater sense of the meaning of community by honouring individual dignity and promoting overall welfare (Sullivan and Conlon, 1997). Corporations are granted by the state not only as an economic entity for a commercial purpose, but more importantly, as a social entity for general community needs. The corporation has a collective, rather than individual identity and executives are representatives and guardians of all corporate stakeholders' interests (Hall, 1989).

2.2.7 The pluralistic model

The pluralistic model supports the idea of multiple interests of stakeholders, rather than shareholder interest alone. It argues that the corporation should serve and accommodate wider stakeholder interests in order to make the corporation more efficient and more legitimate. Unlike the social entity theory that justifies stakeholder interests on the basis of moral value and fundamental human rights, the pluralistic model legitimizes stakeholder value in a more subtle way more attuned to the traditional Anglo-American corporate governance mentality (Gamble and Kelly, 2001).

This model suggests that corporate governance should not move away from ownership rights, but that such rights should not be solely claimed by, and thus concentrated in, shareholders; ownership rights can also be claimed by other stakeholders, particularly employees. Stakeholders who make firm specific investments and contributions and bear risks in the corporation should have residual claims and should participate in the corporate decision making to enhance corporate efficiency (Blair, 1995; Kelly and Parkinson, 1998).

Stakeholding is regarded as an effective means of achieving specific ends, rather than as an end in itself. It is argued that stakeholding is instrumental in increasing efficiency, competition and profitability (Stoney and Winstanley, 2001). Freeman (1984) asserts that if corporations practise stakeholder management, their performance such as profitability, stability and growth will be more successful.

2.2.8 The trusteeship model

Kay and Silberston (1995) argue that a public corporation is not the creation of a private contract and thus not owned by any individual. Ownership is by definition where the owner has exclusive rights of possession, use, gain and legal disposition of a material object. Shareholders merely own their shares in a company and trade their shares with others in the stock market. They do not have rights to possess and use the assets of the company, to make decision about the direction of the company, and to transfer the assets of the company to others. The residual claims of the shareholders are determined by the company and if the company's performance does not satisfy the shareholders requirements, the shareholders are left with a single option of 'exit' rather than 'voice' as shareholders in general are in no way able to monitor the management effectively and neither are they interested in running corporate business. In this sense, the assumption that the corporation is owned by the shareholders is in fact meaningless.

Deakin and Slinger (1997) and Warren (2000) hold that ownership rights are not important to business. Many public institutions such as museums, universities, and libraries perform well without clear owners. Indeed, company law does not explicitly grant shareholders ownership rights because the corporation is regarded as an independent legal person separate from its members, and shareholders are merely the 'residual claimants' of the corporation. The company has its own assets, rights and duties, and has its own will and capacity to act and is responsible for its own actions. Kay and Silberston (1995) reject the idea that management are agents of shareholders. Instead, they suggest that managers are trustees of the corporation.

2.3 Empirical studies linked to this Study

2.3.1 Global Empirical Studies

Commons (1932) describes governance as the means by which order is accomplished in a relation in which potential conflict threatens to undo or upset opportunities to realize mutual gains. Public Sector Corporate Governance Trust (1999) refers to governance as the manner in which power is exercised in the management of economic and social resources for sustainable human development. Governance is concerned with the processes, systems, practices and procedures, the formal and informal rules that govern institutions, the manner in which these rules and regulations are applied and followed, the relationships that these rules and regulations determine or create, and the nature of those relationships. Essentially, governance addresses the leadership role in the institutional framework.

Jensen and Meckling (1976) define the private corporation or firm as simply one form of legal fiction which serves as a nexus for contracting relationships and which is also characterized by the existence of divisible residual claims on the assets and cash flows of the organization which can generally be sold without permission of the other contracting individuals. There is only a multitude of complex relationships (i.e., contracts) between the legal fiction (the firm) and the owners of labor, material and capital inputs and the consumers of output.

Fama (1980), view the firm as a set of contracts among factors of production, with each factor, motivated by its self-interest. In effect, the firm is viewed as a team whose members act from self-interest but realize that their destinies depend to some extent on the survival of the team in its competition with other teams.

Fama and Jensen (1983), state that these contracts or internal ‘rules of the game’ specify the rights of each agent in the organization, performance criteria on which agents are evaluated, and the payoff functions each one face. The contract structure combines with available production technologies and external legal constraints to determine the cost function for delivering an output with a particular form of organization.

The modern corporation has the following 4 significant legal characteristics which make it a vehicle for the ongoing creation of wealth on an extreme scale while at the same time, providing unscrupulous business managers and stock brokers with an easy and fast way to make themselves very substantial fortunes with a minimum of personal financial risk; The firm is a legal entity with a personality separate from that of its members and it can therefore make arrangements to govern its own activities, sue and be sued, purchase, hold and dispose assets in its own name, hire staff, agents and contractors and enter into commercial contracts in its own name. It has transferable shares which (subject at times to share holder agreements) enable shareholders to transfer part or all of their ownership of the corporation without affecting its existence. It has independence from its shareholders so that the corporation’s survival is not dependent on the continuing life of the shareholders. It has limited liability so that the shareholders have no direct liability in respect of the actions of the corporation, its debts, its contracts or the outcomes of its actions (Calder, 2008).

Mitton (2000) defines corporate governance as the means by which minority shareholders are protected from expropriation by managers or controlling shareholders.

Corporate performance is partially a function of the quality of management, which given agency problems within the firm, will be a function of the quality of governance structures within the firm. Observable variables associated with governance structure such as the ownership of top management and the board of directors, the compensation package of top management, and the composition of the board of directors will vary in ways so that firms with certain types of structures systematically outperforming firms with other governance structures (Weisbach, 1993) . Firm value is an increasing function of improved governance quality among firms with high free cash flow. In contrast, governance benefits are lower or insignificant among firms with low free cash flow. Not controlling for this conditional relation between governance and firm value could lead to erroneous conclusions that governance and firm value are unrelated. (Chi et al., 2010)

In an efficient capital market, investors will discount the price they are willing to pay for a company's shares by the expected level of managerial agency costs. It is therefore assumed that for a company to prosper, it will choose a corporate governance structure that is efficient in minimizing agency costs (Evans *et al.*, 2002) note that. For a firm's corporate governance practice to have a positive effect on its market value, two conditions must be satisfied. First, good governance must increase the returns to firm's shareholders; second, the stock market must be sufficiently efficient so that the share prices reflect fundamental values. These conditions are more likely to be satisfied in mature markets than in emerging markets (Bai *et al*., 2004).

Henry (2010) observes that there is a growing body of international evidence supporting the existence of a correlation between corporate governance structure, firm performance and valuation outcomes. What is less clear from this evidence, however, is the channel through which governance mechanisms derive their impact. Prior studies have suggested stronger shareholder rights and legal protection mechanisms which lower investor capital costs. (La Porta *et al.* 2000) or incentive effects associated with takeover vulnerability (Bebchuk *et al*., 2004).

Other suggested channels included greater coverage and reporting by ratings agencies (Klapper and Love, 2004, Brown and Caylor, 2006), improved management structure and oversight through voluntary or legislative enforcement of codes of governance practice (Black *et al.*, 2006; Henry, 2008), and enhanced disclosure informativeness (Beekes and Brown, 2006). Furthermore, there is other work intimating that it may, in fact, be prior or contemporaneous performance or valuation outcomes that are driving changes in the corporate governance structure of firms (Hermalin and Weisbach, 2003).

Gompers *et al*. (2003) classified 24 governance factors into five groups (tactics for delaying hostile takeover, voting rights, director/officer protection, other takeover defenses, and state laws), and created G-Index by summing the 24 binary governance factors. They found that an investment strategy that bought firms in the lowest decile of the index (strongest rights) and sold firms in the highest decile of the index (weakest rights) would have earned abnormal returns of 8.5 percent per year during the sample period. Also, firms with stronger shareholder rights had higher firm value, higher profits, higher sales growth, lower capital expenditures, and made fewer corporate acquisitions. Firms with fewer shareholder rights have lower firm valuations and lower stock returns. However, Gompers *et al.* (2003) caution the interpretation of their results by stating that since this is an experiment without random assignment, no analysis of causality can be conclusive. The main problem is the possibility that some unobservable characteristic is correlated with G and is also the main cause of abnormal returns.

Bauer *et al*. (2004) followed the approach of Gompers *et al*. (2003). Using data from Deminor Corporate Governance Ratings for companies included in the FTSE Eurotop 300, portfolios were built consisting of well-governed and poorly governed companies and their performances compared. The impact of corporate governance on firm valuation was also examined. The results show a positive relationship between these variables and corporate governance. This relationship weakens substantially after adjusting for country differences. Finally, the relationship between corporate governance and firm performance as approximated by net profit margin and return on equity was analyzed. Surprisingly, and contrary to Gompers *et al*. (2003), a negative relationship is found between governance standards and these earnings-based performance ratios.

Cremers and Nair (2005) followed Gompers *et al.* (2003), to study how these governance mechanisms interact with long-term equity prices. Using the classifications from the governance index that they develop, they showed that a portfolio that buys firms with the highest level of shareholder rights and sells firms with the lowest level of shareholder rights generates an annualized abnormal return of 8.5% from 1990 to 1999.

They further consider two different proxies for internal governance: the percentage share ownership by institutional blockholders, defined to be an institutional shareholder with equity ownership greater than 5%, and the percentage of share ownership by public pension funds, which tend to be active shareholders. They find that public pension fund (blockholder) ownership is important only in the presence of takeover vulnerability and that the market for corporate control is important only in the presence of an active shareholder—firms with the highest quartile of blockholder (public pension fund) ownership.

They also document that a portfolio that buys firms with high takeover vulnerability and high public pension fund (blockholder) ownership and shorts firms with low takeover vulnerability and high public pension fund (blockholder) ownership generates an annualized abnormal return (alpha) of 10–15%, depending on which proxy is used for internal governance. On the other hand, a portfolio that buys firms with high takeover vulnerability and low public pension fund (blockholder) ownership and shorts firms with low takeover vulnerability and low public pension fund (blockholder) ownership does not generate any significant abnormal return.

The complementary relation is confirmed using accounting measures of performance such as net profit margin, return on assets, and return on equity. Further, the study finds that internal and external governance mechanisms are stronger complements in firms with low leverage. The study also finds some evidence that external mechanisms are more effective for small firms, suggesting that a larger firm size might reduce the quality of external governance (takeover vulnerability).This paper shows that the results of the importance of corporate governance as presented by Gompers *et al*. (2003) are strengthened when the role of internal governance mechanisms is also considered. In particular, the simultaneous consideration of takeover vulnerability and shareholder activism is crucial for the documented abnormal returns.

Chi (2005) explored the relation between firm value and the shareholder rights – based G index and showed that the relationship is not spuriously driven by unobservable firm heterogeneity or an assortment of unobservable firm characteristics, such as firm growth potential and profitability. The causality seems to run from G to firm value and not the reverse. Granting more rights to shareholders could be an effective way to reduce agency costs and enhance firm value. (Chi, 2005)

Bebchuk *et al*. (2009) constructed an entrenchment index (E-Index) based on 6 provisions. Of the six provisions, four set constitutional limits on shareholder voting power, which is the primary power shareholders have. These four arrangements; staggered boards, limits to shareholder amendments of the bylaws, supermajority requirements for mergers, and supermajority requirements for charter amendments limit the extent to which a majority of shareholders can impose their will on management. Two other provisions are the most well known and salient measures taken in preparation for a hostile offer: poison pills and golden parachute arrangements.

During the sample period of 1990 – 2003, controlling for the rest of the IRRC provisions, the entrenching provisions individually and in the aggregate are negatively correlated with Tobin's Q. Increases in E index are correlated, in a monotonic and economically significant way, with lower Tobin's Q values. Moreover, the provisions in the E index appear to be largely driving the correlation that the IRRC provisions in the aggregate have with Tobin's Q. This study found no evidence that the eighteen provisions not in the E index are negatively correlated, either in the aggregate or individually, with Tobin's Q. Bebchuk *et al*. (2009)

Brown and Caylor (2006) add to this literature by re-examining the links between corporate governance and firm valuation, using a far more extensive database than the oft-used IRRC database. Brown and Caylor (2006) created a simple summary governance index using 51 ISS data items. They showed that Gov-Score increases in firm value. Similar to BCF who showed that a small subset of factors fully drives the relation between IRRC corporate governance data and firm value, Brown and Caylor (2006) show that a small subset of factors fully drives the relation between ISS corporate governance data and firm value.

Brown and Caylor (2006) also examine the link between firm value and five governance provisions that are related either to auditing or stock option expensing (audit committee consists solely of independent outside directors, auditors were ratified at the most recent annual meeting, consulting fees paid to auditors are less than audit fees paid to auditors, company has a formal policy on auditor rotation, and company expenses stock options), and the study show that no significant and positive relation exists between these corporate governance factors and firm valuation.

Lehn *et al*. (2008) tested whether causation runs from governance to valuation or *vice versa*. They showed that the correlation between market-to-book ratios and the contemporaneous values of governance indices, as documented by Gompers *et al.* (2003), reflects causation running from market-to-book ratios to the governance indices, not vice versa. Specifically, they showed that market-to-book ratios during the early 1980s, a period preceding the adoption of the provisions comprising the governance indices, were significantly related to the subsequent value of these indices. In addition, they found that the significant relation between market-to-book ratios and the contemporaneous value of the G governance index during the 1990s vanishes after controlling for market-to-book ratios during 1980–1985.

Finally, when lagged and leading values of the market-to-book ratio are included simultaneously in a regression model where the governance index is the dependent variable the results documented by GIM and BCF hold true for the lagged values and not for the lead values. The results are consistent with two explanations. First, firms with low market-to-book ratios may be poorly run and, hence, more likely to be targets of control contests. If so, these firms are more likely than other firms to adopt takeover defenses that affect the value of their governance indices. Second, firms with low market-to-book ratios are likely to have fewer growth opportunities as compared with other firms. Insofar that low growth firms are more likely to be targets of takeovers than other firms, these firms are more likely to adopt takeover defenses as well. (Lehn *et al*., 2008)

Johnson *et al*. (2009) reexamined Gompers *et al*. (2003) findings of significant long-term abnormal returns for firms sorted on governance index values. Their study documents that the industry distributions of Democracy firms and Dictatorship firms differ statistically and economically from each other, and from the population of firms. They conduct specification tests in industry clustered samples for various methods to test long-term abnormal returns, and find significant specification problems with several methods. For the samples studied in their paper, adjusting firm returns by industry returns solves the specification problems, but the definition of industry is crucial.

Using 1,000 biased random samples of hedge portfolios with governance-neutral non-event firms (non-Dictators minus non- Democracies), Johnson *et al*. (2009) found that adjusting firms' returns by their respective Fama and French (1997) 48 industry median returns rejects the null hypothesis of zero abnormal returns too often. In contrast, tests based on three-digit SIC industry-adjusted returns are well specified. An approach that adjusts returns based on industry and characteristics—size, book-to-market, and momentum, is also well specified. (Johnson *et al*. 2009)

Using either of the well-specified methods, the study finds statistically zero long-term abnormal returns for event firm hedge portfolios (long Democracies, short Dictatorships). The results hold for value- and equal-weighted portfolios, and also hold for hedge portfolios based on Bebchuk *et al*. (2009) entrenchment index. These results have important implications for tests of long-term abnormal returns when industry clustering is present in the event sample. The study also shows that, at least for the industry clustering in portfolios sorted on governance, using a finer three-digit industry return adjustment approach instead of the Fama and French (1997) 48 industry definitions yields better specified tests. (Johnson *et al*. 2009)

These results could be interpreted to mean that first: the traditional asset-pricing models that account for only size, book-to-market and momentum (whether through factor regression or characteristic matching) cannot accurately price the industry cost of equity. Inferences obtained from these models can be highly misleading if the event firms happen to be concentrated in industries that are mispriced in the same direction. The second interpretation is that the traditional asset-pricing models do accurately price the industry cost of equity, but that the particular industries represented in this study have experienced unexpectedly high (for Democracies) or low (for Dictatorships) realized returns during the sample period. Either interpretation points to industry, instead of governance, as a source of variation in returns across the governance portfolios in the 1990s. (Johnson *et al*. 2009)

2.3.2 Local empirical studies Linked to this study

Onyango (2004) studied the relationship between ownership structure value of firms listed at Nairobi Stock Exchange and found a cubic relationship between the value of the firm and insider ownership. The value of the firm increased when insider ownership ranged between 0% and 37%, but decreased when insider ownership ranged between 37% and 51%.Firm value again increased when insider ownership exceeded 51%.In a complementary study, Munywoki (2006) concurred that managerial entrenchment has unambiguous negative effect on firm performance as measured by ROE and that the wealth effect of insider ownership is unambiguously positive. This evidence is consistent with both the convergence of interest and entrenchment hypothesis. Overall, the insider ownership has a positive impact on firm performance.

Lang'at (2006) studied the relationship between corporate governance structures and performance of firms quoted in the Nairobi Stock Exchange and found that frequency of board meetings, ratio of outside directors to total number of directors, % of insider share ownership and executive compensation were all positively related to firm performance. Kihara (2006) studied the relationship between ownership structure, governance structure and performance of firms listed in the Nairobi Stock Exchange and found no significant relationship between ownership structure and firm performance. The study however found a significant positive relationship between foreign share ownership and firm performance.

Manyuru (2005) and Mutisya (2006) studied the relationship between corporate governance structures and performance in firms quoted in the Nairobi Stock Exchange. Manyuru (2005) found a positive correlation between performance and corporate governance, Mutisya (2006) found that board size, number of meetings held in a year and the proportion of shares held by top shareholder were significantly and positively related to firm performance.

Muturi (2007) surveyed the degree of compliance with the Capital Markets Authority guidelines on corporate governance. The study found that the degree of compliance was high among the listed companies in Kenya. Wanjau (2007) surveyed the relationship between corporate governance and performance in microfinance institutions in Kenya and found that Board size was positively related to turnover or loan disbursements. Ngugi (2007) studied the relationship between corporate governance structures and performance of Insurance companies in Kenya and found that Board Size and Insider Holding were positively related to performance of Insurance Companies.

Mwakanongo (2007) conducted a survey of Corporate Governance practices in shipping companies operating in Kenya. His study found that the average board size was 4 with a diverse and professional and business inclination which presupposed that the companies observed and practiced good governance mechanisms. He concluded that time had come for the maritime industry to formally come up with a uniform set of corporate governance practices which every shipping company operating in Kenya should be encouraged to follow.

Ngumi (2008) surveyed the corporate governance practices in the Housing Finance Company of Kenya and found that HFCK had good corporate governance practices as recommended by the various banking industry stakeholders. The board of HFCK is responsible for the overall management of the bank and is committed to ensuring that its business and operations are conducted with integrity and in compliance with the law, internationally accepted principles and best practices in corporate governance.

Nyagari (2008) studied the control and enforcement of corporate governance by the capital markets authority and found that the authority has put in place various measures and reporting requirements for listed companies which essentially act as a guideline. Control and enforcement of the guidelines is effected through various means including use of fines and penalties. This study concluded that there is however varying levels of control and enforcement of the guidelines against prescribed measures.

Kiplagat (2008) surveyed the role of internal audit in promoting good corporate governance in state owned enterprises and concluded that internal audit function plays significant role in enhancing corporate governance. The board and management should offer the necessary support and appreciate the increasing status and role of internal audit in promoting good corporate governance practices. Nambiro (2008) studied the relationship between the level of implementation of CMA guidelines on corporate governance and profitability of companies listed in the Nairobi Stock Exchange. The study found that all companies listed in the Nairobi Stock exchange have implemented the CMA guidelines on corporate governance ,performance of the listed companies have exhibited an increase which can be attributed to the high level of adoption of the guidelines, board size, proportion of outside directors and the number of meetings in a year increase.

Mwirichia (2008) conducted a survey of corporate governance disclosures among Kenyan firms quoted at the Nairobi Stock Exchange and found that compared to other emerging economies, it is apparent that NSE listed companies report more comprehensively and gap between good and poor reporters narrower; Companies in the financial sector found to make more intensive disclosures than non financial companies; corporate governance disclosure index is significantly influenced by whether or not the company is in the finance sector, the size of the board of directors and age of the company. Local ownership, size of the company and whether or not the company is a multinational were not found to have any significant impact on corporate governance disclosure.

Muriithi (2008) studied Corporate Governance and financial performance of state corporations, the case of new KCC and found that the board of new KCC adopted practices of good governance which were reviewed and improved over time and had yielded improved financial performance. Some corporate governance practices identified included appointment and leadership of the board, structure of the organization, purpose and values, balance of power in the board, corporate communication, and assessment of performance of the board, responsibility to stakeholders, social and environmental responsibility.

Kiamba (2008) studied the effect of corporate governance on the financial performance of local authorities in Kenya. The study established that financial performance of local authorities in Kenya is influenced y the political composition of the respective councils, the manner in which internal audits are conducted and the managerial approaches applied by the chief officers. This is further linked to the failure of by the councils to conduct regular assessments of their performance, poor co ordination between the internal and external providers of providers of assurance, high staff turnover and transfers.

2.4 Conclusion

Studies conducted on the relationship between corporate governance and firm performance internationally have yielded mixed results; those conducted in Kenya have dwelt on descriptions and cases. In instances where they have explored the relationship between corporate governance and firm performance, internal governance mechanisms have been used. There is therefore need to reexamine this relationship, in Kenya using external governance mechanisms.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter deals with the preferred research design, sampling design, data collection, the analytical framework and finally hypothesis testing.

3.2 Research Design

Kerlinger (2008) defines research design as the plan and structure of investigation so conceived so as to obtain answers to research questions. This research took a causal analytical design based on the causal relationship between Corporate Governance and performance. The essential element of causation is that A ‘produces’ B or A ‘forces’ B to occur (Cooper and Schindler, 2008).

3.3 Population

Zikmund *et al.* (2010) refers to a population (universe) as any complete group of entities that share some common set of characteristics. The population chosen for this study was the companies listed in the Nairobi Stock Exchange.

3.4 Sample

Cooper and Schindler (2008) refer to sampling as the selection of some of the elements in a population to draw conclusions about the entire population. The sample chosen was the companies listed continuously in the main market segment of the Nairobi Stock Exchange in the year 2008.

3.5 Data collection

Zikmund *et al.* (2010) defines data as facts or recorded measures of certain phenomena (things or events).This study made use of secondary data. Firm performance, Leverage, firm size and past sales growth was computed from data obtained from the published annual reports of the quoted companies for the year 2008.Data on Corporate Governance was obtained from both the Published financial statements and the listed companies by use of structured data sheets. Corporate Governance indices shall be computed based on the following 17 governance attributes.: No dual class structure with unequal voting rights; Cumulative voting; No supermajority required to approve merger; No supermajority required to amend bylaws and charter; No classified board; Shareholders can call special meetings; Shareholders can act by written consent; No blank check or poison pill; CEO not on more than 2 boards; CEO and Chairman are separated ;Majority of board is independent ;Audit committee is independent ;Compensating committee is independent; Nominating committee is independent ;Governance committee exists; No interlocked directors ;Policy on outside directorships exists. One point shall be awarded if an attribute is present and a zero if otherwise

3.6 Data Analysis

Data analysis is the application of reasoning to understand the data that have been gathered (Zikmund *et al.* 2010). A basic regression model of the form; Performance (independent variable) = f (Country level factors, Firm level factors, Control Variables) was used. Tobin's Q (the dependent variable) will be used to measure performance.

For each firm, CG index was computed as an equally weighted sum of the 17 corporate governance attributes. The index ranges from 0 to 17, with higher scores denoting better corporate governance. $\overline{CG}$, an Index to proxy for the minimally accepted criteria for corporate governance that are satisfied by all firms in the country, as dictated by laws and common practices in the country, will be established. This approach is common in the literature (Gompers *et al.*, 2003 and Bebchuk *et al.*, 2004).

To differentiate between governance attributes that are satisfied by all firms in a given country and those that are not, each firm's CG score was compared with a country level score of minimally accepted criteria ($\overline{CG}$).Minimally accepted criterion will be applied to each attribute ,including only those attributes that are satisfied by all firms in this country-level governance index. While some of these attributes may not be enforced by law, including them in the country-level index is not problematic because they represent "corporate norms" that are accepted by all firms in the country. The variable *(CG - $\overline{CG}$)* is the difference between the firm-level CG Index and the country level CG Index therefore proxies for the corporate governance practices adopted by a firm beyond the regulatory stipulations. Using this approach, the degree to which firms adopt governance provisions that go beyond the "corporate practices" accepted by all firms in the country was assessed. By taking out the part that represent common practices in the country, the study will focus on the independent effect of governance attributes that firms choose to adopt, on firm valuation.(Chhaochharia and Laeven,2009).

The following Multiple Regression model shall be used to analyze the data.

$$\mathrm{Q} = \alpha + \beta\left(CG - \overline{CG}\right) + \gamma\ \overline{CG} + \ln S + G + L$$

Where Q denotes the Tobin's Q of a particular firm and is calculated as follows:

$$Tq = \frac{MVCS}{PVCS}$$

where $MVCS$ is the market value of the firm's common stock shares, $PVCS$ is the par value of the firm's common stocks.

Data was analyzed using SPSS software version 17.0. The coefficients of the independent variables were be tested at 95% confidence level.

CHAPTER FOUR

DATA ANALYSIS, FINDINGS AND DISCUSSION

4.1 Introduction

The research objective was to establish whether performance of listed companies at the stock exchange were more significantly related to governance attributes that are adopted at the firm level (firm level factors) or minimally accepted governance attributes that are satisfied by all firms in a given country(country level factors). This chapter presents the analysis and findings with regard to the objective and discussion of the same. The findings are presented in descriptive statistics, regression model fit, correlations and coefficients.

4.2 Descriptive Statistics

The descriptive statistics are presented in table 1, below.

Table 1. Descriptive Statistics

	Mean	Std. Deviation	N
TQ	16.6959	18.96588	43
LEVERAGE	.2860	.46472	43
InS	22.4261	1.25424	43
G	.2021	.20708	43
$CG - \overline{CG}$	3.6471	2.33397	43
$\overline{CG}$	7.0000	.00000	43

The means and Standard deviations of various independent variables can be observed from the table above, from the findings it can established that despite InS having the highest mean and standard deviation, CG has no deviation and has a higher mean, it can further be observed that Leverage and G have lower means and standard deviations in that order.

4.3 Correlations

Table 2: Correlations

		TQ	LEVERAGE	**InS**	G	$(CG - \overline{CG})$
Pearson Correlation	TQ	1.000	-.105	.137	.229	.685
	LEVERAGE	-.105	1.000	.082	-.166	.146
	InS	.137	.082	1.000	.071	-.006
	G	.229	-.166	.071	1.000	.468
	$(CG - \overline{CG})$	.685	.146	-.006	.468	1.000
	$\overline{CG}$	.	.	.	.	.
Sig. (1-tailed)	TQ	.	.278	.219	.096	.000
	LEVERAGE	.278	.	.322	.174	.205
	InS	.219	.322	.	.346	.487
	G	.096	.174	.346	.	.003
	$(CG - \overline{CG})$	.000	.205	.487	.003	.
	$\overline{CG}$	.000	.000	.000	.000	.000

In relation with the Pearson correlation it can be observed that leverage has a negative correlation with $(CG - \overline{CG})$.Leverage has a weak negative correlation with G. $(CG - \overline{CG})$ has a strong positive correlation of 0.685 with TQ which is represents more than 65% of the performance contributors, G ,22.9% and InS governance attribute having a positive correlation of 13.7%.

4.4 Model Summary

Table 3: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.756[a]	.572	.513	13.24182

a. Predictors: (Constant), $(CG - \overline{CG})$, InS, LEVERAGE, G

In summary, the enlisted the independent variables affected firms performance by 57.2%,with the other 42.8% being as a result of other factors.

4.5 Coefficients

Table 4 Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t
		B	Std. Error	Beta	
1	(Constant)	-61.716	41.697		-1.480
	LEVERAGE	-11.280	5.236	-.276	-2.154
	InS	2.725	1.856	.180	1.468
	G	-19.802	13.150	-.216	-1.506
	$(CG - \overline{CG})$	6.728	1.159	.828	5.806

From the regression table above, various governance attributes are further analysed to establish which has the highest positive impacts to a firms performance, the equation which can be derived from the above is in the form of

TQ= -61.716 - 11.280LEVERAGE + 2.725InS – 19.802G + 6.728($CG - \overline{CG}$)

From the equation above therefore, it can be observed that the ($CG - \overline{CG}$) has the highest positive impact on the performance of the firm with 6.728 .The coefficient of the variable ($CG - \overline{CG}$), is also significant at the 0.05 significance level since it falls within the upper bound of 9.098 and the lower bound of 4.358. It can further be noted that InS has a positive relationship of 2.725.G and the leverage have -19.802 and -11.280 effects respectively. It can therefore be singled out that that ($CG - \overline{CG}$) is the governance attribute which has a huge impact on the firms’ performance.

CHAPTER FIVE

FINDINGS, LIMITATIONS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary of Findings

The objective of this research was to assess whether performance of listed companies are more significantly related to governance attributes that are adopted at the firm level (firm level factors) or minimally accepted governance attributes that are satisfied by all firms in a given country(country level factors). This objective was achieved by use of a linear regression analysis which was carried out using SPSS package version 17.The intention was to test the significance of the coefficient of the independent variable ($CG - \overline{CG}$).The findings indicate the variable ($CG - \overline{CG}$) has a significant positive coefficient.

5.2 Conclusion

The findings from the analysis show that it of significance to adopt corporate governance attributes which exceed the minimum level prescribed by regulations and common practice. The additional corporate governance attributes have a significant relationship to firm performance.

5.3 Limitations of the study

Since the sample period for this study was the year 2008, the post election violence which was experienced could have affected firm performance in varying degrees. This is one of the other factors which could have an independent effect on firm performance besides the identified independent variables.

Studies on the effect of corporate governance on firm performance have been plagued by endogeneity and reverse causality. A positive relationship between corporate governance and firm performance may not mean that corporate governance causes firms to perform better.

Availability of data was also a challenge since governance data on some listed companies was not availed.

5.4 Suggestions for further Research/Recommendations

Due to the problems of reverse causality and endogeneity in studies such as this, similar studies should be conducted in a manner that takes care of the twin problems of endogeneity and reverse causality.

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