THE RELATIONSHIP BETWEEN CORPORATE GOVERNANCE AND FINANCIAL PERFORMANCE OF PARASTATALS IN KENYA

BY

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DECLARATION

I declare that this research project is my original work and has never been submitted to any other university for assessment or award of a degree.

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

Signature……………………………………. Date ………………………………………

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DEDICATION

I dedicate this project to the Republic of Liberia through the General Auditing Commission for their sponsorship, and to my deceased father, Thomas T. Guzeh.

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Attainment of post-graduate Studies has finally been made a dream comes true in my academic sojourn. This journey has not been an easy one. It has been a blend of tireless effort, sleepless nights and challenges meant to make me a whole and complete person in the realm of academia. However, these conditions fulfilled this journey through the instrumentality, contributions and support from astute individuals who directly or indirectly contributed immensely to this process. Therefore, this paper will be incomplete if the contributions and support of these individuals were not acknowledged.

I first like to acknowledge the Almighty God for his bountiful blessings bestowed upon me throughout the period of this study. I also greatly acknowledge John S. Morlu, II, former Auditor General of the Republic of Liberia, for his preferment in selecting me as one of the 33 staff in pursuit of higher education at the University of Nairobi. The invaluable role of Dr. Josiah Aduda, who prioritized the speedy completion of this work through his supervision, is highly appreciated. I also want to give special acknowledgement to my family and friends for their support and patience while I pursue this program far away from home. I also like to, in a very special way, recognize the enormous effort of my Dad, Thomas T. Guzeh for his countless contribution toward my education and for his words of motivation while I was away pursuing this program. Unfortunately, he predeceased the conclusion of this study.

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ABSTRACT

Recent and continuous global events involving major corporate and business failures continue to reverberate the importance of good corporate governance as a catch phrase necessary for ensuring the financial health and viability of business entities so that the interests of all stakeholders are protected and to prevent the unfair dominance of the interests of any stakeholder over those of the others. Studies on Corporate governance have mainly focused on private firms. Inefficiency, financial impropriety and mismanagement have characterized most public sector financial management. Therefore, corporate governance needs to be emphasized as a means of revitalizing government's investment and increasing profitability of parastatals. This study sought to establish the relationship between corporate governance and financial performance of parastatals in Kenya. The financial performance parameter used for the study was return on asset while four attributes of corporate governance practice were used, namely, board size, board structure, multiple directorship and audit committee.

The study used descriptive research design. The population was 127 parastatals and a sample of 30 was chosen for the study. Data were obtained from 27 of the 30 selected parastatals and analyzed using descriptive statistics and multiple regression analysis between April 2012 and July 31, 2012. In general, the study found that there exists a positive relationship between corporate governance and return on asset. This implies that good corporate governance practices enhance financial performance of parastatals. Therefore, policy makers and management of parastatals must ensure that tenets of good corporate governance should be applied to the latter to enhance performance.

TABLE OF CONTENTS

LIST OF TABLES

ABBREVIATIONS

Abbreviations	Meaning
AC	Audit Committee
BS	Board Structure
BSz	Board Size
BVTA	Book Value of Total Asset
CACG	Commonwealth Association of Corporate Governance
CBK	Central Bank of Kenya
CED	CEO Duality
CEO	Chief Executive Officer
CG	Corporate Governance
CMA	Capital Market Authority
GDP	Gross Domestic Product
GoK	Government of Kenya
IMF	International Monetary Fund
Ksh	Kenyan Shilling
MD	Multiple Directorship
M(PAT)	Mean of Profit After Tax
MVE	Market Value of Equity
NSE	Nairobi Security Exchange
OECD	Organization for Economic Cooperation and Development
PM	Profit Margin
ROA	Return on Asset
ROE	Return on Equity
ROI	Return on Investment
SC	State Corporation
SPSS	Statistical Packages for Social Sciences
U.S	United States

CHAPTER ONE

INTRODUCTION

1.1 Background of the study

The study derives from the fact that competition within the global business environment has continued to get intense and complex thereby increasing the scramble for more resources and increment in perceived better performance and economic standard of good business health. With global market and large scale productions, the size and capital requirement of firms have sharply risen and performance requirement has placed huge burden on managers as they strive to ensure that firm performance is enhanced. However, incidence occurring between 2000 and 2002 revealed the uncovering of various unethical practices undertaken by management to present a profitable picture of their entities. The scandals of WorldCom, Enron, Global Crossing amongst others presented a misleading picture of financial status and financial manipulations by management and auditors. These situations served as an impetus in strengthening regulations and highlighting corporate governance in the U.S. and other countries. The Sarbanes-Oxley Act, for example, was passed by the U.S. Congress in 2002 regulating corporate governance (Byrnes et al, 2003) expanding corporate oversight and bringing a new dimension toward corporate responsibility and disclosure both by those in charge of governance and management. OECD (2001) indicates that corporate governance involves the direction and control of the organization.

Corporate governance is of significance to the growth, expansion and stability of the economy. It enhances investors' confidence as well as provides platform for ensuring that duty of loyalty by managers to shareholders exist and that managers will efficiently and effectively strive to maximize the firm's wealth (Kihumba, 1999). According to the McKinsey and Company Investor Opinion Survey (2000), more than 80% of investors are willing to pay for the shares of well-governed firms than poorly governed firms of comparable financial performance.

1.1.1 Overview of Parastatals in Kenya

The State Corporation Act Cap 446 (1987) defines a parastatal as a state corporation (SC) or a corporate body established by or under an Act of parliament; it is also a corporate body established by order of the president to perform the functions specified in that order; it also includes a bank or a financial institution licensed under the banking Act or other company incorporated under the company Act whose shares or majority of whose shares are owned by the government of Kenya or by another state corporation (Government of Kenya, 1987; Wamalwa, 2003).

Government the world over including Kenya established parastatals with both economic and public policy motives. The government of Kenya forms parastatals to meet both commercial and social goals. They exist for various reasons including: to accelerate economic social development, to redress regional economic imbalance, increase Kenyan citizen's participation in the economy and to promote foreign direct investment through joint ventures (GoK- Sessional Paper No. 4, 2005). The economic motive arose out of the government desire to promote or enhance private African enterprises (Wamalwa, 2003), since after independence, most private enterprises and entrepreneurships were European owned while a bulk of the locals were lacking in undertaking such business ventures. Establishing parastatals was also viewed as a means of generating other non-tax revenue for the government in order to support the country's agenda. On the other hand, despite the high level of commercial and economic intents, parastatals were established with public policy motive in the conduct of their operations. They are required to serve as a stabilizer of highly profit oriented capitalists whose goal is profit maximization. They therefore stand as a bridge in providing goods and services to the general public at a much lower affordable prices compared to the private firm.

At independence in 1963, parastatals were retooled by Sessional Paper no. 10 of 1965 into vehicles for the indigenization of the economy. Thus majority of key parastatals that exist today were established in the 1960s and 1970s. By 1995, there were
240 state corporations. The number currently stands at 127.

The financial performance of parastatals in Kenya has continuously been unimpressive to the public, which to a larger extent are its majority shareholders. The dismal performance can be largely attributed to lack of discipline in expenditure pattern, mismanagement, wastage, poor governance and lack of adequate supervision both by management and regulatory bodies (Sessional Paper No.4, GoK 1991). These mismanagement and poor governance practices have led to parastatals not achieving their objectives, rather most have lagged in the delivery of the required services, failed to meet the demands of the consuming public, while most services provided were poor and unreliable, thereby making the public to lack confidence in the performance of state-owned enterprises.

Consequently, the parastatals became a liability to national government instead of been a profit-driven investment vehicle. Billions of shillings flowed out of central government accounts to sustain the parastatals. By 1991, about 1 percent of GDP flowed out of central government account as subsidies to parastatals because of dismal performance in the previous year. Between 1990 and 1992, the GoK had transferred about Ksh 7.2 billion as direct subsidies and Ksh. 14.2 billion as indirect subsidies to parastatals in Kenya. 5.5 percent of the country GDP was paid as subsidies to parastatals by 1994 (Miringu, 2009). This situation seemingly reflected on the general performance of parastatals in Kenya. As a result, it heightened the GoK drives to redefine the objectives for the establishment of parastatals, setting performance targets and instituting measures geared toward enhancing performance. After the GoK realized that measures of enhancing performance was not all together successful, the government, then, embarked on a massive divestiture and privatization program aimed at raiding the public sector of non-performing parastatals (Kamung'a, 2000).

1.1.2 Principles of Good Corporate Governance

The enhancement of corporate accountability and governance framework rely largely on understanding the underlying principles of corporate governance. These principles serve as invaluable catalyst in enhancing corporate performance. The essential corporate governance principles, according to Government of Australia (2003), include laying solid foundations for management and oversight by recognizing and publishing the respective roles and responsibilities of board and management; structuring the board to add value to the entity; promoting ethical and responsible decision making; safeguarding integrity in financial reporting; disclosing on a timely basis all material matters concerning the entity; respecting the rights of shareholders; establishing a system of risk oversight and internal control; enhancing board and management performance; remunerate fairly and responsibly all officials and recognize legal and other obligations to all legitimate stakeholders. The Commonwealth Association of Corporate Governance (CACG, 1999) sets out well-organized benchmark principles to be used within the Commonwealth. These principles highlight accountability, transparency and disclosure in corporate matters.

1.1.3 Importance of Corporate Governance in Parastatals in Kenya

Parastatals in Kenya are organizations wholly owned or owned in part by the GoK with objectives ranging from public policy implementation to profit making. Thus, it is the citizens who are represented by the government that are shareholders in these entities. Accordingly, the GoK has a responsibility to enhance the value of its assets through the efficient delivery of public services where the public socio-economic needs of its citizenry are required or through optimizing profits where profit motives are expected. However, conflicts usually arise between attaining set motives (provision of affordable services to the underprivileged and the rational expectation on making return on invested capital). These objectives are attainable only through the establishment and enforcement of appropriate governance mechanisms. Therefore corporate governance in the parastatals mitigates wastage, pilferage, bureaucratic abuses and financial impropriety in the financial and administrative management. Thus corporate governance induces accountability, transparency and financial probity in the parastatals thereby enhancing their integrity, restoring public and investors' confidence, attaining policy objectives and commercial imperatives of effectively utilized assets (CACG, 1999).

Effective corporate governance is important to parastatals in Kenya it influences and enhances firms' performance. It clearly delineates the role of the board and management, enabling the board to perform its oversight role while management performs its day-to-day functions; corporate governance in the parastatals also mitigates the agency conflict thereby prioritizing the state interest over individual management's interest. Moreover, transparency and full disclosure exert pressure to perform, as public pressure and outcry can render management as incapable, which can lead to dismissal. Good Corporate Governance also serves a motivator for employees which tremendously benefit any organization, as happy workers will more likely produce more, thus enhancing the firm's financial performance, and staying loyal to the organization (OECD, 2005).

The relevance of good corporate governance cannot be over-emphasized since it constitutes the organizational climate for internalizing success in the activities of a company. Corporate governance brings new outlook and enhances a firm's corporate entrepreneurship and competitiveness (Kihara, 2006). Stakeholders can demand change in management if the firm does not provide the required services for which they were established. Success in the provision of these services is interpreted as good corporate governance (Wachter et al., 2001).

1.1.4 Financial Performance of Firms

A firm financial performance is a measure of how well it uses its assets from its core operations and generates revenues over a given period of time. This measure is thus compared to some given industrial average standard of similar firms in the same industry. Brealey, Myers and Marcus (2009) measure financial performance in terms of profitability, liquidity, solvency, financial efficiency and repayment capacity. However, the performance measure significant for this study is the return on asset (ROA).

The study uses ROA as a key performance indicator for parastatals in Kenya. This measure is an indicator of how profitable a firm is relative to its total assets. The ROA portrays how efficient management is at utilizing its asset to generate earnings. It is calculated by dividing net income by average total asset. The result is then converted to percentage. The higher this percentage the more a company has generated from smaller investment. On the other hand, a smaller ROA indicates that despite a higher investment of resources, the firm profit generated is lower (Pandey, 2010).

1.2 Statement of the research problem

Corporate governance has taken center stage in the modern global business arena. It is defined as the general set of customs, regulations, policies and laws that are determined to achieve the economic health of the firm thereby maximizing the wealth of its owners and other stakeholders. Corporate governance involves focusing on the interest of directors, shareholders, employees and other stakeholders and how these interest can be expressed, aligned and reconciled to enhance the financial performance of the firm and to achieve long term strategic goals to satisfy its stakeholders. These desires, in today's society, have made corporate governance a catch phrase in the business environment and have prompted a lot of studies on the topic. Intermittent turmoil in the business environment, market failures, willful misrepresentation of material facts and financial crises owing largely to governance issues, coupled with changing circumstances in the business environment continue to necessitate the drive for more research in corporate governance (Muthukumar, 2009).

These changes required that corporate governance practices will continue to evolve as on-going development in global business also continues to change. There is no one size fits all model of good corporate governance that leads to higher firm performance. In fact, despite the numerous studies conducted on this topic, there has not been an all inclusive single finding agreed to by the various researchers. There have been diverse findings by different researchers in establishing the relationship between corporate governance and the financial performance of firms. What is widely acclaimed is that the governance structure of the firm affects its ability to respond to externalities that bear on its performance (Berglof and Von Thadden, 1999, Bebchuk, Cohen & Ferrell, 2004).

Atieno (2009) stressed that most parastatals in Kenya are characterized by inefficiency, losses and the provision of poor products and services. These conditions were a consequence of poor governance, poor public sector financial management, bureaucratic wastage and pilferage in the management of parastatals, all of which subsequently led to heavy budgetary burden to the public. As a result, The IMF and World Bank in 1994 proposed the privatization of parastatals in Kenya.

Some studies have concluded that well-governed firms perform better (Charkham, 1995; Bebchuk, Cohen & Ferrell, 2004; Stanwick and Stanwick 2002, Kamung'a, 2000; Wambua, 2009, Kihara, 2006); yet, other studies have found there is no difference in the performance of firms having poor and excellent quality of governance. Hence, no significant relationship (Lamport et al, 2010) exists between the variables. This broad spectrum of findings suggests that the relationship between CG and FP may not be consistent across firm specific context or for all types of CG attributes. Some studies found a mixed finding, indicating that some elements of corporate governance has significant effect on firm's performance whereas other elements enhance performance (Javed &Iqbal, 2007).

In Kenya, Wambua (2009) conducted a study on corporate governance practices of commercial banks; Kamung'a (2000) in an unpublished thesis, study focused on private firms but also mentioned a number of issues in corporate governance. Kihara (2006) carried out a study to establish the relationship between, ownership structure, Governance Structure and Performance among the firms listed with the Nairobi Security Exchange.

Despite numerous studies conducted in corporate governance, corporate failures, bankruptcy and managerial inefficiency continue to pose serious challenge to investment. There still exists a gap that has necessitated this particular research. Most studies on corporate governance in Kenya have concentrated largely on private firms especially those listed on the NSE and ignoring to a large extent the governance practices and financial performance of state-owned entities, especially the parastatals in Kenya. This study will therefore seek to address this knowledge gap. Therefore, the research will seek to answer the following question: how does corporate governance relate to performance of parastatals in Kenya? Which corporate governance attribute significantly has a positive effect on performance?

1.3 Research objectives

This study aims to meet the following objective:

i. To establish the relationship between corporate governance and financial performance of parastatals in Kenya

1.4 Significance of the research

i. To the Policymakers

Decision makers at the various levels of management at the parastatals will gain value added information corporate governance as a key enabler of developing economic perspective. The government of Kenya will also be able to understand how politics impacts on corporate governance of state corporations. This will assist the government to improve on areas that negatively impact corporate governance in parastatals in Kenya in order to enhance productivity.

This study is also significant to policy makers of the Republic of Liberia (RL). As most parastatals continue to perform dismal in the post-war country, it is anticipated that policy makers will replicate findings from the study that best suit the Liberian scenario which will improve governance in the parastatals.

ii. To Management of Parastatals

Management of parastatals will benefit from the findings of this study by adopting findings which will help them enhance responsible governance which lead to sustained productivity and better financial performance.

iii. To the Academicians

Those in the academic realm cannot be forgotten too. Future researchers and academic institutions, especially those of higher learning can use the findings of this research as a source for future reference.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter highlights the concept of corporate governance, some of its definitions and its importance in the financial health of a firm. The chapter also briefly presents relevant theories that support and explain various issues in corporate governance and provides an insight of corporate governance attributes significant to the study, as well as reviews some of the empirical studies that have been conducted on the topic which have explained the relationship between both the corporate governance attributes and practices and the firm's financial performance. A summary of the empirical studies concludes the chapter.

2.1.1 Overview of Corporate Governance

Corporate governance has been the major theme making headline in business over the past two decades. Major accounting failures at Enron and other corporations have dented investors' confidence and raised more questions on managerial ethics, efficiency and effectiveness of company internal controls and governance. Thus, it implies that corporate governance mechanisms are enhanced and enforced in other to mitigate the business anomalies. Corporate governance therefore involves ensuring that the right decisions are made at the right time. Donaldson and David (1991) defines corporate governance as referring to the private and public institutions, including laws, regulations and accepted business practice, which in a market economy govern the relationship between corporate managers and entrepreneurs (corporate insiders) on the one hand, and those who invest resources in corporations (corporate outsiders), on the other hand.

Because of its importance in the promotion of better business and efficient and effective performance, good corporate governance has been emphasized through the participation of an increasing number of parties. In Kenya, the campaign for good corporate governance has been led by regulatory authorities such as the capital market authority (CMA), the Nairobi Security Exchange (NSE) formerly the Nairobi Stock Exchange, and the Central Bank of Kenya (CBK). Corporations and institutional investors, as well as shareholders have also stressed good corporate governance practices and have developed or issued guidelines to enhance good governance and corporate responsibility in running the affairs of various corporate bodies. International organizations are also very keen on governance issues. In 1998, the OECD developed a comprehensive guidelines outlining corporate governance practices for member countries and encouraging their incorporation into legal and regulatory mechanisms. The International Monetary Fund (IMF) has stressed good corporate as one of the requirements of debt relief for nations needing the fund's assistant.

2.2 Theoretical Review

This section reviews significant theories in corporate governance which are relevant to this study. The relevant theories include agency theory, stewardship theory, stakeholder theory, political theory, resource dependency theory and transaction cost theory

2.2.1 Agency Theory

Berle and Means (1932) discuss issues surrounding the separation between ownership and control in large firms, and became widely accepted when Jensen and Meckling (1976) formulated the agency problem in the governance of firms. The theory is defined as the relationship between the principals (shareholders) on the one hand and the agents

(CEOs and Managers) on the other hand. The principals (shareholders) usually dedicate their authority to agent (managers) who are employed to work toward maximizing the value of the firm. However, according to the agency theory, shareholders' wealth maximization may not work because of moral hazard. That is, the agents (managers), with whom shareholders have entrusted the operations of their firm, will act opportunistically to attain their own interest instead of the principals' (shareholders), thus creating the agency conflict. The main concern of this theory in corporate governance is to develop rules and incentives to eliminate or minimize the conflict of interest between managers and shareholders. To mitigate the agency problems, Jensen (1983) identifies two steps: the principal-agent risk bearing mechanism must be designed efficiently; and the design must be monitored through the nexus of organizations and contracts. This makes the firm incurs agency costs in ensuring that managers' activities are aligned to the shareholders' wealth maximization.

As a corporate governance solution to the agency conflict, Fama (1980) suggests that the conflict can be controlled efficiently by means of internal mechanisms formulated in response to competition from other firms.

2.2.2 Stewardship Theory

Donaldson and Davis (1991), in their description of the stewardship theory, note that managers are goal-oriented and self-motivated stewards of the firm. They further describe the stewards as executives and managers who work for shareholders, protect and make profit for shareholders. As such, they will work diligently, responsibly and honestly in the interest of the company and its owners. The theory argues that managers should be given freedom to act more autonomously in running the affairs of the firm in order to maximize shareholders' wealth, as failure of the firm will be ascribed to failure by the managers whereas success of the firm will boost their morale and provide bonuses and additional incentives. Thus, they will work more assiduously in attaining success of the firm. On the other hand, managers may feel constrained if controlled by external directors, which may hinder their optimum performance.

The theory was developed as an antithesis or an alternate view to the agency theory (Davis, Schoorman and Donaldson, 1997). Instead of assuming that managers will act opportunistically in their self interest and not the firm, the stewardship theory posits that management will act in the best interest of the firm. As such the principal empowers the steward with all relevant logistics, authority and information to act in the best and most productive interest of the firm thereby increasing its value. The controls employed by principals in the agency theory are lacking in the stewardship theory because proponents of the stewardship theory view controls as de-motivating to managers and may impair their ability to maximize the value of the firm (Argyris, 1964). However, most firms have not adopted this approach despite the upside potential provided by its proponents.

2.2.3 Stakeholder Theory

This theory states that the purpose of the firm is to create wealth or value for all its stakeholders, rather than just only shareholders, by converting their stakes into goods or services (Clarkson, 1994). Stakeholders include any group or individual who has a stake in the achievement of an organization objective. Corporate governance efforts are intended to empower all stakeholders who contribute or control resources and to ensure that their interests are aligned with that of the shareholders.

Freeman (1994) articulates that the focus of stakeholder theory is put forth in two key questions. First, "what is the purpose of the firm?" This encourages management to create a shared sense of the value they create, thus bringing its stakeholders together. This enhances the firm performance. Second, "what responsibility does management have to stakeholders?" This propels to design how they want to do business and how they will relate to their stakeholders in achieving their business goals. In the view of this theory everyone comes together in creating economic value that improves everyone circumstances. In essence, every legitimate person participating in the activities of the firm do so to obtain benefits and their priority is not self-evident.

2. 2.4 Political Theory

Hawley and Williams (1996) recognize that it is the government that allocates corporate power, responsibility and profits between owners and all other stakeholders. Therefore, it is each stakeholders that tries to enhance its bargaining power to negotiate higher allocation in its favor. This theory connotes developing voting support from shareholders rather than vote-buying. Bargaining is of essence.

2.2.5 Resource Dependency Theory

This theory focuses on the role of the board of directors in availing access to resources needed by the organization. This entails that directors play active role in providing or securing resources essential to an organization through their linkages with the external environment (Hillman, Canella and Paetzold, 2000). Because the organization exists in a complex competitive environment, it requires directors who can bring resources and skills to an organization to give it competitive advantage. According to the theory, directors can be classified in to four categories: insiders, composed of former and present executives that provide expertise in specific areas of the firm itself as well as general strategy and direction; business experts who provide expertise on business strategy, decision making and problem solving; the support specialists are those who provide support in specialized fields such as banking, law, insurance or public relations; and the community influentials who are usually politicians, clergymen, university faculty members, leaders of social or community organizations.

2.2.6 Transaction Cost Theory

This theory views the firms as an organization comprising of people with different views and objectives. It assumes that the firm has outgrown to the extent that it substitutes for the market in determining the allocation of resources. This means the organization and structure of the firm determine price and production. The unit of analysis in this theory is the transaction. The theory suggests that managers are opportunists and arrange firms' transactions to their interest (Williamson, 1996).

2.3 Review of Empirical Studies

Bebchuk, Cohen and Ferrell (2004) indicate that well-governed firms have higher firm performance. Pandey (2010) provides financial measures in terms of return on assets (ROA) which is measured by dividing profit after tax by book value of total assets (BVTA); return on investment (ROI) which is found by dividing earnings before interest and tax by total asset; return on equity found by dividing net profit by shareholders equity, and the Tobin Q which is the market value of equity plus book value of debt all divided by book value of total assets. The financial performance measure selected for the study is the return on assets.

2.3.1 Board size and Firm Performance

The board size refers to the number of directors on the board or the number of directors of the board at a given period. The effect of board size on firm performance has been a mixed one. Empirical studies have given mixed finding on the relationship between both variables. Lipton and Lorch (1992) recommend limiting members on a board to seven or eight. A large board could also result in unproductive result as discussing in large group is often difficult and time consuming and sometimes lead to incohesiveness amongst members. Yermack (1996) empirically tested these arguments using 452 large U.S firms and reported a negative relationship between board size and performance. Sundgren and Wells (1998) tested relationship between board size and profitability on small and midsize Finnish Firm and found a negative association between the two. However, Barnhart and Rosentein (1998) found that firms with smaller board size perform better, and are highly valued than those with larger size.

Hermalin and Weisbach (2003) argue in their paper that larger boards can be less effective than smaller boards. They further that too many members on a board may create agency problem, and some members may be considered free rider without corresponding impact to relevant decision making. More recent empirical studies have supported this finding (Jensen, 2003; Lipton and Lorsch, 1992, Yermack, 1996) and noted that large board size can be disadvantageous and expensive for the firm.

On the other hand, Dalton and Dalton (2005) concluded that smaller board may lack the expertise, experience and wise decision that would have otherwise been available around a table of more board members.

2.3.2 Multiple Directorship and firm performance

Chen (2008) in his studies of 923 large firms from 1998 to 2004 on multiple directorship concluded that the multiple directorship have both cost and benefits to the firm. He found that firms with high growth opportunity and low agency conflict need multiple directorships which can be source of beneficial advising and can lead to improvement in firm performance. On the other hand multiple directorships as a result of director's reputation are positively associated with shareholders wealth. A multiple director is a director who sits on multiple boards.

Kajola (2008) seeks to examine the relationship between four corporate governance mechanisms (board size, board composition, chief executive status and audit committee) and two firm performance measures: return on equity (ROE), and profit margin (PM), of a sample of twenty Nigerian listed firms between 2000 and 2006. Using panel methodology as a method of estimation, the results provide evidence of a positive significant relationship between ROE and board size as well as chief executive status. The implication of this is that the board size should be limited to a sizeable limit and that the posts of the chief executive and the board chair should be occupied by different persons. The results further reveal a positive significant relationship between PM and chief executive status. The study, however, could not provide a significant relationship between and board composition and audit committee.

2.3.3 Ownership Structure and Financial Performance of the Firm

Xu and Wang (1997) in the study of ownership structure and its effects on performance of publicly listed firms in China find that ownership structure (both mixed and concentrated) has significant effect on performance. They further that there is a positive correlation between ownership concentration and profitability. They continue that profitability is positively correlated with legal persons or institutional ownership, but is negatively correlated or uncorrelated with state ownership.

Mwangi (2001) did a survey of corporate governance practices among insurance companies in Kenya. He found out that most companies appeared to have addressed governance issues fairly well. He also found out that jointly owned companies had an edge over their locally owned counterparts in governance practices. He concluded that there is a relationship between the level of governance and ownership in as far as companies are categorized into locally or jointly owned.

Lehman, Warning & Weigang (2009) study of 361 German Corporations for the period 1991 to 1996 was to determine whether more efficient governance structures lead to profitability. To determine such, the researchers determined efficiency by comparing the firms with respect to ownership concentration, identity of the owners, capital structure, and firm growth by multi-inputs/ multi output Data Envelop Analysis. Their findings revealed that the efficiency scores indeed contribute significantly to increasing profitability explaining differences between firms even after controlling for industry effects and unobserved systematic effects.

2.3.4 Audit Committee and Financial Performance of Firms

Of late, the Audit committee (AC) has become a common corporate governance mechanism in many countries. The AC has been endorsed by professional and regulatory committees to be adopted by corporate entities. The AC is thought to be effective in overcoming weaknesses in corporate governance and serving as one of the measures in curtailing the agency conflict. The agency framework developed by Jensen and Meckling (1976; Fama and Jensen, 1983) depicts the AC as a means of reducing these agency costs, providing more credibility to the firm, boosting its image which subsequently lead to increased performance.

Kajola (2008) seeks to examine the relationship between audit committee and two firm performance measures: return on equity (ROE) and profit margin (PM) of a sample of twenty Nigerian listed firms between 2000 and 2006. Using panel methodology as a method of estimation, the results could not provide a significant relationship between the two performance measures and audit committee. These results are consistent with prior empirical studies.

2.3.5 Corporate governance and performance of Parastatals in Kenya

Miring'u and Muoria (2011) indicate that in early 1970, many governments in Africa had recognized the fact that SCs were performing poorly. Poor SCs performance was associated with Labor rigidities in the market, increased fiscal and foreign debt and inflation problems. Parastatals provided poor and unreliable services, failed to meet demand and were lagging behind in technology areas like telecommunications. Mismanagement, bureaucracy, wastage, pilferage incompetence and irresponsibility by directors and employees are the main problems that have made SCs to fail to achieve their objectives.

2.4 Summary of empirical studies

There is evidence from the various empirical studies reviewed that efficiency scores indeed contribute significantly to increasing profitability of organizations. This probably explains the differences between firms even after controlling for industry effects and unobserved systematic effects. It was also revealed that the posts of the chief executive and the board chair should be occupied by different persons in order to achieve good corporate governance. The other important finding from the empirical review is that jointly owned companies have an edge over their locally owned counterparts in governance practices. The studies also revealed that small size board size seems to be more effective as it tend to make efficient use of board members whose expertise are required by the firm in an effective manner rather than a large number of board membership which may breed ineffectiveness and may provide additional cost to the firm without a corresponding productivity level as the issue of free rider may exist. A more concentrated ownership structure consisting of legal individuals or firms tend to enhance performance more as compare to a diversely disperse ownership structure and state-ownership as the desire to thoroughly monitor may be lacking.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter discusses the methodology that the researcher employed in the study. The methodology included the research design, the target population, the sampling design and the sample size, the data collection instruments as well as the data analysis techniques that were used to analyze the data.

3.2 Research design

The study adopted a descriptive research design in investigating the relationship between corporate governance and financial performance of parastatals in Kenya. The researcher conducted a survey of parastatals based in Nairobi. Descriptive research design allowed the researcher to study the elements in their natural form without making any alterations to them. The design also allowed the researcher to come up with descriptive statistics that assisted in explaining the relationship that exists among variables.

3.3 Population of the study

The total number of parastatals currently operating in Kenya is 127. The entire 127 formed the target population for this study. It is from the 127 that the researcher sampled the ones that were considered for the study.

3.4 Sample size and sampling procedures

The study consisted of a sample size of 30 respondents who were drawn from parastatals operating in Nairobi. There are currently 70 parastatals that have their offices in Nairobi and were therefore accessible to the researcher. The researcher randomly selected 30 of the 70 parastatals for the study. From each of the 30 parastatals, the researcher selected one respondent in order to achieve the sample size of 30. Simple random sampling was applied in selecting the respondents. The respondents included heads of parastatals and chief financial officers.

3.5 Data collection

Both qualitative and quantitative primary and secondary data were used for the study. Primary data are information gathered directly from the respondents (Kothari, 1990). The primary data were collected by use of a structured questionnaire using the Linkert Scale. The questionnaire contained closed ended questions; it was self-administered through a drop-and-pick method. The questionnaire was divided into five sections. The first four sections were relevant in collecting relevant information on the four corporate governance attributes significant to the study, whereas as the last section was relevant in obtaining financial information relevant to financial performance in consonance with the objective of the study. Secondary data were collected. The secondary data included annual reports of the parastatals including financial statements. Secondary data required covered the period from January 2006 to December 2010. The data were collected between May to July 2012.

3.6 Data Validity

Validity of a research instrument is concerned with the accuracy with which the instrument measures what it is supposed to. This study used a questionnaire and tested its validity by use of content validity, which is a process of logical analysis that involves careful and critical examination of items in the research questionnaire. A few managers from selected parastatals were given the questionnaires to fill in order to ensure that they carry valid content.

3.7 Data Reliability

The research questionnaire used in this study gave reliable information that was used in decision making. It should therefore be able to produce the same results if used by other researchers. To determine the reliability of the research questionnaire, a pre-test of the same was done among few state corporations.

3. 8 Data analysis

The study collected both quantitative and qualitative data. Two methods of data analysis were adopted to enable the researcher conduct a comprehensive analysis. The descriptive data were analyzed using Statistical packages for social sciences (SPSS) while the qualitative data were analyzed by content analysis. Multiple regression analysis was used to analyze the quantitative data since it involves one dependent variable and multiple independent variables. The findings from the quantitative data were presented in tables. Data collected using the structured questionnaires were analyzed using content analysis.

3. 9 Variable Definition and model specification

i. Independent Variables

The following corporate governance practices constituted the independent variables for the study. The relationship followed the description of the variables depicting the relationship between the independent and dependent variables holding other exogenous factors, which have the propensity to impact the firm performance, constant. The variables and their relationship are:

CEO Duality (CED): That is whether or not the Manager or CEO Plays a dual role as CEO and Board chair. This variable determines whether the CEO acts only as CEO and not board chair; or the CEO also is the board chair. This is measured using a dichotomic variable, assuming the value of 1 if the CEO is the Board chair and a value of 0 if the chair is separate from the CEO. Based on argument propounded by the Agency Theory stressing separation of ownership and control and the establishment of controls to mitigate the opportunistic self-seeking interest of management, CED is significant and positively related to ROA if the CEO acts only as CEO. This curtails spending on unproductive investment and other perquisites. If CED exist, then their will exist a negative relationship with financial performance as inadequate oversight may induce unnecessary which adversely affects ROA.

Board Size (BS): BS is the number of members who constitute the board over a given fiscal period. It is measured by the total number of members in a given financial period. Based on argument provided by Lipton and Lorch (1992) and Hermalin and Weisbach (2003), BS is expected to have an insignificant and negative relations with ROA. This indicate that a small larger board BS increases board expenses as board output will not correspond to expenses incurred by board as free riders and effectiveness will characterized such board. However, board numbering between 8 to 10 members is recommended. Smaller than the number may not attract the skills and expertise needed while greater than 10 may pose timely decision making problem, is disadvantageous and expensive to maintain.

Audit Committee: that is whether the Board of Director has an audit committee responsible for monitoring financial and compliance activities of Management. It is measured taking the proportion of total AC members to total board members. Though very significant as one of the mechanisms to resolve the agency conflict, the AC enhances financial performance. Thus, the relationship is positive.

Multiple Directorship: That is whether Director(s) serve(s) on Board of other entities. It is measured by the proportion of directors serving on other boards to total number of board members. Based on the Resource Dependency Theory which requires directors who can bring resources and skills that give the organization a competitive advantage, the relationship of MD to ROA is expected to have a significant and positive, indicating that board with MDs are expected to have a higher ROA.

ii. Dependent variable

This is the variable whose state was altered by the independent variables. The dependent variable constitutes the financial performance which was measured using the following:

Return on Asset: This is obtained by dividing the profit after tax by book value of total asset and took the form of the below model:

ROA = M (PAT)/M (TA)

Where:

M (PAT) is the mean of the total profit after tax of the parastatals under study, and

M (TA) is the mean of the Total assets of the parastatals

3.10 Model

The study sought to establish the relationship between corporate governance as an explanatory variable and ROA as a dependent variable. Because the relationship involves one dependent variable (ROA) which is determine by multiple independent variables (corporate governance attributes as mentioned in the study), the model used to determine such relationship was the multiple regression model. Multiple regression analysis tends to establish the relationship between one dependent variable and multiple independent variables. Depicted below is the multiple regression model.

$Y= \beta_0+\beta_1F_{it}+\beta_2F_{it}+\beta_3F_3+\beta_4F_4+ Er$

Where Y= dependent variable (Financial performance depicted by the return on Assets)

$\beta_{o,} \beta_{1,} \beta_{2,} .. + \beta_n$ = the coefficients of corporate governance attributes

Er = error term or the disturbance term; this variable includes all other factors which influenced the dependent variable, y, (ROA), other than the corporate governance attributes mentioned herein.

Therefore

ROA= f (board size, board structure, multiple directorship and Audit committee); this generates the general equation for the model as follows:

$ROA= \beta_o+\beta_1BCED+\beta_2Bs+\beta_3MD+ \beta_4AC+e$

CHAPTER FOUR

DATA ANALYSIS AND PRESENTATION OF FINDINGS

4.1 Introduction

This chapter presents the data analysis, results and discussion of the findings on relationship between corporate governance and financial performance of parastatals in Kenya. The chapter concludes with a summary and interpretation of the findings.

The research targeted 30 parastatals operating in Nairobi. The questionnaires were self-administered; however, Table 4.1 shows that out of the 30 questionnaires distributed; 27 questionnaires were received back completely filled, making a response rate of 83.3%. This was in line with Mugenda and Mugenda (1999) who suggested that for generalization a response rate of 50% is adequate for analysis and reporting, 60% is good and a response rate of 70% and over is excellent.

Table 4.1: Response Rate

Questionnaires	Frequency	Percentage
Returned	27	83.3
Unreturned	03	16.7
Distributed	**30**	**100**

4.1.1 Pretest Study

A pretest was conducted in order to determine reliability of the questionnaires. Reliability of the questionnaires was then evaluated through Cronbach's Alpha which measures the internal consistency. The Alpha measures internal consistency by establishing if certain item measures the same construct. Nunnally (1978) established the Alpha value threshold at 0.6 which the study benchmarked against. Cronbach Alpha was established for every objective in order to determine if each scale (objective) would produce consistent results should the research be done later on.

Table 4.2 shows that all the scales were significant, having an alpha above the prescribed threshold of 0.6. Board size had the highest reliability (α=0.833) followed by board structure (α=0.719), and Audit committee (α=0.693), multiple directorship had the lowest (α=0.621). The study found that the analysis was reliable and could be used for further investigation.

Table 4.2: Reliability Coefficients

Scale	Cronbach's Alpha	Number of Items
Board size	0.833	11
Board structure	0.719	6
Multiple directorship	0.621	4
Audit committee	0.693	6

Source: Author (2012)

4.2 Data Presentation

4.2.1 Descriptive Statistics of Explanatory Variables

The results obtained depict the descriptive analysis of the variables used in the study. As mentioned in chapter 3, the dependent variable, return on asset (ROA) was obtained using the following model:

$$ROA = \frac{M\ (PAT)}{M\ (TA)}$$

From the above formula, M (PAT) was the mean of the total profit after tax of the parastatals selected for the study, whereas M (TA) was the mean of the total assets of the parastatals selected for the study. These were obtained from their financial statements.

Table 4.3:Descriptive Statistics of Explanatory Variables

Descriptive Statistics

	N	Minimum	Maximum	Mean		Std. Deviation	Variance
	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic	Statistic
ROA	27	-.0343	.9348	.0841	.0356	.1853	.034
AC	27	.00	1.00	.926	.0514	.2667	.071
CED	27	.00	.00	.000	.000	.000	.000
ACN	27	2.00	5.00	3.333	.16879	.8770	.769
BSz	27	6.00	14.00	11.111	.34316	1.783	3.179
Company size	27	7.856	11.33	10.23	.1575	.8179	.669
MD	27	2.000	.4000	.125	.0248	.1289	.017
Valid N (list wise)	27						

Source: Author (2012)

As presented in Table 4.3, ROA had a maximum value of 0.9348, meaning that the highest ROA attained by any of the parastatals was 93.48% thus indicating that the firm realized a favorable 93.48% on return on asset invested. On the other hand, the minimum value of ROA was -0.343 or -3.43%, which was very unfavorable. The mean was 0.0841 which indicates that on average the parastatals provided less than 10% return on asset invested.

Board size was measured considering the number of directors sitting as member during the period. Table 4.3 shows that the minimum number of board members was 6 while the maximum number was 14. The mean of board members was 11.111. This suggests that on average the parastatals selected for the study had about 11 member directors. This number is slightly above the limit provided for by best corporate governance practice but can be considered. The standard deviation was 1.783 suggesting that some boards size are relatively smaller while others are larger.

CED indicates whether the board is chaired by the CEO or whether the chair of the board is separate and distinct from the CEO. The study utilized a dichotomic variable as a measurement for this parameter. The researcher assigned a value of 1 where the CEO serves as board chair and the value of 0 if two distinct individuals occupied the position. Table 4.3 shows that the minimum was 0 and maximum was 0. The mean was also 0.This suggests that the parastatals did not have board structure as a problem as the CEO was distinct from the board chairman in all of the parastatals studied.

Multiple directorship was measured by the proportion of board members who also served on board of other firms to total number of board members. This variable had a minimum value of 2 and a maximum value of 4 as shown in Table 4.3. The analysis reveals that the mean proportion of board members was 0.125. The standard deviation was 0.1289 suggesting a little deviation from the mean.

Audit Committee was measured by proportion of total AC members to total board membership. This can be observed from the min and max values in Table 1. The analysis also reveals that the mean proportion of board members was 0.2667. The standard deviation was 0.51 suggesting a moderate deviation from the mean.

Company size and committee numbers were used as control variables. Company size was measured by finding the natural log of the average total assets of the selected parastatals for the period under study, whereas committee numbers measured the total number of committees that existed on the boards of the selected parastatals for the study. Company size had a minimum of 7.856 while the maximum was 11.33. The mean of the company size was 10.23. The minimum number of committee that existed on the board of the parastatals was 2 while the maximum was 5. The boards had on average about 3 committees. Some parastatals had larger asset base than others as is reflected in the variance.

4.2.2 Relationship between governance attributes and financial performance

A multiple regression analysis was conducted in order to determine the relative impact of board Size, board structure, multiple directorships and audit committee on return on assets. The regression model was as shown below:

ROA = $\alpha + \beta_1$ (Board Size) + β_2 (board structure) + β_3 (multiple directorship) + β_4 (Audit committee) + ε

Regression analysis also produced correlation, coefficient of determination and analysis of variance (ANOVA). Correlation sought to show the nature of relationship between dependent and independent variables and coefficient of determination showed the strength of the relationship. Analysis of variance was done to show whether there is a significant mean difference between dependent and independent variables. The ANOVA was conducted at 95% confidence level.

Table 4.4: Model Goodness of Fit

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.535[a]	.455	.770	.2003455

a. Predictors: (Constant), Multiple Directorship, Company Size, Board size, audit committee, committee number

Source: Author (2012)

Regression analysis was used to establish the relationship between ROA and corporate governance attributes that affect it such as Board Size, board structure, multiple directorship, and Audit committee. The results, as shown in Table 4.4 show a Pearson correlation value (R) of 0.535 which depicts that there is a fairly linear dependence of ROA on corporate governance. R^2 reveals that governance attributes influenced about 45.5% of variation in return on asset. An adjusted R-squared of 0.77 shows that Board Size, board structure, multiple directorship, and Audit committee also explain 77 percent of the variations in ROA when there is a unit decrease in good corporate governance practice, while 23 percent is explained by other factors not in the model. The value of 0.77 (adjusted R^2) shows that the relationship between the ROA of the parastatals and corporate governance is positive. The standard error estimate of 0.200 is deemed fairly low.

Table 4.5: Analysis of Variance

ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.049	5	.010	.246	.037[a]
	Residual	.843	21	.040		
	Total	.892	26			

a. Predictors: (Constant), Multiple Directorship, Company size, Board size, audit committee, committee number

b. Dependent Variable: ROA

Source: Author (2012)

ANOVA statistics was conducted to determine the differences in the means of the dependent and independent variables thus showing whether a relationship exists between the two. The P-value of 0.037 implies that ROA has significant joint relationship with Board Size, board structure, multiple directorship, and Audit committee which is significant at 5 percent level of significance. This also depicts the significance of the regression analysis done at 95% confidence level.

Table 4.6: Regression Coefficient Results

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.368	.566		.651	.022
	Audit committee	.010	.153	.015	.068	.047
	Committee number	.022	.063	.102	.345	.033
	Board size	-.007	.030	-.070	-.240	.113
	Company size	-.031	.050	-.135	-.615	.545
	Multiple Directorship	.218	.334	.152	.653	.021

a. Dependent Variable: ROA Source: Author (2012)

The researcher conducted a linear regression analysis so as to determine the effect of the independent variables (Multiple Directorship, Company size, Board size, audit committee and committee number) on the dependent variable (ROA). As per the R generated in the table above, the equation (ROA= $\beta_o+\beta_1Bsz+\beta_2CN+\beta_3MD+\beta_4AC+\beta\mathbf{CS}+\boldsymbol{\varepsilon}$) becomes: **ROA=**0.368-0.007BSZ+0.022 CN+0.218MD+ 0.010AC-0.31CS

According to the regression equation established as derived from Table 4.6, when all the corporate governance attributes considered for the study assumed the value of zero, ROA will be 0.368. The error term was 0.5666. The beta values of the board size and the company size indicate that they have a negative impact on corporate governance. This further suggests that the larger the board size, the lower its impact ROA. Similarly, the size of the parastatals negatively influenced ROA.

Table 4.6 depicts that multiple directorship, audit committee and the number of committees established to monitor on behalf of the board was positively related to ROA. This indicates that parastatals with directors serving on other boards experienced higher ROA because of the expertise and experienced gathered from directing other boards. Further, an active audit committee enhances ROA by mitigating the agency conflict as propounded by Jensen and Mecklin. The number of committee, as a control variable, established by the board to oversee other activities of the parastatals is also positively influenced ROA.

The data findings analyzed also shows that if all other independent variables assumed the value of zero, a unit increase in audit committee will lead to a 0.010 increase in ROA of parastatals in Kenya; a unit increase in committee number will lead to a 0.022 increase in ROA of parastatals in Kenya, a unit increase in board size will lead to a 0.396 decrease in ROA, a unit increase in company size will lead to a 0.031 decrease in ROA of parastatals in Kenya. A unit increase in Multiple Directorship would lead to an increase of 0.218 in the ROA of parastatals in Kenya. This infers that multiple directorship has a strong and positive relationship with ROA of parastatals in Kenya. Thus, professional directors bring in expertise from experience gathered in the administration of other entities by the professionalism of staff, a situation that tends to support the stakeholder theory in corporate governance; the analysis also reveals a positive relationship between audit committee and ROA, but the relationship cannot be determined to be strong or weak.

This depicts that audit committee does not significantly impact the ROA, with board size contributing the least. At 5% level of significance and 95% level of confidence, audit committee had a 0.047 level of significance; committee number showed a 0.033 level of significance, board size showed a 0.113 level of significance, company size showed a 0.545 level of significance and multiple directorships showed 0.021; hence the most significant factor is multiple directorships.

4.3 Summary and Interpretation of findings

Board Size

The beta values for board size and board structure suggest that they had a negative and significant influence on ROA. Thus, the larger the board size the most likely that there might be lower or no impact on ROA. Larger board size indicate board numbering above 10 members while smaller board size refer to board comprising of less than 8 members as was found in previous studies. The study supported that smaller boards enhance firm performance indicating a negative relationship between board size and organizational performance. The researcher explained that an organization with a board of directors that is larger in size may need to deal with more conflicts among board members and, thereby, encounter difficulty reaching consensus. An organization with a larger board size has more social loafing and free riding which reduces the efficiency of the board in providing better governance. This finding corroborates earlier findings by previous researchers who concluded that larger board can be less effective and that the size of the board negatively correlates to the performance of the firm (Yermack, 1996; Wells, 1998, & Hermailin and Weibasch, 2003). The study also found that average number of members on the board of the parastatals studied was about 11, which also contradicted those found by Lorch (1992). In order to avoid free loafing and free riding by directors there is a need to maintain a smaller board size of about 10 members. Notwithstanding this average, some board had as large as 14 members while others had as low as 6 members.

Board structure

Board structure depicts whether CEO duality exist or not. This attribute determines whether the board is structured so that the CEO ultimately becomes the board chair. The study found out that this was not a factor to consider for the parastatals in Kenya. This is because there was a clear separation of the position of CEOs and board chairs of all the parastatals studied. These two positions were occupied by separate individuals. Hence the agency conflict inherent in one individual occupying both positions which may have subsequently had an impact on ROA could not be established. However, previous study established that the dual capacity of CEO is counterintuitive to the tenets of agency theory if the role of the board of directors is to truly monitor the CEO and other agents. The inherent conflict of interest between the agents and principals can easily be exacerbated by the lack of oversight when so much power is vested in one person, thus compromising the independence of the board. It is possible for an unrestrained dual CEO to pursue his own self-interests to the detriment of the shareholders and stakeholders.

Multiple directorships

The study found that multiple directorships tend to have high ROA. This might be due to the labor market for directors allocating more seats to better directors and also outside directorship by executives can add value to firms by helping to broaden the executives' expertise and perspective. This also supports the resource dependency theory which entails that directors bring in their expertise and secure resources for the firm through their linkages with the external environment (Hillman et al, 2000). The study findings, thus, concord with earlier study by Chen (2008) that multiple directorship is resourceful to the firm.

Audit committees

The audit committee is one of the key elements in the corporate governance structure that helps control and monitor management. The study found that an effective audit committee positively correlates with ROA. The AC plays an important role in monitoring the company's operation and internal control system with the aim of protecting the interest of the shareholders. As a result, it recognized that an effective audit committee would focus on improving the company performance (Fama and Jensen, 1983). An effective audit committee is expected to focus on the optimization of shareholders' wealth and prevent the maximization of personal interests by the top management. The finding is consistent with earlier study by Murage (2010) that there exists a positive relationship between the audit committee and the financial performance of state parastatals in Kenya.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary

Parastatals where initially established by the government of Kenya to fill the entrepreneurship gap that existed at the time, to enable government participate in the delivery of goods or services to the Kenyan populace at a much lower cost than those provided by the private capitalists. Those parastatals created with commercial motives were meant to be self-sustainable, profitable and to contribute to national development agenda through payment of dividends and service provision. Contrary to these motives, most of these parastatals failed to achieve their motive by performing dismally to the extent that they became liability to national budget through receipt of huge subsidies. A majority of the poor performance has been attributed to mismanagement, inefficiency, bureaucratic wastage and overall poor corporate governance.

The concept of good corporate governance is one of the cardinal steps in ensuring that the economic health of the state-owned corporations is revived to restore investor confidence. Corporate governance encompasses all processes and mechanisms adopted to ensure that firms achieve motives for which they were established with no deviation from such.

The study finds that good corporate governance is a vital element to firm performance. The study established that, generally, there is a positive relationship between corporate governance and the financial performance of parastatals in Kenya. ROA, used as a measurement of financial performance, positively correlates with good corporate governance practice.

5.2 Conclusion

The study focused on the relationship between corporate and financial performance of parastatals in Kenya. Corporate governance attributes deemed significant for the study include board size, multiple directorship, board structure and audit committee.

The findings of the study revealed that the board size is negative but insignificantly correlated to return on asset. Multiple directorship showed a strong and positive relationship to return on investment; thus directors who bring in expertise and experience from other boards contribute a share of their wealth of experience which enhances performance. The study did not find board structure (CEO duality) as a problem because none of the parastatals studied had a CEO occupying both positions. This can be attributed to the law that governs corporate governance in Kenya. No analysis could be carried out to determine this relationship. The study also found that audit committee, which is a major component of the board in exercising control through monitoring of financial and operational activities through internal and external audit mechanisms as well as monitoring compliance to ensure efficiency and effectiveness of operations, showed that their exist a positive but weak relationship to financial performance.

The study therefore concludes that good corporate governance practices are positively correlated to the financial performance of parastatals in Kenya. These governance attributes are good predictor of financial performance, but should not be considered in isolation of other factors such as industry environment, quality of leadership as well as competence and innovation of the board.

5.3 Policy Recommendations

Good corporate governance practice is essential to the enhancement of the firm. In order to further improve performance in the state-owned enterprises, the government and other regulatory agencies with oversight responsibility on these state enterprises must ensure that governance is enhanced at every parastatal and that the audit committee is sufficiently empowered in carrying out its function.

As the study has revealed that that multiple directorship has positive and strong relationship to financial performance, the researcher recommends that only individuals with proven records of experience, innovation and with the capacity to galvanize resources are appointed to the board of the parastatals. These individuals, as determine by the resource dependency theory can exercise requisite oversight and can create linkage with the organization and its external environment.

The parastatals should adopt smaller boards as they enhance firm performance indicating a negative relationship between board size and organizational performance as the decision making process is very quick as no much free riding and loafing of members will exist. A size of about ten members which is in line with best corporate governance practice in other countries is recommended. In addition to maintaining a small but effective board, qualification of appointees must relate to the core activities of the business in which the parastatal is engaged in rather than based on political lineage.

5.4 Limitations of the Study

One limitation that affected the results of the study was the availability of data. The study targeted thirty (30) parastatals. Aside for those parastatals which posted their annual reports, it was difficult in obtaining data from the others whose reports were not posted. As a result, it took the researcher longer time than expected to have obtained the relevant data required for the analysis. This affected the timeframe expected for the study to have been completed. However, the researcher managed to have obtained data on 27 of the 30 parastatals.

Second, the sample selected included commercial, regulatory, public policy and social-oriented parastatals. As such, some of these entities relied highly on subsidies received from government rather than income generated from their business activities. The study considered these fundings as revenue and ignored them as subsidies or debt in determining profit.

The study did not consider the quality of the board of directors to determine competence and experience in their oversight of the parastatals. This limitation may have probably generated other findings.

Finally, findings generated as a result of the study are not in themselves all conclusive as the study focused only on four corporate governance attributes determined necessary for the study by the researcher. Also, availability of data determined the elements for the study and not any statistical or probabilistic criterion. Hence, caution should be exercised in generalizing the results.

5.5 Suggestions for further studies

There is a need for further studies to be conducted separately on each sector of the parastatals. That is, separate studies should be conducted exclusively on profit-oriented commercial parastatals, exclusively on regulatory parastatals and public policy and social-service oriented parastatals to determine the impact of corporate governance on their performance. This will enable the government undertake a more comprehensive measure aimed at enhancing efficiency and productivity.

Second, the number of the independent variables (corporate governance attributes) needs to be increased as this study only explained 77% of variation in the ROA in the parastatals in Kenya are attributable to the corporate governance attributes used in this study. Also, there is need for future studies to increase the sample firms and also the number of years under study. The study only covered 30 parastatals in the country. It would be prudent to cover at least 50 firms in future studies.

Future researchers should focus in their study on corporate governance specific analysis on characteristics of the board of directors considering qualification, experience, appointing authority and how they impact on performance.

Finally, it would be more rewarding if further studies on corporate governance were to take on a more holistic approach to performance. This should include operational efficiency and other non-financial performance indicators.

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APPENDICES

APPENDIX I: QUESTIONNAIRE

Introduction

This questionnaire has been designed to collect data on the relationship between corporate governance and financial performance of parastatals in Kenya from 1996 up to 2010. Information provided herein will be used solely for academic research purpose.

Questions

To what extent do you agree with the following statements on the corporate governance practices as observed in your organization? Please indicate so by marking an X or a check mark (√) in the column that appropriately fits your organization

Key: 5 strongly agree; 4 agree; 3 undecided; 2 disagree; 1 strongly disagree

Name of Entity (Optional):____

Section A: Board Size

1. **Number of Directors ……………….**(please indicate)

	5	4	3	2	1
Smaller boards enhance firm performance					
Board of directors that is larger in size may need to deal with more conflicts among board members and, thereby, have difficulty reaching consensus					
Larger size boards are more adept at providing resources					
Larger boards benefit firms by providing effective oversight of management and available necessary resources so that larger boards may help in improving performance of an organization					
Large boards improve board performance by reducing CEO domination of the board					

A larger board will also make it easy to create committees to delegate specialized responsibilities					
Section B: Board structure					
The CEO is the chairman of the Board of Directors					
The Chairman is a separate person from the CEO					
There is an established clear job description for the board chair and members which is different from those of the CEO and Management					
Separating the roles of CEO and Chairman of the board (COB) potentially leads to confusion and lack of clarity, both internally with employees and externally with other stakeholders					
Separating the CEO and COB roles does not necessarily guarantee a strong monitoring function if the collective board is otherwise weak					

Section C: Multiple directorships **Number of Directors sitting on boards of other entities…………**(please indicate)	**5**	**4**	**3**	**2**	**1**
Market-to-book ratios are higher for firms with directors holding more Board seats.					
Multiple directorships tend to yield high Return on Asset					
Outside directorship by executives can add value to firms by helping to broaden the executives' expertise and perspective.					
Parastatals risk is positively related to multiple board appointments of Parastatals directors.					
Section D: Board Committee(s) **Number of committees established by the Board………..**(please indicate)					
There is an audit committee established on the board					
Audit committee would focus on improving the company performance and competitiveness					

The audit committee is independent, competent, financially literate, adequately resourced and properly compensated					
Audit committees are expected to oversee corporate governance, financial reporting, internal control structure, internal audit functions, and external audit services					
Audit committee are not effective against risk they are just overloaded					
Section E: Transparency and Disclosure					
The company makes full disclosure of corporate governance practices to its stakeholders					
There is disclosure of the biographies of the board of directors and senior management					
There is disclosure of board and senior management compensation					
Relevant material information about the company is disclosed on a timely basis					
The company prepares and publishes its annual financial statements to relevant authorities as required					
Reports of the internal audit and audit committee are made available to all stakeholders					

SECTION F

Kindly indicate the after tax profit and total asset figures for your parastatal for the five years mentioned below

YEAR	AFTER TAX PROFIT	TOTAL ASSETS
2010		
2009		
2008		
2007		
2006		

THANK YOU VERY MUCH FOR YOUR TIMELY RESPONSE

APPENDIX II: PARASTATALS IN KENYA

Agricultural Development Corporation	Kenya Post Office Savings Bank
Agricultural Finance Corporation	Kenya Railways Corporation
Agro-Chemical & Food Company Ltd	Kenya Re-insurance Corporation
Athi Water Services Board	Kenya Revenue Authority
Bomas of Kenya Ltd	Kenya Roads Board
Capital Markets Authority	Kenya Safari Lodges & Hotels
Catchment Area Advisory Committee	Kenya Seed Company Ltd
Catering Tourism and Training Development Levy Trustees	Kenya Sisal Board
Central Water Services Board	Kenya Sugar Board
Chemilil Sugar Company Limited	Kenya Sugar Research Foundation
Coast Development Authority	Kenya Tourist Board
Coast Water Services Board	Kenya Tourist Development Corporation
Coffee Board Of Kenya	Kenya Utalii College
Coffee Research Foundation	Kenya Water Institute
Commission for Higher Education	Kenya Wildlife Service
Communication Commission of Kenya	Kenya Wine Agencies Limited
Consolidated Bank of Kenya	Kenyatta International Conference Centre
Cooperative College of Kenya	Kenyatta University
Council for Legal Education	Kerio Valley Development Authority
Deposit Protection Fund Board	Lake Basin Development Authority
East African Portland Cement Co.	Lake Victoria South Water Service Board
Egerton University	Local Authority Provident Fund
Ewaso Ng'iro South Development Authority	Maseno university
Export Processing Zone Authority	Moi University
Export Promotion Council	National Aids Control Council
Gilgil Telecommunications industries	National Bank of Kenya
Higher Education Loans Board	National Cereals and Produce Board
Horticultural Crops Development Authority	National Council for Law Reporting
Kenya College of Communications Technology	National Environmental Management Authority
Kenya Dairy Board	National Hospital Insurance Fund
Kenya Electricity Generating Company	National Housing Corporation
Kenya Ferry Services Limited	
Kenya Forestry Research Institute	National Irrigation Board
Kenya Industrial Estates	National Museums of Kenya
Kenya Industrial Property Institute	National Oil Corporation of Kenya Ltd

Kenya Industrial Research & Development Institute	National Social Security Fund(NSSF)
Kenya Institute Of Administration	National Water Conservation and Pipeline Corporation
Industrial and Commercial Development Corporation	National Co-ordinating Agency for Population and Development
Industrial Development Bank	New K.C.C
Investment Promotion Centre	NGO's Co-ordination Bureau
Jomo Kenyatta University of Agriculture and Technology	Numerical Machining Complex
KASNEB	Numerical Machining Complex
Kenya Agricultural Research Institute	Nyayo Tea Zones Development Corporation
Kenya Airports Authority	Nzoia Sugar Company
Kenya Anti-Corruption Commission	Pest Control Products Board
Kenya Broadcasting Corporation	Postal Corporation of Kenya
Kenya Bureau of Standards	Pyrethrum Board of Kenya
Kenya Bureau of Standards (KEBS)	Retirement Benefits Authority
Kenya Civil Aviation Authority	Rift Valley Water Services Board
Kenya College of Communication & Technology	School Equipment Production Unit
Kenya Institute of Public Policy Research and Analysis	South Nyanza Sugar Company
Kenya Literature Bureau	Sports Stadia Management Board
Kenya Marine & Fisheries Research Institute	Tana and Athi Rivers Development Authority
Kenya Maritime Authority	Tea Board Of Kenya
Kenya Meat Commission	Tea Research Fountation Of Kenya
Kenya National Assurance Company	Teachers Service Commission
Kenya National Examination Council	Telkom (k) Ltd
Kenya National Library Service	University of Nairobi
Kenya National Shipping Line	University of Nairobi Enterprises & Services Ltd
Kenya National Trading Corporation Limited	Water Resources Management Authority
Kenya Ordinance Factories Corporation	Water Services Regulatory Board
Kenya Pipeline Company Ltd	Western University College of Science and Technology
Kenya Plant Health Inspectorate Services	
Kenya Ports Authority	

Source: http://www.afribiz.info/content/government-state-corporations-in-kenya

APPENDIX III: NET INCOME/PROFIT

Net Income /Profit (Ksh)				
2,006.00	**2,007.00**	**2,008.00**	**2,009.00**	**2,010.00**
12,982,833,441.00	14,710,274,812.00	1,004,643,000.00	1,120,529,000.00	1,772,577,000.00
3,768,933,000.00	2,445,666,000.00	5,896,679,000.00	1,943,807,000.00	3,320,812,000.00
1,664,231,000.00	1,718,477,000.00	1,764,870,000.00	3,225,094,000.00	16,738,306,000.00
411,793,000.00	764,164,000.00	536,652,000.00	1,834,054,000.00	-292,402,000.00
1,756,000.00	2,319,525,000.00	2,737,936,000.00	2,967,962,000.00	4,863,067,000.00
879,063,000.00	1,506,151,000.00	1,829,322,000.00	2,502,355,000.00	2,439,718,000.00
1,240,610,000.00	1,119,396,000.00	1,240,600,000.00	1,699,847,000.00	2,021,919,000.00
1,016,101,000.00	1,252,663,000.00	992,483,000.00	1,425,687,000.00	2,743,000,000.00
8,375,049,000.00	9,563,202,000.00	9,011,320,000.00	-7,412,772,000.00	17,360,118,000.00
99,000,100.00	101,000,000.00	109,000,000.00	123,000,000.00	127,000,000.00
87,780,120.00	97,000,000.00	118,000,000.00	126,000,000.00	134,000,000.00
1,010,644,010.00	1,393,611,000.00	1,213,837,000.00	1,609,972,000.00	829,095,000.00
66,006,700.00	73,662,000.00	-782,872,000.00	-517,598,000.00	-324,898,000.00
57,011,800.00	60,345,000.00	72,634,000.00	89,592,000.00	36,381,000.00
711,800,909.00	716,274,606.00	793,813,107.00	804,813,118.00	848,632,199.00
2,009,876.00	2,143,122.00	2,220,000.00	2,700,000.00	2,817,000.00
2,476,900,010.00	2,720,993,000.00	3,295,000,000.00	3,765,529,000.00	4,538,208,000.00
754,700,180.00	742,466,811.00	777,531,812.00	797,561,912.00	812,641,100.00
118,138,000.00	122,000,000.00	132,000,000.00	146,000,000.00	154,000,000.00
212,000,090.00	213,143,952.00	217,412,833.00	222,567,622.00	221,997,999.00
1,350,900.00	1,642,677.00	1,867,843.00	1,977,614.00	1,991,967.00
1,667,700,000.00	1,866,947,000.00	1,917,812,000.00	2,101,211,000.00	2,112,812,000.00
198,100,650.00	201,124,340.00	214,124,312.00	225,217,814.00	288,494,854.00
1,990,123,000.00	2,400,221,000.00	2,731,812,000.00	300,201,000.00	3,142,101,000.00
7,700,670.00	9,521,470.00	9,464,810.00	9,828,800.00	10,210,014.00
22,580,000.00	25,821,000.00	96,223,000.00	80,938,000.00	172,478,000.00
3,070,000.00	3,121,000.00	3,141,000.00	4,220,000.00	4,223,000.00
2,700,000.00	2,997,000.00	3,000,000.00	3,012,000.00	3,116,000.00
1,980,000,000.00	2,008,000,000.00	21,124,120.00	3,002,000.00	3,212,000.00
1,768,670.00	2,000,000.00	3,000,000.00	4,000,000.00	4,100,000.00

APPENDIX IV: TOTAL ASSETS

Total Asset (KSh)				
2006	2007	2008	2009	2010
5,393,516,780	7,292,640,840	13,941,110,000	15,000,633,000	17,240,929,000
64,786,242,000	94,732,672,000	99,408,035,000	102,736,136,000	136,641,616,000
38,728,912,000	47,321,864,000	59,812,122,000	70,648,425,000	85,025,890,000
9,052,207,000	8,938,572,000	9,073,345,000	12,053,977,000	12,037,565,000
57,435,000	65,324,205,000	83,485,855,000	110,531,373,000	153,983,533,000
4,720,207,000	5,951,751,000	7,761,950,000	9,423,314,000	8,637,233,000
42,685,700,000	41,414,272,000	42,695,700,000	51,404,408,000	60,026,694,000
23,100,000,000	23,060,115,000	24,029,773,000	25,606,769,000	27,390,242,000
71,842,688,000	81,310,870,000	90,508,481,000	82,147,886,000	98,606,651,000
4,300,000,000	5,000,100,090	5,020,000,000	6,000,000,000	7,600,000,000
4,406,730,000	4,700,000,000	4,701,008,000	4,789,100,000	5,230,000,090
9,890,990,000	11,916,869,000	14,152,154,000	17,475,715,000	23,176,516,000
8,006,765,000	8,295,671,000	8,620,190,000	8,569,469,000	8,738,367,000
1,010,760,000	1,349,522,000	1,412,242,000	1,443,962,000	1,301,536,000
2,008,900,000	2,268,141,408	2,413,603,642	2,506,117,211	2,819,932,177
55,480,900	68,413,000	70,107,000	81,000,000	84,214,000
76,210,554,000	81,310,870,000	90,508,481,000	82,147,886,000	98,606,651,000
199,976,100,000	212,416,211,000	216,552,321,000	219,642,412,000	221,891,302,000
5,678,000,000	6,000,000,000	6,300,000,000	6,700,000,000	7,000,000,000
154,999,170,000	162,671,233,000	163,671,244,000	166,677,111,000	167,982,400,000
49,878,765,000	52,714,866,000	63,814,944,000	65,866,114,000	66,812,001,000
50,989,200,000	56,326,966,000	59,415,822,000	62,166,811,000	63,899,921,000
8,010,900,000	8,111,324,125	9,120,621,312	10,145,979,749	11,859,140,986
90,000,870,000	97,772,215,000	99,171,521,000	103,166,812,000	112,176,812,000
590,740,100	661,412,122	771,122,436	888,422,986	967,948,886
3,700,680,000	4,108,814,000	4,656,792,000	6,898,919,000	10,478,682,000
118,000,700,000	122,214,166,000	124,612,122,000	130,614,822,000	143,612,944,000
88,189,000	93,508,000	94,000,000	94,716,000	95,222,000
201,200,000	218,000,000	218,612,000	319,712,000	321,812,000
2,798,900,000	3,000,000,000	3,300,000,000	3,700,000,000	3,900,000,000

APPENDIX V: RETURN ON ASSETS

Return on Asset				
2006.00	**2007.00**	**2008.00**	**2009.00**	**2010.00**
2.41	2.02	0.07	0.07	0.10
0.06	0.03	0.06	0.02	0.02
0.04	0.04	0.03	0.05	0.20
0.05	0.09	0.06	0.15	-0.02
0.03	0.04	0.03	0.03	0.03
0.19	0.25	0.24	0.27	0.28
0.03	0.03	0.03	0.03	0.03
0.04	0.05	0.04	0.06	0.10
0.12	0.12	0.10	-0.09	0.18
0.02	0.02	0.02	0.02	0.02
0.20	0.02	0.03	0.03	0.03
0.13	0.12	0.09	0.09	0.04
0.01	0.01	-0.09	-0.06	-0.04
0.06	0.04	0.05	0.06	0.03
0.35	0.32	0.33	0.32	0.30
0.04	0.03	0.03	0.03	0.03
0.03	0.03	0.04	0.05	0.05
0.00	0.00	0.00	0.00	0.00
0.02	0.02	0.02	0.02	0.02
0.00	0.00	0.00	0.00	0.00
0.00	0.00	0.00	0.00	0.00
0.03	0.03	0.03	0.03	0.03
0.02	0.02	0.02	0.02	0.02
0.02	0.02	0.03	0.00	0.03
0.01	0.01	0.01	0.01	0.01
0.01	0.01	0.02	0.01	0.02
0.00	0.00	0.00	0.00	0.00
0.03	0.03	0.03	0.03	0.03
9.84	9.21	0.10	0.01	0.01
0.00	0.00	0.00	0.00	0.00