THE RELATIONSHIP BETWEEN BOARD STRUCTURE AND BOARD COMPENSATION ON FINANCIAL PERFORMANCE FOR COMPANIES LISTED AT THE NAIROBI STOCK EXCHANGE (NSE)

BY
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DECLARATION

This research project is my original work and has not been presented for a degree in any other University or Institution. No part of this proposal may be reproduced without prior permission of the author and/or University of Nairobi

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

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DEDICATION

This project is dedicated in all sincerity and due respect to my parents for having granted me the opportunity to go to school and acquire knowledge.

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A project of this kind is without doubt beyond the efforts of a single individual. In this regard, I am indebted to both those who inspired me to pursue the course and those who assisted and guided me in this study.

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ABSRACT

This study set out to determine the relationship between board structure and board compensation on financial performance for companies listed at the Nairobi Stock Exchange (NSE).

Financial reports for listed companies were obtained from Nairobi stock exchange for the years 2006 to 2010. From the data extracted from the financial reports, multiple regression analysis was performed with the aid of a statistical package (SPSS) to establish the relationship between board structure and board compensation and performance measures i.e. Return on assets (ROA), Return on equity (ROE) and Profit.

The regression results displayed no significant relationship between Board size and Board composition and performance measures while there was significant relationship between Board compensation and firms performance for companies listed at Nairobi stock exchange.

LIST OF ABBREVIATIONS

ANOVA	Analysis of Variance
CEO	Chief Executive Officer
DUAL	CEO Duality
IAS	International Standards of Auditing
ITT	International Telephone and Telegraph
KLSE	Kuala Lumpur Stock Exchange
PROP NED	Non-Executive Directors
ROA	Return on Investments
ROI	Return on Assets
SGX	Singapore Stock Exchange
TC	Total Board Compensation
U.K	United Kingdom

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CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

Corporate governance has been part of research in business economics since Adam Smith's (1776) seminal publication of An Inquiry into the Nature and Causes of the Wealth of Nations and undoubtedly given impetus through Berle and Means's (1932) classic publication of the separation of corporate ownership from control. The latter authors sought to explain why a firm with several dispersed shareholders gave vested control powers to the manager who may not have substantial shares in the firm. Going onto the diamond jubilee of this classic publication, there is still unparalleled interest in the field of corporate governance. In the wake of high profile business collapses such as Enron, WorldCom, HIH Insurance, and OneTel, and the increase in shareholder activism, public attention has become more focused on corporate governance (Petra, 2005; Peaker, 2003; Roberts et al., 2005). A common feature of these corporate scandals has been an inadequate system of corporate governance (O'Regan et al., 2005).

The concept "corporate governance" has attracted various definitions. Metrick and Ishii (2002) define corporate governance from the perspective of the investor as "both the promise to repay a fair return on capital invested and the commitment to operate a firm, efficiently given investment". The implication of this definition is that corporate governance has an impact on a firm's ability to access the capital market. Metrick and Ishii argue that firm level governance may be more important in developing markets with weaker institutions as it helps to distinguish among firms. Cadbury Committee (1992) defines corporate governance as "the system by which companies are directed and controlled".

According to Mayer (1997), corporate governance is concerned with ways of bringing the interests of (investors and managers) into line and ensuring that firms are run for the benefit of investors. Corporate governance is concerned with the relationship between the internal governance mechanisms of corporations and society's conception of the scope of corporate accountability (Deakin and Hughes, 1997). It has also been defined by Keasey et al (1997) to include 'the structures, processes, cultures and systems that engender the successful operation of organisations.' Corporate governance is also seen as the whole set of measures taken within the social entity that is an enterprise to favour the

economic agents to take part in the productive process, in order to generate some organizational surplus, and to set up a fair distribution between the partners, taking into consideration what they have brought to the organization (Maati, 1999).

Conflicts of interest between company directors and executives have prompted both legislative and non-legislative reform aimed at safeguarding the interests of corporate stakeholders and strengthening the independence of company boards through the appointment of non-executive directors. Described as the "mainstay of good governance" (Editorial, 2003, p. 287), non-executive directors are considered to be a guarantee of the integrity and accountability of company boards. Although efforts to define the role of a non-executive director are said to have "taxed the nation's finest intellects" (Ham, 2002), non-executive directors typically participate in long-term decision making, contribute external business expertise, identify potential business opportunities, and monitor the actions of company executives (Pass, 2004; Long et al., 2005; Higgs, 2003).

Much of the academic literature concerning corporate governance and board composition has sought to establish causal relationships between board structure and firm performance or sought to apply a theoretical explanation for the behaviour of corporate boards. Another element of debate in corporate governance or the broader field of business management has been how to assess firm performance, Profits, prices and rates of return are the most popular. Profitability however depends on many factors outside the direct control of firms and may not be a true measure of firm performance that can be attributable to firm specific characteristics.

The importance of corporate Board structure and Executive compensation as a mechanism of Corporate Governance has been a matter of considerable academic debate in both theoretical and empirical literature. These issues have also received renewed attention among the policy makers in both developed and developing countries engaged in reforming internal corporate governance system, particularly after the East Asian financial crisis and recent corporate debacles involving Giant Corporation like Enron and WorldCom (Ghosh, 2003). There is an important need for research to inform current corporate governance debates. Yet the study of corporate governance is complicated by the fact that the structure, role and impact of boards have been studied from a variety of theoretical perspectives, which in turn have resulted in a number of sometimes competing theories concerning

corporate governance. Scholars from the disciplines of law (Richards and Stearn, 1999), economics (Jensen and Meckling, 1976; Tirole, 2001), finance (Fama, 1980), sociology (Useem, 1984), strategic management (Boyd, 1995) and organisation theory (Johnson, 1997) have all made contributions to the corporate governance research agenda. From these disciplines we have numerous governance theories including agency theory, stewardship theory, resource dependence theory, institutional theory and stakeholder theory, to name but some of the more dominant theoretical perspectives.

A common aim of many of the theories of corporate governance has been to posit a link between various characteristics of the board and corporate performance. Agency theory (Jensen and Meckling, 1976; Eisenhardt, 1989) has been a dominant approach in the economics and finance literatures (Hermalin and Weisbach, 2000). Agency theory is concerned with aligning the interests of owners and managers (Jensen and Meckling, 1976; Fama, 1980; Fama and Jensen, 1983) and is based on the premise that there is an inherent conflict between the interests of a firm's owners and its management (Fama and Jensen, 1983). The clear implication for corporate governance from an agency theory perspective is that adequate monitoring or control mechanisms need to be established to protect shareholders from management's conflict of interest – the so-called agency costs of modern capitalism (Fama and Jensen, 1983). Agency theory leads to normative recommendations that boards should have a majority of outside and, ideally, independent directors and that the position of chairman and CEO should be held by different persons (Bosch, 1995; Committee on the Financial Aspects of Corporate Governance, 1992; OECD, 1999; Toronto Stock Exchange Committee, 1994).

The owners of the firm can try to influence the quality of the Board and through that the performance of the firm. It is known in the continental European Economies that this is a common practice. For instance in Germany Banks have a great influence on Board Composition (Edwards and Fischer, 1994).The movement to officially mandate or encourage minimum levels of independent Directorship in public companies has rapidly gained momentum over the past decade. Much of this trend was influenced by the publication of the Report of the committee on the Financial Aspects of corporate government chaired by Sir Adrian Cadbury, on December 1, 1992. The primary aim of the Cadbury report is to recognize the paramount importance of effective Board monitoring and to suggest ways of achieving that goal by codifying a regulatory framework for corporate governance.

To ensure agent and principal's interests are aligned, shareholders should implement monitoring mechanisms or corporate governance controls. These company monitoring mechanisms should prevent opportunistic behaviour of management, thus shareholder returns are maximized. Key corporate governance mechanisms recommended by the Cadbury committee include a greater proportion of non-executive independent directors on the board and directors that have the qualifications and experience to influence the board. The Cadbury committee recommends that there should be a sufficient number of the high calibre non-executive directors to influence the board's decisions.

1.2 Statement of the problem

There is a considerable worldwide interest in the effect on firm performance of companies' ownership and control structures. The composition and compensation of Board of Directors in large companies is currently attracting much debate. Most of the empirical literature on the board of directors and pay performance is based on developed countries. For example; U.S (Fama and Jensen 1983), Mehran (1995) and Palia (2001), U.K. (Dahya et al (2002), Japan Aoki (1988) e.t.c Yet in recent years the issue of the effect of Board Structure and executive compensation on firm performance has been no less important in developing and emerging economies.

Empirical studies conducted in Kenya showed that various components corporate governance is linked to firm performance. In her study Jebet (2001) documented the corporate governance structures prevalent in listed companies including; nature of shareholding, Statutory voting rights as well as composition and leadership of the board. Ogoye (2002) examined the components of management compensation and the associated proportions as well as the relationship between management compensation, performance and sales. Maina (2005) studied a relationship between the board composition & performance in quoted companies while Okiro (2006) investigated the relationship between board composition and firm performance on non-financial listed companies at the (NSE). A similar study by Molonko (2004) detailing the relationship between the Board structure and compensation and financial performance of banking industry was conducted. Using a sample of 30 banks for the period 1999-2003 had sought to explore this argument. Board size (SIZE), proportion of non- executive directors (PROP NED), CEO duality (DUAL) and Board Total compensation (TC) where used to proxy bank profitability.

The key findings of the study revealed the existence of a positive relationship between Board compensation and firm size with bank's profitability. The relationship between board size and proportion of non-executive directors was found to be negatively and statistically insignificant. However such a study within the listed companies between 2006 to 2010 has not been done.

The analysis of the above studies undertaken indicates that whereas Ogoye (2002), Maina (2005) and Okiro (2006) had evaluated the effects of either Compensation or Structure on Performance, no one of them had come close to the examining the combined effects of the two variables on performance jointly in a study. However despite the fact that Molonko (2004) did a similar study, his was based on the banking sector. To cover this gap, this study has sought to carry out a research to establish whether board structure and board compensation has an effect on financial performance for the listed companies.

1.3 Objectives of the study

The overall objective was to review the performance of the listed firms within the Nairobi Stack Exchange in relationship to board characteristics and corporate compensation.

1.3.1 Specific objectives

i. Analyze the effects of board Composition on organization's performance.
ii. Analyze the effects of Board compensation on organization's performance

1.4 Importance of the study

i) Will enable owners understand the pertinent board attributes that add value to their wealth.
ii) Will aid policy makers in designing guideline that promotes good corporate governance practices by providing an insight into current corporate board structures in the listed sector.
iii) Will contribute to the existing literature and provide a basis for further research in the area of corporate governance, agency costs and Board characteristics.

CHAPTER TWO: LITERATURE REVIEW

2.1 Review of Empirical Studies

Corporate governance research has identified a variety of mechanisms that are intended to ensure that management act in the best interest of shareholders. They include internal mechanisms such as the Board of Directors, ownership by managers, and executive compensation; and external mechanisms such as the market for corporate control, institutional ownership and level of debt financing.

Most academic literature concerning corporate governance and board composition has sought to establish casual relationships between board structure and firm performance or sought to apply a theoretical explanation for the behaviour of corporate boards. Keil and Nicholson (2003) examined the top 348 companies in the Australian stock exchange (ASX), describing the board composition, examining the correlates of board composition and attempting to link the demographics with corporate performance. Sharma (2004) studied the relationship between board independence and fraud across a sample of 62 Australian listed companies. He found that the presence of independent directors on company boards, and the absence of duality significantly reduced the likelihood of fraud (Sharma, 2004).

Long et al. (2005) compared the role of non-executive directors between listed and unlisted UK companies. Based on a series of semi-structured interviews which covered issues relating to strategy involvement, financial monitoring, and overall board contribution, they found that non-executive directors on listed boards are inhibited by high levels of visibility, shareholder perception, information asymmetry, and impact of corporate governance regulation (Long et, 2005). Brennan and Mc Dermott (2004) assessed the extent of independence of boards of companies listed on the Irish stock exchange, profiling 80 company's boards and their adherence to the independence requirements set out in the Higgs Report.

Hooghiemstra and van Manen (2004) proposed an "independence paradox" concerning the role of non-executive directors. They conducted telephone interviews and mail questionnaires to survey the opinions of Dutch non- executive directors regarding their roles and limitations. They found that, although non-executive directors are expected to operate independently from management, in practice,

they are unable to so because they rely on this same group to provide them with the information necessary for decision making, thus leading to an independence paradox (Hooghiemstra & van Manen, 2004, p. 332). In examining the characteristics of non-executive directors in UK, Pass (2004) conducted an empirical study of 50 listed companies. Gathering data on non-executive directors' characteristics such as age, gender, length, of service, remuneration, and other directorships, Pass's (2004) study presented a comprehensive profile of non-executive directors within large UK companies and considered the consistency of this profile with the requirements and recommendations contained in legislative reforms.

Developing 'good practices' in Boards of Directors has become an important issue in research teaching and practice in enhancing corporate governance. Researchers and managers acknowledge the importance of well functioning Board of Directors, as good governance practice seem to result in the creation of firm value, improved (financial) results firm continuity and improved company structure (Johannison and Huse 2000). Effect of size and composition of the Board on firm performance is a debatable issue in literature (Hermalin and Weisbach 2001). Large Boards are likely to be efficient monitor of the CEO and other executive Directors. But there is evidence that firm performances fall with the increase in Board size due to free rider problems. The relation between proportion of outside Director and firm performance is ambiguous e.g. Bhagat and Black (1997).

Effect of CEO holding the chairman position of the Board and its effect on firm performance is another debatable issue. There are evidences that moral hazard problem increase when CEO becomes the chairman of the Board and therefore it reduces the performance of the firm (Jensen (1993), Crystal (1991), Pi and Timme 1993. Counter evidence argue that due to information sharing advantage the firm can perform better (Brickley et al (1997). The theoretical literature on pay-performance is mainly based on agency cost. In setting managerial or Board compensation, shareholders have to keep two things under consideration. The first consideration is the 'participation constraint' and secondly is the incentive constraint. The easiest way to mitigate the moral hazard problem is to align the incentive of the Board with those of the owners.

2.2 Roles of Boards of Directors

Although a long list of functions can be attributed to Board of Directors, no consensus exists on the importance of each of these functions. (Johnson, et al, 1996, Finkelstein and Hambrick, 1996).

On the basis of this discussion are the different theoretical perspectives researchers apply, starting with Agency theory, many studies focus on the control function of the Board. This theory treats business organizations as a nexus of contracts through which various participants transact with each other (Jensen and Meckling, 1976). As assets are the property of the shareholders, and managers have to take decisions concerning the application of these assets, a principal – agent problem may arise. Installing a Board of Directors can be an effective instrument to cope with this problem (Fama and Jensen, 1983).

Board roles studied by (Pfeffer and Salancik, 1978) focus on the following strategic functions:

(i) Advising management in relation to strategic decisions making.
(ii) Ratifying and controlling strategic decisions and
(iii) Providing access to additional resources.

A third group of studies focus on the networking or information providing function (Eisenhardt, 1989). Outside directors are important for developing and managing a network of key external relationship.

The Capital Markets Authority provides that board of directors should assume a primary responsibility of fostering the long-term business of the corporation consistent with their fiduciary responsibility to shareholders. It further provides that, the Board of Directors should accord sufficient time to their functions and act on a fully informed basis while treating all shareholders fairly, in the discharge of duties and responsibilities.

2.3 Board Size and Firm Performance

Research has also focused on the optimal size of firm boards. Too few directors on the board may imply a lack of knowledge to solve decisions, while too many directors may imply coordination

problems. The earliest literature on board size is by Lipton and Lorch (1992) and Jensen (1993). Jensen (1993) argued that the preference for smaller board size stems from technological and organizational change which ultimately leads to cost cutting and downsizing. Hermalin and Weisbach (2003) argued the possibility that larger boards can be less effective than small boards. When boards consist of too many members agency problems may increase, as some directors may tag along as free-riders. Lipton and Lorch (1992) recommended limiting the number of directors on a board to seven or eight, as numbers beyond that it would be difficult for the CEO to control. A large board could also result in less meaningful discussion, since expressing opinions within a large group is generally time consuming and difficult and frequently results in a lack of cohesiveness on the board (Lipton and Lorch, 1992). In addition, the problem of coordination outweighs the advantages of having more directors (Jensen, 1993) and when a board becomes too big, it often moves into a more symbolic role, rather than fulfilling its intended function as part of the management (Hermalin and Weisback, 2003). On the other hand, very small boards lack the advantage of having the spread of expert advice and opinion around the table that is found in larger boards. Furthermore, larger boards are more likely to be associated with an increase in board diversity in terms of experience, skills, gender and nationality (Dalton and Dalton, 2005). Expropriation of wealth by the CEO or inside directors is relatively easier with smaller boards since small boards are also associated with a smaller number of outside directors. The few directors in a small board are preoccupied with the decision making process, leaving less time for monitoring activities.

The above arguments were empirically tested and a negative association between board size and performance were reported by Yermack (1996), Eisenberg, Sundgren and Wells (1998) and Barnhart and Rosenstein (1998). Yermarck (1996) analysed a sample of 452 large U.S industrial corporations between 1984 and 1991 and consistently found an inverse relationship between board size and firm value even when regressions were carried out using numerous models such as fixed effects, random effects and OLS estimates. Even when firm value represented by Tobin's Q was substituted with other proxies such as return on assets, return on sales and sales/assets, the negative relation persisted. Following Yermarck's analysis of large firms, Eisenberg, Sundgren and Wells (1998) tested the relationship between board size and profitability on small and midsize Finnish firms. They presented evidence of a negative association between board size and profitability, thus supporting the theory put forward by Lipton and Lorch (1992) and Jensen (1993).

Similarly, Barnhart and Rosenstein (1998) found that firms with smaller board size perform better than firms with large board size. Vafeas (2000) reported that firms with the smallest boards (minimum of five board members) are better informed about the earnings of the firm and thus can be regarded as having better monitoring abilities. Echoing the above findings, Mak and Yuanto (2003) reported that listed firm valuations of Singaporean and Malaysian firms are highest when the board consists of five members. Bennedsen, Kongsted and Nielsen (2004), in their analysis of small and medium-sized closely held Danish corporations reported that board size has no effect on performance for a board size of below six members but found a significant negative relation between the two when the board size increases to seven members or more. In investigating the changes in board size over time, Wu (2000) discovered that on average, board sizes of corporations (Forbes 500) decreased over the 1991-95 periods. Wu argued that the cause of the decrease could partly be due to pressure from large active investors. This implies that the market generally is more confident if monitoring is carried out by smaller boards.

While Yermack (1996) and others found significant negative association between board size and performance, Bhagat and Black (2002), found no solid evidence on the relationship between board size and performance, although there are hints of an inverse correlation between the two. Thus their results do not fully support Yermark's findings. They explained that board size is often taken to be endogenously related to other control variables that may correlate with performance and although Yermark included other control variables in his analysis, the approach taken might cause the difference in results. In an attempt to compare the effects of board structure on firm performance between Japanese and Australian firms, Bonn, Yokishawa and Phan (2004) found that board size and performance (measured by market-to-book ratio and return on assets) was negatively correlated for Japanese firms but found no relationship between the two variables for its Australian counterpart. However, contrary to the Japanese firms the ratios of outside directors and female directors to total board numbers have a positive impact in the Australian sample (Bonn, 2004).

Contrary to the above findings, a positive impact on performance was recorded with larger board size by Mak and Li (2001) and Adams and Mehran (2005); however, in examining 147 Singaporean firms from 1995 data, Mak and Li (2001) support the argument that board structure is endogenously

determined when the results of their OLS indicate that board size, leadership structure and firm size have a positive impact on firm performance but their 2SLS regressions do not support this result. On the other hand, Adam and Mehran (2005) found a positive relationship between board size and performance (measured by Tobin's Q) in the U.S banking industry, which is contrary to the findings of Yermack (1996), and Eisenberg, Sundgren and Wells (1998) in US non financial firms. Adam and Mehran's results suggest that such performance relationship may be industry specific, indicating that larger boards works well for certain type of firms depending on their organizational structures. A meta-analysis based on 131 studies by Dalton and Dalton (2005) revealed that larger boards are correlated with higher firm performance which is in contrast to the results of an earlier meta-analysis by Dalton, Daily and Johnson (1999).

In summary, empirical research on board size suggests that greater board size in most cases is negatively associated with firm performance, although a meta-analysis by Dalton and Dalton (2005) found positive correlations between the two variables. Since very few studies examine board size and its effect on firm performance, a study on the size of Malaysian boards, which are relatively small in size compared to those found in the US, could shed some light on the situation found in connection with Malaysian boards in particular and on Asian boards in general.

Jebet, (2001) on her study of corporate governance on listed companies in Kenya establishes that the size of the Board varied from one company to the other. 70 percent of the sample companies had between five and ten directors whereas as 16 percent has between 11 and 15 directors.

2.4 Outside Directors and Firm Performance

While the board of directors consists of a composition of outside/independent directors and inside/ executive directors, discussions on board of directors are always centered on the advantages and disadvantages of outside directors. Thus, evidence on the beneficial role of inside directors is scarce.

Similar to outside directors, inside directors are also expected to play their role as a governance agent safeguarding between the firm and shareholders' interest and at the same time safeguarding the contractual relation between the firm and the board (Williamson, 1985). With regards to their

monitoring role, inside directors are expected to provide first-hand information on the firm's operation to other board members (Boumosleh & Reeb, 2005). Since inside directors are active participants in the firm's overall decision making process, they have access to all pertinent information that facilitates the decision making on the firms' activities. This is in contrast to outside directors who do not hold any executive powers and who usually sit on the boards of other firms too.

Therefore, as suggested by Anderson and Reeb (2004) when outside directors posed questions on the firm's operation during board meetings, inside directors are expected to provide them with satisfactory explanation. Apart from channeling pertinent information to outside directors, inside or outside directors also play a role in monitoring the CEO. While this monitoring role maybe indirect as inside directors themselves are under the evaluation of the CEO, inside directors may channel relevant information to outside directors if there are prove of CEO entrenchment. In other words if inside directors play an effective monitoring role and alleviates information asymmetries, this may increase the corporate governance structure of the firm which will eventually lead to a better firm performance.

Though the issue of whether directors should be employees of or affiliated with the firm (inside directors) or outsiders has been well researched, yet no clear conclusion is reached. On the one hand, inside directors are more familiar with the firm's activities and they can act as monitors to top management if they perceive the opportunity to advance into positions held by incompetent executives. On the other hand, outside directors may act as "professional referees" to ensure that competition among insiders stimulates actions consistent with shareholder value maximization (Fama, 1980). John and Senbet (1998), argue that boards of directors are more independent as the proportion of their outside directors increases. Though its been argued (Fama & Jensen 1983, Baysinger and Butler 1985, Baysinger & Hoskinsson, 1990, Baums 1994) that the effectiveness of a board depends on the optimal mix of inside and outside directions, there is very little theory on the determinants of an optimal board composition (Hermalin & Weisbach 2002).

A number of empirical studies on outside directors support the beneficial monitoring and advisory functions to firm shareholders (see Brickley & James 1987; Weisbach 1988; Byrd & Hickman 1992; Brickley et al. 1994). Baysinger & Butler (1985) and Rosenstein & Wyatt (1990) showed that the market rewards firms for appointing outside directors. Brickley et al (1994) found a positive relation

between proportion of outside directors and stock-market reactions to poison pill adoptions. Also Kyereboah-Coleman and Biekpe (2005) found a positive relationship between proportion of outside board members and performance of Micro finance Institutions (MFIs) in Ghana. However, Forsberg (1989) found no relation between the proportion of outside directors and various performance measures. Hermalin & Weisbach (1991) and Bhagat & Black 2002 found no significant relationship between board composition and performance. Yemack (1996) also showed that, the percentage of outside directors does not significantly affect firm performance. This was also confirmed by Kyereboah-Coleman and Biekpe (2005) when studying nontraditional export firms in Ghana. Agrawal & Knoeber (1996) suggest that boards expanded for political reasons often result in too many outsiders on the board, which does not help performance.

Byrd and Hickman (1992) and Baysinger and Butler (1985) define outside director based on three categories: Inside director, affiliated outside directors and independent outside directors. Inside directors typically include the CEO, other officer of the firm, or their families. Also included in this category are retired former officers of the firm. It is not unusual for a retiring CEO to retain his or her Board position so this latter delineation can be important. The second category, affiliated outside directors, recognized that many so-called outside directors are not truly independent. This category includes those outside who have business relationship with the firm, such as investment bankers, consultants, lawyers, major suppliers or customers. The final category, independent outside directors, includes those directors who have no affiliation with the firm other than their role as a Director. Members of this group may include academicians, retires executives from other non-affiliated firms, private investors, public sector members, etc. It is only members of third category that the author considers to be true Directors. This is important because traditional two-way classification may fail to consider potential conflicts of interest for affiliated outside Directors who are not full time employees of the firm, but have incentive to maintain their affiliation at the potential expense of shareholder wealth (Byrd and Hickman, 1992).

Cadbury report contains a variety of specific recommendations concerning Board structure and responsibilities. Among these recommendations are two key guidelines to ensure board independence, namely that Boards include at least three non-executive Directors (Section 4.11) and that the positions of Chief Executive Officer and Chairman of the Board be separate (section 4.9).

The empirical evidence on the monitoring effectiveness that outsider directors provide is somewhat mixed. While several authors find that independent outside Directors protect shareholders in specific instances where there is an agency problem (Weisbach, 1988; Byrd and Hickman, 1992), others find there is no relationship between outside Directors and shareholder welfare (Agrawal and Knoeber, 1996; Klein 1998). In particular, Agrawal and Knoeber documents that outsiders on the Board affect firm performance negatively even after accounting for their interdependence among various corporate control mechanisms.

Mc Avoy, et.al. (1983), Hermalin and Weisbach (1991), Mehran (1995), Klein (1998), and Bhagat and Black (2000) report an insignificant relation between performances, while Morck, et. al (1988), Hermalin and Weisbach (1991), and Bhagat and Black (2002) using Tobin's Q as a measure of firm value find no relation between the board independence and firm value. Overall, there is little evidence that there is a consistent cross sectional relation between Board composition and firm value using the sample of firms listed on US stock exchanges.

Rosenstein and Wyatt (1990) document a positive stock price reaction to the appointment of outside Directors even when outside Directors already constitute a majority, suggesting that outside Directors provide expertise beyond monitoring service.

2.5 CEO Duality and Firm Performance

A major corporate governance mechanism that minimizes managerial opportunism is the board of directors. This body, in theory, is in place to safeguard the interests of the company's shareholders and provides a monitoring of managerial actions on behalf of shareholders by setting strategic policies and goals (Mallin, 2007). Considerable attention has been given to the role of boards in monitoring managers and in removing non-performing CEOs. Jensen (1993) voices his concern that a lack of independent leadership makes it difficult for boards to respond to failure in top management team. Fama & Jensen (1983) also argue that concentration of decision management and decision control in one individual reduces board's effectiveness in monitoring top management. Thus, the literature reveals a board structure typology, the one-tier system and the two-tier system. In the one-tier system the Chief Executive Officer (CEO) is also chairman of the board, whilst the two-tier system has a

different person as the board chairman and is separate from the CEO. It has been noted though that the one-tier board structure type leads to leadership facing conflict of interest and agency problems (Berg & Smith 1978, Brickley & Coles 1997) thus giving preference for the two-tier system.

Agency problems tend to be higher when the same person holds both positions. Yermack (1996) argue that, firms are more valuable when the CEO and board chair positions are separate. Relating CEO duality more specifically to firm performance, researchers however find mixed evidence. Daily & Dalton (1992) find no relationship between CEO duality and performance in entrepreneurial firms. Brickley et al. (1997) show that CEO duality is not associated with inferior Performance. Rechner & Dalton (1991), however, report that a sample of Fortune 500 companies with CEO duality have stronger financial performance relative to other companies. Goyal & Park (2002) examine a sample of U.S. companies and find that the sensitivity of CEO turnover to firm performance is lower for companies without CEO duality. Sanda et al (2003) found a positive relationship between firm performance and separating the functions of the CEO and Chairman. Kyereboah-Coleman and Biekpe (2005) realized that while CEO duality is positively important for MFIs, it is relatively inconclusive on several performance measures in the non-traditional export sector in Ghana.

When the chairman of the Board and the CEO is the same person, it becomes more difficult to hold the Chief Executive Officer of the firm accountable for his/her actions and consequently firm performance might suffer. Fama and Jensen, (1983), suggest that the CEO duality "signals the absence of separation of decision management and decision control" which would then make the organization to suffer in competition for survival". CEO duality has been blamed for the poor performance of firms such as Sears, Westinghouse, General Motors and IBM (White and Ingrassia, 1992).

In defense of CEO duality, Anderson and Anthony, (1986), argue that it provides "a single focal point for company leadership" with a potentially clearer organization mission and strategy. According to this viewpoint CEO duality leads to stability and continuity of the organization, which in turn would lead to superior firm performance.

Rechner and Dalton (1991) examine the performance of firms with dual and non-dual CEOs over the period 1978 and 1983. They use Return on Assets (ROA), Return on Equity (ROE) and profit margin

(MARGIN) as their measures of performance in trying to distinguish between duality and non-duality firms. They find results that are not entirely consistent, and report that in periods with high financial returns (1987 – 1980) the non-duality firms out-performed the duality firms. The difference in performance was less significant in 1981 – 1983 when Returns were more modest.

Pi and Timme, (1993), find that in the Banking industry, over the 1987 – 1990 period, non-duality firms outperformed duality firms. Contrary to these studies Chargarti et al (1985) while comparing 21 Banking firms with 21 surviving firms in the retailing industry, finds no difference as a function of CEO duality.

Simpson and Gleason (1999) investigate the different aspects of ownership and governance when examining the relationship between the ownership and governance structure of the board of Directors and the internal control mechanism that influences the survival of the firm. The research considers a number of ownership attributes, including ownership by the CEO, number of Directors, percentage of inside Directors, the CEO duality and their effect on Bank failures. The empirical tests indicated a lower probability of financial distress when one person is both the CEO and chairman of the Board, whilst other factors did not have a significant effect.

2.6 Board Compensation and Firm Performance

According to Baker, Jensen and Murphy (1988), one of the most important, but least analyzed factors affecting organizational behavior is the internal structure, which includes ... compensation policies ..." Further they note, "A thorough understanding of internal incentives is critical to developing a viable theory of the firm, since they largely determine how individuals behave in an organization".

With regard to the role of compensation contracts in controlling managerial behavior, Jensen and Murphy (1990) observe that, "If shareholders had complete information regarding the CEO's activities and the firm's investment opportunities, they could design a contract specifying and enforcing managerial action to be taken in each state of mind" Given that managerial actions and investment activities of a firm are generally not perfectly observable by the market, Jensen and Murphy suggest that compensation policy can be designed to give the manager incentives to select and implement actions that increase shareholder wealth.

According to Murphy (1998), most executives pay packages can be thought of as containing four components: A Base Salary, An annual bonus usually tied to an accounting performance measure, and long-term incentive plans. Murphy notes that during the early (1990) stock options replaced base salaries as the single largest component of compensation. Yermack (1995) observes that stock option rewards represents one-third of CEO compensation in 1990 and 1991, and account for the majority of income from contingent instruments.

The dominant approach to the study of compensation practices in corporate governance setting is the 'Optimal Contracting Approach'. Under this approach, compensation in large quoted companies is designed to minimize agency costs. Boards of Directors exert a pivotal role between the top management teams (the agents) and shareholders (principals). The Board is viewed as seeking to maximize shareholder value, with the compensation system being designed to service this objective.

The extent of this alignment of the Board's behavior with the interest of the shareholders is a function of first the Board composition – The board should have independent/non-executive members (outside Directors) to discipline CEO and Executive Directors. Secondly the Board Remuneration – If compensation of Directors is not related with some performance indicator (profit, cash flow, earnings per share, etc.) management decisions will not maximize shareholder's wealth. The principle of value maximization will be forgotten and managers with fixed compensation will pursue their own objectives expanding its spur of control, seeking safe projects in order to get security, power, etc.). There are some stylized facts in empirical literature on pay performance; There is a positive relation between CEO compensation and firm performance, for example Hall and Liebman (1997) find that for the firms with $1Million median CEO compensation have annual return of 7% and for the firms with median compensation $5 Million the figure is 20.5%. There is an inverse relationship between pay performance sensitivity and market value of the firm; Schaefer (1998) finds pay performance sensitivity to be approximately inversely related to square root size of the firm. The firm which have significant and positive relationship between CEO compensation and firm performance, will give higher returns to the shareholders than those companies which is have less sensitive relation between CEO compensation and firm performance (Mehran 1995). The composition of the compensation package of the executive is also equally important as the level of compensation package of the

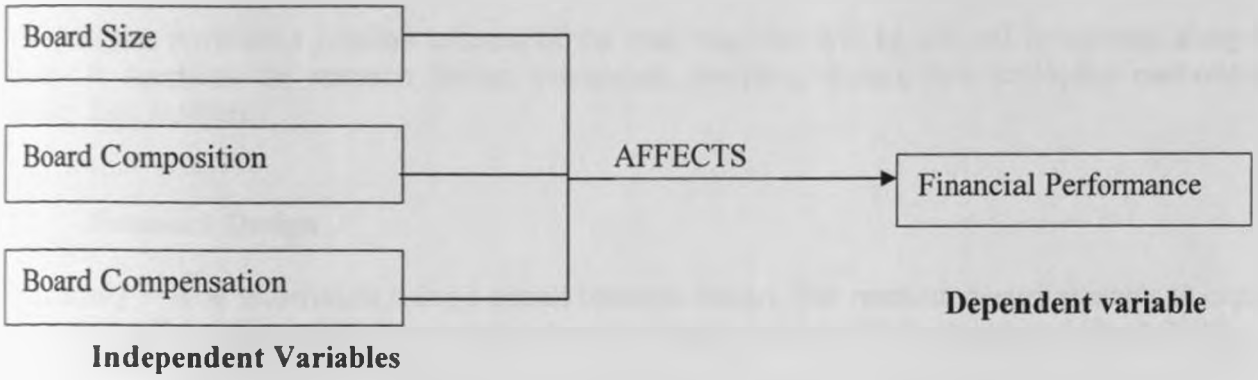
executive. Jensen and Murphy (1990) concludes that the average fraction of executive compensation, which performance based, say commission is quite high and ranging from one half to five-sixth of the total compensation.

A common argument against stock option is that it is easier to hike stock price over a short period than to build a long term – value. Options are inherently speculative and they can be exercised into cash when the share price is attractive. Option is another form of currency and not highly sensitive to performance as measured by changes in market value of equity as asserted by Jensen and Murphy (1990a) and Harvard Business Review, Jan 2003. Ogoye (2002) found that salary is the main component of remuneration of the management of companies quoted at the NSE. Performance was found to play insignificant role in determination these remunerations. Sales were found to be the main determinant of management compensation.

Firkelstein and Hambrick, (1988) assert that Board compensation can be examined from the dual perspective; amount as well as the mix of the compensation. The different components in the mix of Boards of Directors have different impacts on managerial motivation. Each predicts differing degrees of short term versus long-term orientation in managerial decision-making as well as different degrees of risk sharing between the shareholders and the managers. Cash compensation i.e. year-end salary and bonus, promotes primarily a short-term orientation. Year-end bonuses are mostly tied to annual earnings based performance, and tend to fluctuate more. On the other hand, stock options are intended to encourage a larger- term orientation in managerial decision-making.

2.7 Conceptual Framework

Figure 2.1 Conceptual Framework



There are several factors which the researcher believes affects the performance of the companies listed at the Nairobi Stock Exchange. The researcher will seek to establish how the size of the board in terms of number affects the performance of the companies, the researcher will further establish the board composition in terms of executive and non executive affects the performance. The researcher will establish how the different structures affect the performance of the companies. Lastly the researcher will establish the board compensation in monetary terms and establish its effect on the financial performance.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter provides a detailed account of the road map that will be utilized in accomplishing this study. It describes the research design, population, sampling design, data collection methods and finally data analysis.

3.2 Research Design

This study will be undertaken using a casual research design. The research design attempts to explore cause and effect relationships between two or more variables (Ader Mellenbergh and Hand, 2008).

3.3 Population

The population used in this study was all the listed companies at the Nairobi Stock Exchange as at 31st December 2010.

3.4 Sample

A study of all the listed companies that were continuously listed for the period 2006 – 2010 was undertaken. The five-year period (2006 – 2010) was considered adequate.

3.5 Data Collection

The study used both the secondary and primary data, from the following sources; listed companies' published financial statements, Annual reports of Nairobi Stock Exchange, Statistical bulletins from Nairobi Stock Exchange, Monthly economic reviews by the Nairobi Stock Exchange. However primary data in form of structured questionnaires was administered to complement what was provided by the secondary data especially on board structure & compensation.

3.5 Data Analysis

Data was analysed through the use of regression model where a computer application package SSPS version 16 will be used.

Model Specification

The Null hypothesis of this paper was that observed Board size, (SIZE), composition of Executive and Non-Executive Directors, (PROP NED), and Total Board Compensation (TC) give optimal incentives to improve the performance of the listed companies. Under this Null hypothesis, owners or compensation committee choose the compensation of the different Directors that maximize the organizational performance. Besides, organizations performance is dependent on the Micro and Macro Economic Environment.

Dependent Variable

Two proxies for organizations performance were used as dependent variables;

ROA (Return on Assets): Estimated by Net Earnings and Losses after Taxes/Book Value of Total Assets. The annual ROA was determined by dividing the total net earnings and losses after tax by the corresponding average total assets. Total assets were averaged in the successive years to smoothen any anomalies.

ROE (Return on Equity): Estimated by Net Earnings and losses after Taxes/Total Owners' Equity. The Annual ROE was determined by dividing the Total Net Earnings and losses after tax by the corresponding average total owners' equity. Owners' equity was averaged in the successive years to smoothen any abnormal functions. The two ratios were calculated from the published financial statements of each organization for the years of study. The use of accounting based measures as opposed to market based is more relevant to the objectives of the study. This is because the market measures such as shareholders return and Tobin's Q, security prices are affected by factors beyond the management's control. Thus accounting information can be more informative with respect to management actions.

Independent Variables;

Board Size (SIZE);

Board size was measured in terms of numbers i.e. the number of members serving in a firm's board.

Board Composition ((PROP NED) ;

The board members are normally identified as executive and non-executive, executive directors are employees of the firm primarily responsible for the management of the company to increase the wealth of the owners because non-executive directors have little involvement in the company's profit-making operations.

Board Compensation (TC);

In this study the total remuneration for the executives' and directors is the sum of fixed component comprising of basic salary, fringe benefits, commissions and directors' fees which would be depicted in the organization's financial statements and the nature of such compensation was also clarified from the information gotten from the questionnaires.

Multiple regression model was used to determine both the nature and the strength of the relationship between the dependent and independent variables. A multiple regression model is one with at least two decision variables and generally expressed as $Y=a + b0X1 + b1X2 + b2X3$

-Where Y is the dependent variable (ROA & ROE) to be predicted. a is the constant term,

-X1(SIZE),

-X2 (PROP NED)

-X3(TC) are the decision variables,

b0. b1 and b3 are the parameters to be estimated and indicate the specific effect of the corresponding variables.

Multiple regressions was selected due to its suitability in examining the joint effect of several variables through the use of student-t, Fisher F, and R2, multiple correlation coefficient, confidence intervals, standard errors and p-level statistics.

Data analysis commenced with the application of Pearson correlation test to examine the decision variables for Multicollinearity. It was however applied on ROE and ROA since these measures of performance are mutually exclusive in the Regression analysis.

CHAPTER FOUR: DATA ANALYSIS AND INTERPRETATION

4.1 Introduction

The main objective of this study was to determine the relationship between Board structure, Board compensation and firm performance measures for companies listed at the Nairobi stock exchange. In order to achieve this objective, multiple regression analysis was performed to establish the relationship between Board structure and performance indicators i.e. ROA, ROE and Profit where Average board structure and compensation were regressed against earnings performance indicators for the same period.

4.2 Data Analysis and Interpretation

4.2.1 Measures of central tendency

Basic analysis begun with the determination of various measures of central tendency; namely mean, mode and median and standard deviation were used as measures of dispersion (variation).
Calculations were carried out for coefficient of correlation (R), coefficient of determination (R2), F test and t- test.

Table 4.1: Descriptive Statistics

	Minimum "000"	Maximum "000"	Mean "000"	Std. Deviation "000"
Profit	4340.00	9884521.00	2014497.4038	2719854.85189
Board Compensation	356.00	219027.00	53350.3077	59689.58188
Executive Directors	1.00	3.00	2.0385	.34418
Non Executive Directors	3.00	14.00	6.9615	2.37454
Board Size	5.00	16.00	9.0000	2.41661
Return on assets	.01	.34	.1400	.08664
Return on equity	.03	5.64	1.9791	1.49318

The Descriptive procedure above displays univariate summary statistics for several variables in a single table and calculates standardized values (z scores). Variables are ordered by the size of their means (descending order). From the analysis performance which was measured by profit, return on

assets and return on equity are displayed in terms of minimum, maximum, mean and std deviation values. The descriptive values for the board compensation, number of executive and non executive directors and the total number of directors are displayed. The minimum values for Profit was 4,340,000, Board compensation 356,000, executive directors 1, Non executive directors 3, Board size 5, ROA 0.01 and ROE 0.03. The maximum values were found to be Profit 9,884,521,000, Board compensation 219,027,000, number of executive directors 3, Non executive directors 14, Board size 16, ROA 0.34 and ROE 5.64. The mean values were Profit 2,014,497,000, Board compensation 53,350,000, number of executive directors 2.04, Non executive directors 6.96, Board size 9, ROA 0.14 and ROE 1.98. The standard deviation was; Profit 2,719,854,000, Board compensation 59,689,000, number of executive directors 0.344, Non executive directors 2.37, Board size 2.42, ROA 0.866 and ROE 1.49.

4.3 Board structure, board compensation and financial performance

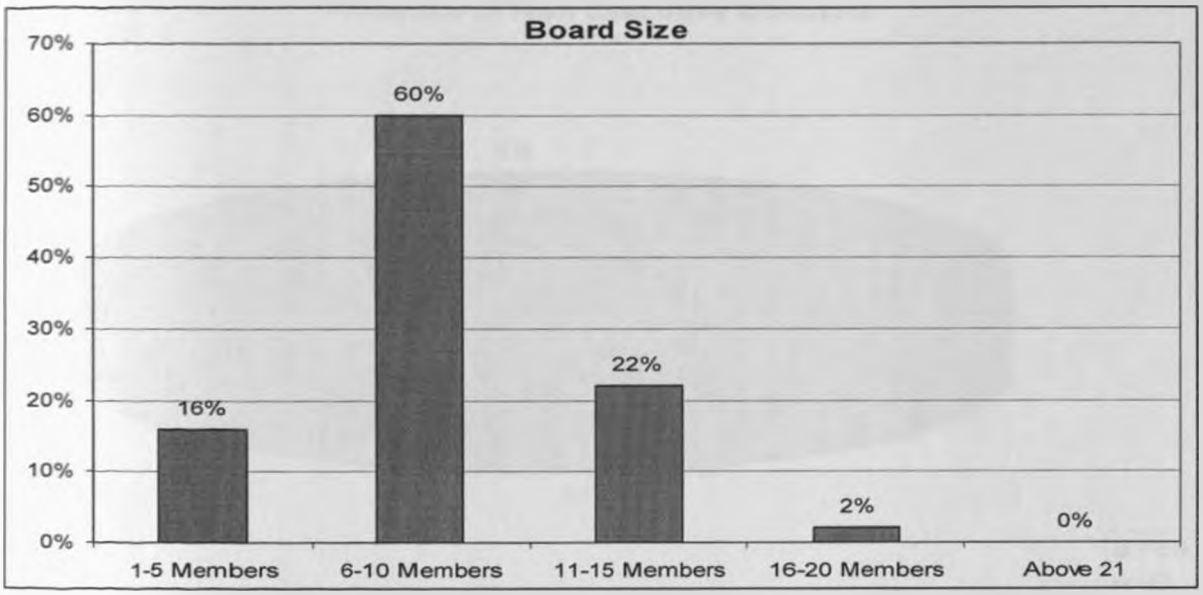
The Coefficient of correlation - R was used to establish the relationship between ROA, ROE and Profit as dependent variables and board structure and compensation as independent variables. A positive R showed a direct relationship while a negative R showed an inverse relationship.

The correlations table displays Pearson correlation coefficients, significance values, and the number of cases with non-missing values. Pearson correlation coefficients assume the data are normally distributed. The Pearson correlation coefficient is a measure of linear association between two variables.

The values of the correlation coefficient range from -1 to 1. The sign of the correlation coefficient indicates the direction of the relationship (positive or negative). The absolute value of the correlation coefficient indicates the strength, with larger absolute values indicating stronger relationships. The correlation coefficients on the main diagonal are always 1.0, because each variable has a perfect positive linear relationship with itself.

4.3.1 Board size and financial performance

Figure 4.1 Board Size



Majority of the listed companies at the Nairobi stock exchange has between 6-10 board members forming 90%, 22% has between 11-15 members, 16% has less than 5 members while 2% has between 16-20 members.

Table 4.2 Correlation between board size and performance

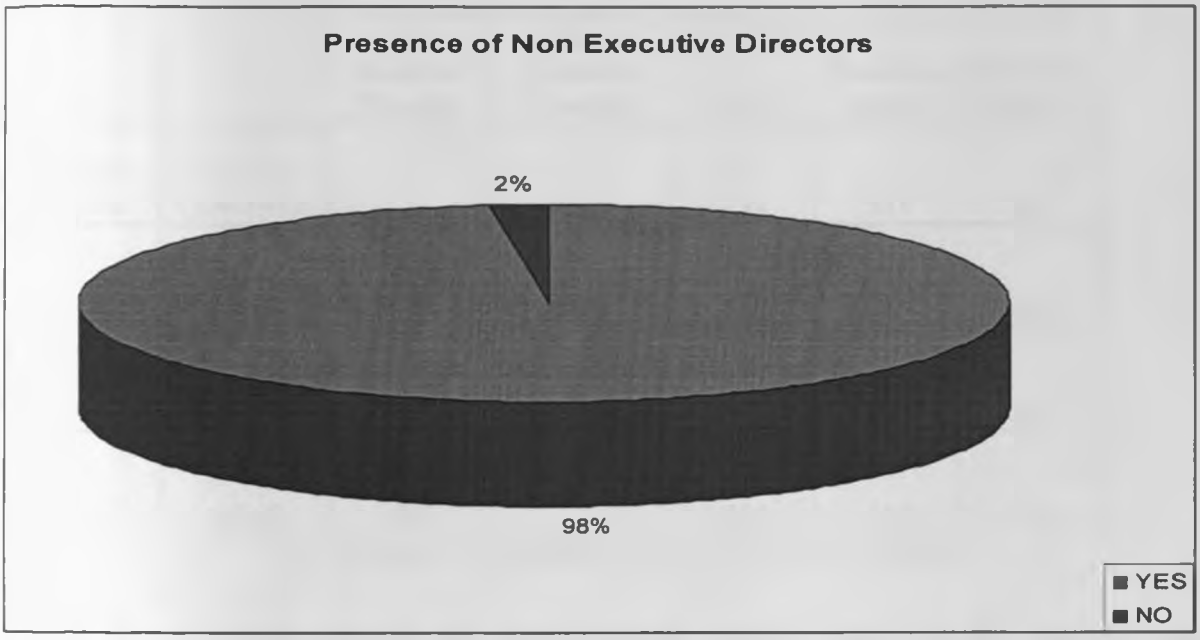
		Board Size	Profit	Return on assets	Return on equity
Board Size	Pearson Correlation	1	.288	.332	-.054
	Sig. (2-tailed)		.154	.098	.793

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

The results shows a positive correlation between board size and financial performance for profit and return on assets and a negative correlation of -0.054 for board size and return on equity as a measure of financial performance. In all the measures of performance there was no significance impact caused by board size as all returned significance levels of over 0.01 significance level. For profit the significance was 0.154, 0.098 for return on assets and 0.793 for return on equity.

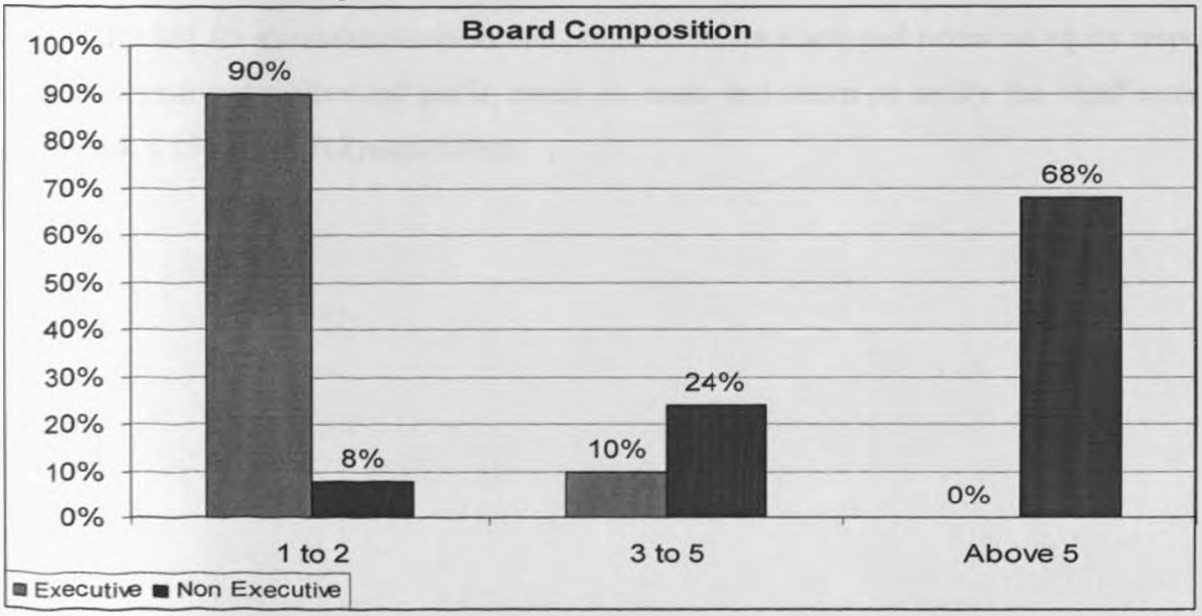
4.3.2 Board composition and financial performance

Figure 4.2 Presence of Non Executive Directors



When asked whether they had Non executive directors on their board, 98% of the listed companies agreed while 2% do not have executive directors

Figure 4.3 Board Composition



Majority of the listed companies 90% have between 1-2 executive directors while 68% have over 5 non executive directors, 24% have between 3-5 non executive directors and 8% have between 1-2. 10% of the listed companies have between 3-5 executive directors.

Table 4.3 Correlation between Board composition and performance

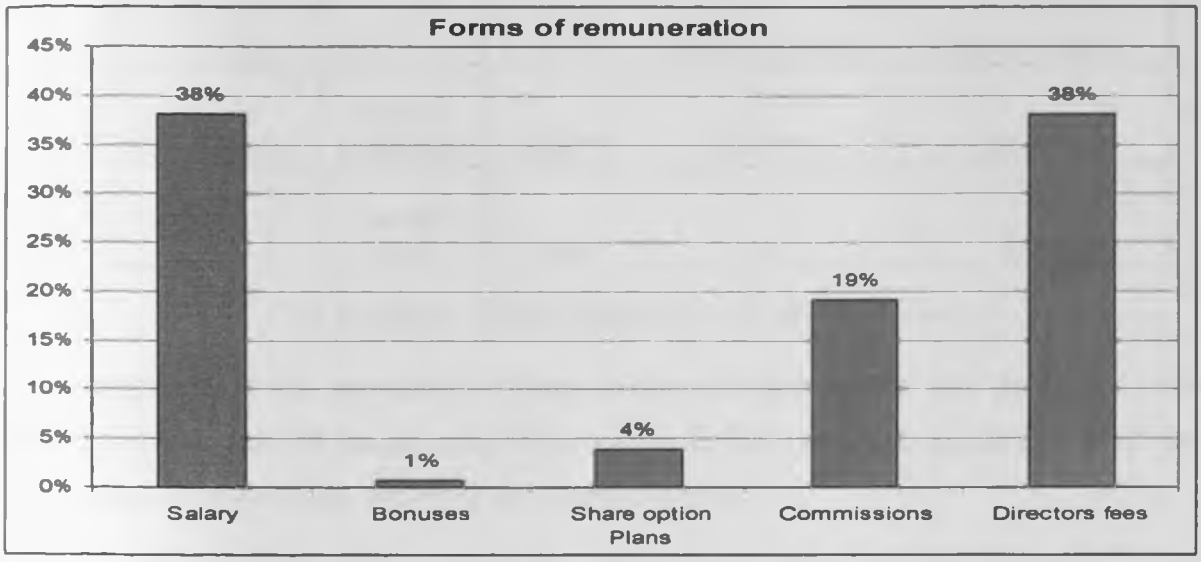
		Executive Directors	Non Executive Directors	Profit	Return on assets	Return on equity
Executive Directors	Pearson Correlation	1	.051	.279	.343	.164
	Sig. (2-tailed)		.805	.167	.086	.425
Non Executive Directors	Pearson Correlation	.051	1	.252	.288	-.079
	Sig. (2-tailed)	.805		.214	.154	.702

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

Number of executive directors and non-executive directors was used to represent the board composition which was correlated to the financial performance measures i.e. profit, return on assets and return on equity. The results showed a positive relationship for all the measures of performance except between non-executive directors and return on equity. The significance levels were 0.279, 0.343 and 0.164 for executive directors and profit, return on assets and return on equity respectively. For non-executive directors and profit, return on assets and return on equity the significance levels were 0.214, 0.154 and 0.702 respectively.

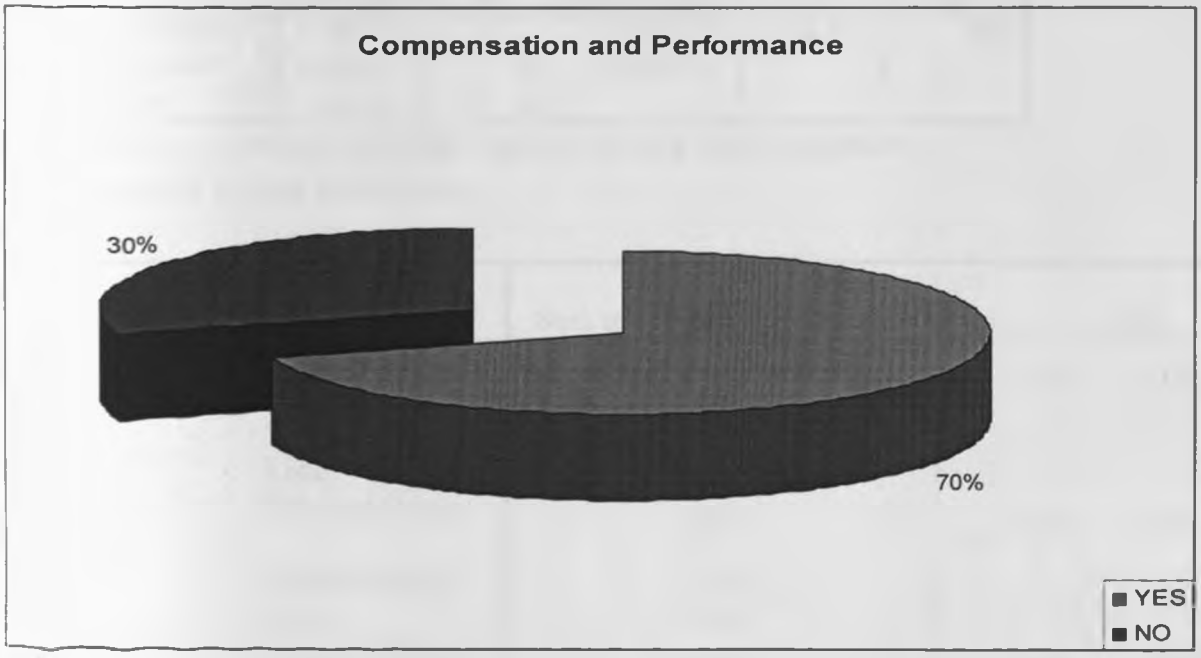
4.3.3 Board compensation and financial performance

Figure 4.4 Forms of Remuneration



The listed companies 38% indicated to be paying their board members salary and director's fees respectively, 19% of the respondents pay commissions, 4% pay share option plans while 1% pay bonuses.

Figure 4.5 Compensation and Performance



When asked whether compensation of Directors is related with some performance indicator (profit, cash flow, and earnings per share) 70% agreed while 30% disagreed.

Table 4.4 Correlation between Board compensation and performance

		Profit	Return on assets	Return on equity
Board Compensation	Pearson Correlation	.865(**)	.625(**)	.508(**)
	Sig. (2-tailed)	.000	.001	.008

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

Board compensation was correlated to forms of financial performance with the results indicating a positive correlation for all the measures of performance. There was high significance levels for profit, 0.000, return on assets 0.001 and 0.008 for return on equity.

4.4 Advanced Analysis

Table 4.5: Analysis of Variance (ANOVA)

ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1.39E+14	3	4.631E+13	22.137	.000[a]
	Residual	4.60E+13	22	2.092E+12		
	Total	1.85E+14	25			

a. Predictors: (Constant), Board Size, Executive Directors, Board Compensation

b. Dependent Variable: Perfromance

		Sum of Squares	Mean Square	F	Sig.
Board Compensation	Between Groups	89071154613.538	356284618 4.542	0.00	0.00
	Within Groups	.000	.		
	Total	89071154613.538			
Executive Directors	Between Groups	2.962	.118	0.00	0.00
	Within Groups	.000	.		
	Total	2.962			
Non Executive Directors	Between Groups	140.962	5.638	0.00	0.00
	Within Groups	.000	.		
	Total	140.962			

Board Size	Between Groups	146.000	5.840	0.00	0.00
	Within Groups	.000	.		
	Total	146.000			
Return on assets	Between Groups	.188	.008	0.00	0.00
	Within Groups	.000	.		
	Total	.188			
Return on equity	Between Groups	55.740	2.230	0.00	0.00
	Within Groups	.000	.		
	Total	55.740			

The above table summarizes the results of an analysis of variance. The sum of squares, degrees of freedom, and mean square are displayed for two sources of variation, regression and residual. The output for Regression displays information about the variation accounted for.

A model with a large regression sum of squares in comparison to the residual sum of squares indicates that the model accounts for most of variation in the dependent variable. Very high residual sum of squares indicate that the model fails to explain a lot of the variation in the dependent variable. The mean square is the sum of squares divided by the degrees of freedom. The F statistic is the regression mean square (MSR) divided by the residual mean square (MSE).The regression degrees of freedom is the numerator df and the residual degrees of freedom is the denominator df for the F statistic. The total number of degrees of freedom is the number of cases minus 1.

If the significance value of the F statistic is small (smaller than say 0.05) then the independent variables do a good job explaining the variation in the dependent variable. If the significance value of F is larger than say 0.05 then the independent variables do not explain the variation in the dependent variable.

Table 4.6: Regression model summary

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.867[a]	.751	.717	1446306.40

a. Predictors: (Constant), Board Size, Executive Directors, Board Compensation

This table displays R, R squared, adjusted R squared, and the standard error. R is the correlation between the observed and predicted values of the dependent variable. The values of R range from -1

to 1. The sign of R indicates the direction of the relationship (positive or negative). The absolute value of R indicates the strength, with larger absolute values indicating stronger relationships.

R squared is the proportion of variation in the dependent variable explained by the regression model. The values of R squared range from 0 to 1. Small values indicate that the model does not fit the data well. The sample R squared tends to optimistically estimate how well the models fit the population. Adjusted R squared attempts to correct R squared to more closely reflect the goodness of fit of the model in the population.

Table 4.7: Regression coefficients

Coefficients [a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	45446.817	1981288		.023	.982
	Board Compensation	39.441	5.343	.866	7.382	.001
	Executive Directors	-261456	902406.2	-.033	-.290	.775
	Board Size	44205.560	125862.3	.039	.351	.729

a. Dependent Variable: Performance

The unstandardized coefficients are the coefficients of the estimated regression model. Often the independent variables are measures in different units. The standardized coefficients or betas are an attempt to make the regression coefficients more comparable. The t statistics determines the relative importance of each variable in the model. As a guide regarding useful predictors, look for t values well below -2 or above +2. Thus from the above table, board compensation was found to be a useful predictor as it had 7.382 t-value with significance level of below 0.05.

CHAPTER FIVE: SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary of findings

The minimum values for Profit was 4,340,000, Board compensation 356,000, executive directors 1, Non executive directors 3, Board size 5, ROA 0.01 and ROE 0.03. The maximum values were found to be Profit 9,884,521,000, Board compensation 219,027,000, number of executive directors 3, Non executive directors 14, Board size 16, ROA 0.34 and ROE 5.64. The mean values were Profit 2,014,497,000, Board compensation 53,350,000, number of executive directors 2.04, Non executive directors 6.96, Board size 9, ROA 0.14 and ROE 1.98. The standard deviation was; Profit 2,719,854,000, Board compensation 59,689,000, number of executive directors 0.344, Non executive directors 2.37, board size 2.42, ROA 0.866 and ROE 1.49.

Board compensation was found to be a useful predictor as it had 7.382 t-values with significance level of below 0.05. Board compensation had a significant impact of the performance of the listed companies with ROA having a Pearson correlation of 0.625, ROE 0.508 and profit 0.85 with significance levels of 0.000, 0.001 and 0.000 respectively. However there were no significant impact for Board structure vis-à-vis firms performance; Number of executive directors had a significance of 0.086 and 0.425 for ROA and ROE respectively. Number of non executive directors had a significance of 0.154 and 0.702 for ROA and ROE respectively while Board size had a significance of 0.098 and 0.793 for ROA and ROE respectively.

Majority of the listed companies at the Nairobi stock exchange has between 6-10 board members forming 90%, 22% has between 11-15 members, 16% has less than 5 members while 2% has between 16-20 members. When asked whether they had Non executive directors on their board, 98% of the listed companies agreed while 2% do not have executive directors. Majority of the listed companies 90% have between 1-2 executive directors while 68% have over 5 non executive directors, 24% have between 3-5 non executive directors and 8% have between 1-2. 10% of the listed companies have between 3-5 executive directors. The listed companies 38% indicated to be paying their board members salary and director's fees respectively, 19% of the respondents pay commissions, 4% pay share option plans while 1% pay bonuses. When asked whether compensation of Directors is related

with some performance indicator (profit, cash flow, and earnings per share) 70% agreed while 30% disagreed.

5.2 Conclusion

This study concludes that there is strong relationship between board compensation and earnings performance measures while there is no established relationship between board structure and earnings performance measures as evidenced by the low proportions of total variations in the dependent variables (PROFIT, ROA & ROE) explained by the variations in the independent variables (Board structure).

5.3 Areas for further Research.

Further research on board structure, board compensation and earnings based performance measures could focus on the following areas:

- This study focused on determining whether there exists a relationship between board structure, board compensation and earnings performance measures for companies listed at Nairobi stock exchange. An improvement on this study would be to extend this study to include companies not listed at Nairobi stock exchange.
- A study could also be undertaken to establish the relationship if any between firm size, cash flows and earnings performance measures.

5.4 Limitations of the study.

Considering that it is difficult to have a perfect research situation, it is then expected that this research will had some limitations. There is need to highlight some of these limitations so that the conclusions can be understood in view of the weaknesses of the research study.

Some of the limitations of this research study are:

- Computations of earnings performance measures are based on accounting data. Accounting practices differ between firms and this may introduce bias into the study.

- The study focused only on the companies listed at Nairobi stock exchange. However, there are less than sixty companies that are listed while there are many other unlisted private companies operating in Kenya. Consequently, the findings of this study cannot be generalized.

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APPENDIX 1: LETTER OF INTRODUCTION

LETTER OF INTRODUCTION

Dear respondent,

This questionnaire is intended to collect information about board compensation in all the companies quoted on the Nairobi Stock exchange. It is intended to collect data purely for academic purposes for the project proposal paper in partial fulfillment of the requirements for the degree of Master of Business Administration from University of Nairobi.

The information in the questionnaire will be treated with confidentiality and in no instance will your name be mentioned in this research. The information provided will not be used for any other purpose other than for this research.

Your assistance in facilitating the same will be highly appreciated.

Thank you in advance.

Yours Sincerely,

....

MBA STUDENT **SUPERVISOR**

APPENDIX II: QUESTIONNAIRE

INSTRUCTIONS

Tick the appropriate response.

1. What is the size of your board composition?
   a. 1-5
   b. 6-10
   c. 11-15
   d. 16-20
   e. 21 and above

2. Do you have non- executive directors in your board composition?

   a. Yes
   b. No

3. What is the composition in terms of numbers of the executive and non-executive Directors in your board?

   i. Executive .....
   ii. Non- Executive.....

4. There are various forms of Directors remuneration in Kenya, including but not limited to;
   i. Salary
   ii. Bonuses
   iii. Share option plans.
   iv. Commissions
   v. Directors fees

   What form of compensation are Directors entitled to in you company?.....

5. Is compensation of Directors related with some performance indicator (profit, cash flow, earnings per share?)

   Yes..... No.....

APPENDIX III: LIST OF LISTED COMPANIES

	AGRICULTURAL
1	Eaagads Ltd Ord 1.25
2	Kapchorua Tea Co. Ltd Ord Ord 5.00
3	Kakuzi Ord.5.00
4	Limuru Tea Co. Ltd Ord 20.00
5	Rea Vipingo Plantations Ltd Ord 5.00
6	Sasini Ltd Ord 1.00
7	Williamson Tea Kenya Ltd Ord 5.00
	COMMERCIAL AND SERVICES
8	Express Ltd Ord 5.00
9	Kenya Airways Ltd Ord 5.00
10	Nation Media Group Ord. 2.50
11	Standard Group Ltd Ord 5.00
12	TPS Eastern Africa (Serena) Ltd Ord 1.00
13	Scangroup Ltd Ord 1.00
14	Uchumi Supermarket Ltd Ord 5.00
15	Hutchings Biemer Ltd Ord 5.00
	TELECOMMUNICATION AND TECHNOLOGY
16	AccessKenya Group Ltd Ord. 1.00
17	Safaricom Ltd Ord 0.05
	AUTOMOBILES AND ACCESSORIES
18	Car and General (K) Ltd Ord 5.00
19	CMC Holdings Ltd Ord 0.50
20	Sameer Africa Ltd Ord 5.00
21	Marshalls (E.A.) Ltd Ord 5.00
	BANKING
22	Barclays Bank Ltd Ord 2.00
23	CFC Stanbic Holdings Ltd ord.5.00
24	Diamond Trust Bank Kenya Ltd Ord 4.00
25	Housing Finance Co Ltd Ord 5.00
26	Kenya Commercial Bank Ltd Ord 1.00
27	National Bank of Kenya Ltd Ord 5.00
28	NIC Bank Ltd 0rd 5.00
29	Standard Chartered Bank Ltd Ord 5.00
30	Equity Bank Ltd Ord 0.50
31	The Co-operative Bank of Kenya Ltd Ord 1.00
	INSURANCE
32	Jubilee Holdings Ltd Ord 5.00
33	Pan Africa Insurance Holdings Ltd 0rd 5.00

34	Kenya Re-Insurance Corporation Ltd Ord 2.50
35	CFC Insurance Holdings
	INVESTMENT
36	City Trust Ltd Ord 5.00
37	Olympia Capital Holdings ltd Ord 5.00
38	Centum Investment Co Ltd Ord 0.50
39	Trans-Century Ltd
	MANUFACTURING AND ALLIED
40	B.O.C Kenya Ltd Ord 5.00
41	British American Tobacco Kenya Ltd Ord 10.00
42	Carbacid Investments Ltd Ord 5.00
43	East African Breweries Ltd Ord 2.00
44	Mumias Sugar Co. Ltd Ord 2.00
45	Unga Group Ltd Ord 5.00
46	Eveready East Africa Ltd Ord.1.00
47	Kenya Orchards Ltd Ord 5.00
48	A.Baumann CO Ltd Ord 5.00
	CONSTRUCTION AND ALLIED
49	Athi River Mining Ord 5.00
50	Bamburi Cement Ltd Ord 5.00
51	Crown Berger Ltd 0rd 5.00
52	E.A.Cables Ltd Ord 0.50
53	E.A.Portland Cement Ltd Ord 5.00
	ENERGY AND PETROLEUM
54	KenolKobil Ltd Ord 0.05
55	Total Kenya Ltd Ord 5.00
56	KenGen Ltd Ord. 2.50
57	Kenya Power & Lighting Co Ltd