

**EFFECT OF CORPORATE GOVERNANCE ON FINANCIAL PERFORMANCE OF  
PUBLIC LISTED COMPANIES IN KENYA**

**BY**


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## DECLARATION

This research is my original work and has not been presented anywhere else for academic purpose in this university or any other learning institution.

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This research project has been presented for approval with my authority as the project supervisor.

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## **DEDICATION**

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## **LIST OF ABBREVIATIONS**

<b>CEO</b>	Chief Executive Officer
<b>CG</b>	Corporate Governance
<b>CMA</b>	Capital Markets Authority
<b>CMC</b>	Cooper Motor Corporation
<b>NSE</b>	Nairobi Securities Exchange
<b>OECD</b>	Organisation for Economic Co-operation and Development
<b>ROA</b>	Return On Assets
<b>ROE</b>	Return on Equity
<b>RVP</b>	Rea Vipingo Plantations
<b>US</b>	United States

## **ABSTRACT**

Due to the obvious reasons why companies exist, there is ever a growing need that company financial performance is emphasised and this makes it a critical area of research. This study aimed at exploring some of the factors which can affect financial performance with the aim of contributing to the existing literature and advising management on what can affect the performance of their firms. The study explored corporate governance effect on financial performance and explored it together with other variables which could potentially affect the relationship between the two key variables. The other variables were the board composition as indicated by the proportion of non executive directors and leverage as measured by the ratio of debt to equity. The study established that corporate governance and board structure affects performance negatively as indicated by their negative coefficients of -10.03 and -0.006 respectively. Whereas the effect of corporate governance was significant, that of board composition was insignificant at a 5% significance level, with p-values of 0.025 and 0.864 respectively. On leverage, the study established that it impacts on financial performance positively with a coefficient of 0.0198. Its effect is however insignificant at 5% significance level as indicated by the insignificant p-value of 0.635. Based on these findings, there is a need for company stakeholders in Kenya to relook at the boards and ensure that companies boards are not unnecessarily too big. Increasing the number of board members should be supported by an advantage like oversight, expertise or diverse experience but not by virtual assumption that financial performance can be improved by board sizes composed of more members. On the boards composition, it is very likely that the advantage of oversight provided by non executive directors is watered down by their lack of knowledge on the specific company operations. Companies should therefore not have more than 40% of its board being non executive directors as they would not advise on challenges and opportunities of their specific

company which could have brought a strategic advantage as well as their commitment. More executive directors should therefore be sought with even functional departments. The findings of this research support other researches and therefore suggest that further researches be done to establish why big board sizes and bigger proportions of non executive directors cause a poor performance to be experienced by firms as it is not enough to know the relationship. Knowing why the relationship helps convince and take corrective measures.

## **CHAPTER ONE: INTRODUCTION**

### **1.1 Background of The Study**

Corporate governance is a global concern for the stock market success of the listed companies. Corporate governance has been thought to be the structure a firms puts in place to govern the relations between the different stakeholders (Razaee & Zabihollah, 2008). Each business entity has a dynamic part to play in advancing economic and social improvement, as it delivers growth and provides services, creates employment opportunities, goods, and infrastructure. The Global Corporate Governance Forum (2013) said corporate performance and transparency are now matters of public and private concerns. Governance has, therefore, been at the forefront of the international agenda. It is about establishing an appropriate environment that would make it easier for companies to thrive, and maximize shareholder value while ensuring the well-being of all other stakeholders and society (Wong, 2010). Wong (2010) established that corporate governance even though thought to be a costly practice, it influences financial performance in a positive way.

The Agency theory by Meckling & Jensen (1975) describes agency as an agreement between the principal and the agent. The Agent is appointed to perform duties on principal's behalf, which entailed decision-making authority delegation. When all parties are concerned with value maximization, then agents may not function for the principal's best interests. The principal can mitigate this risk by providing the agent conducting the work with adequate rewards and also by spending on monitoring to limit the agent's decision making with conflicting interest from that of the principal. Stewardship Theory of Davis and Donaldson (1991) defines a steward, as someone who takes care of the Principals' interests by paying more attention to principal's interests than to their interests. A company that follows the stewardship principle puts the position of the CEO and the board chairman under one executive as they

have a greater understanding of the enterprise as a whole; hence they are the right individual to behave in the interest of the company shareholders. The Stakeholders' Theory by Freeman (1984) emphasizes the relationship between an organization and its stakeholders, which includes suppliers to customers and the community as a whole. The organization has a role to play in creating value for all stakeholders, not just shareholders.

Due to the contemporary failures witnessed in corporate governance mechanisms in many functional organizations as a result of a lack of transparency and accountability, the CMA, has become an essential resolution tool that is, hence, the capital market authority: regulates & license capital market players, Provides a guidelines Code based on an 'apply or explain' principle, Shift from the 'comply or explain' approach (2002) that allows for flexibility in the decision-making process of corporate governance. The CMA guarantees, however, that the organizational decisions result in the implementation of the highest governance standards while at the same time guides the standards recommended for the proper running of a corporate organization (CMA, 2016). Since proper employment of principles of CMA guarantees improvement in the financial performance of a corporate organization, it is worth heeding. Corporate governance is the critical measure of the health of a firm, hence the need to emphasize its study in institutions offering corporate managerial courses contemporarily.

### **1.1.1 Corporate Governance**

Razaee and Zabihollah (2008) denotes corporate governance as a body set up to enforce shareholder rights by establishing rules and principles governing the power relationship between its stakeholders. Bloomfield (2008) describes corporate governance as a mechanism to direct and manage organizations. Corporate governance is, in the opinion of Parkinson (1994), a process of applying a supervisory role to ensure management is acting under the shareholder interests. In general, corporate governance is about development of policies and

procedures to ensure that all stakeholders' interests are taken into consideration. Good governance is a vital part that is holding market economy, economic growth and public confidence in any system.

Different scholars have had diverse opinions on the measurement of the corporate governance which all approaches seem to have given variant results on impact of corporate governance. According to Besho (2019), the variable was measured using a number of indicators among which board size, board composition and audit committee indeces were used as a measure for CG. Another study by Matic (2013) adopted a more complex approach for measuring the variable with the balanced score card being at the centre of measuring the variable in conjunction with CG quotient and CG score. Odiero (2018) concluded that Board size, size of audit committee, and gender diversity affected the performance of companies. These corporate governance practices were measured primarily with board issues such as board size and composition, audit committee role, separation of CEO role, and the chair. It also focused on shareholders' rights. In the current study, the CG variable was measured using the size of the board and which is in line with the approaches adopted by Odiero (2018) and Besho (2019)

### **1.1.2 Financial Performance**

Financial performance shows the industry's business sector outcomes and financial health over a specific period by showing how well an organization uses its resources to maximize shareholder wealth and profitability (Farrukh, 2016). Alfred (2007) defines financial performance as a measure of the proper use of resources based on its operations and revenue generation. Tobin's Q market performance measure compares a company's value from financial markets to the value of its assets (Tobin, 1969). Financial performance is generally measured by the calculation of ratios like profitability ratios and liquidity ratios on the financial statements.

Financial performance is a significant factor which is used to determine firm's strengths and weaknesses relative to its competitors. Financial performance is also a fundamental determinant for determining a company's strengths and weaknesses relative to other companies in the same industry. Financial performance helps an enterprise know its value. Brealey et al. (2009) indicate that profitability, solvency, liquidity levels, financial efficiency, and repayment capacity can be used to measure financial performance.

Yasser et al. (2011) measured financial performance using ROE and profit margin while Besho (2019) used the ROA as a measure of the financial performance of firms listed in the NSE. Bhagat and Black (2002), used Tobin's Q, Asset Return (Operating Income/ Assets), Sales/ Assets Ratio, Operating Margin (Operating Income/ Sales), Employee Sales and Asset Growth, Sales, Operating Income, Employees and Cash Flows as dependent variables to measure firm performance. In the current study, measuring the financial performance of the NSE listed companies was done by looking at ROA.

### **1.1.3 Corporate Governance and Financial Performance**

From the past researches so far done, CG has been seen to be among the key factors that influences the financial performance of firms. Muka (2010) established that there exist a positive relationship between the corporate governance and the financial performance of the firms. These results agreed with those of Wong (2010) which established the same relationship even though found that CG could be a costly thing as keen monitoring needed to be done on its influence on the financial performance of firms.

Marek (2006) in his study established a variant results that established that the CG was a multidisciplinary aspect and established that the different indicators of the CG were found to have both positive and negative influence on the financial performance of firms. On the other hand, Odier (2018) established that even though a positive relationship existed between the



CG and the financial performance, the results showed that the relationship was insignificant. Tamer (2015) who studied the same variables established that the CG affected the financial performance in a negative manner. It is on the basis of this contradicting findings that the current study sought to establish the real relationship and the magnitude between CG and financial performance.

#### **1.1.4 Nairobi Security Exchange**

In Kenya, 64 companies are listed on the NSE (NSE, 2020). The Nairobi Security Exchange divides these companies into 11 different industries. They include agriculture, commerce and services, telecommunications and technology, automotive and accessories, insurance, banking, investment, manufacturing and allied services, investment services, construction and allied services, petroleum and energy (NSE, 2020). Firms that have been listed are publicly traded and normally have the authority to issue their shares within the stock market to interested member of the public.

The stock market has been known to offer a platform where firms that qualify for listing are governed by the rules and regulations that exist in the market. With the level of monitoring in relation to financial obligations to be met by the listed firm being a key priority, firms in the stock market are expected to publish their financial statement in a stipulated manner which enhances the level of reliability (NSE, 2020). The requirement for the publications of financial report in the NSE website of which disclosures include the CG practices by firms make it an appropriate target for the current study.

#### **1.2 Research Problem**

In essence, governance examines the position of leadership in the institutional system. Corporate governance, therefore, calls for the ability of a corporation to manage its resources and assets to increase the value of shareholders and cause a satisfaction to the other

stakeholders (Hasnah, 2009). Good corporate governance and financial performance are closely linked (Eisenhofer & Barry,2006). Due to this close linkage, sound financial performance improves shareholder value, which is the primary objective of all companies. However, regardless of this fact, some companies have continued to perform poorly and others even collapsing. According to Mutua (2019), Nakumatt and Midland Hauliers are examples of companies strugling financially which indicates some corporate governance deficiencies. As superior as well as poor performance depends on strategies from the corporate management, financial performance of corporations can be traced back to corporate governance.

Over the last ten years, companies have been delisted from the NSE. According to Mwaniki (2013), Access Kenya Telecommunications Company delisted following the purchase by a South African company. Cooper Motor Corporation Holdings had also experienced hostile environment which forced a it to apply for a takeover bid. The company problems which led to its delisting were attributed to, among other factors, hostility in its boardroom (Okoth, 2013). The failure and delisting of the firms can therefore be traced to Corporate Governance failure in the company operations. A lot should be done in CG otherwise, more organizational failures and malfunctions are likely to be seen. Surprisingly, regardless of the increased interest in CG, there is very little valid evidence from empirical studies. Therefore, the scope of our knowledge of the matter is minimal. This research aims to address this enormous gap by exploring the impact of corporate governance on financial performance of NSE listed companies to provide local knowledge.

A study by Drobetz, Beiner, Schmid and Zimmerman (2004) based on Swiss firms discovered a positive connection between CG and performance. The study used Tobin's Q for performance. They established that for every unit increase in the Corporate Governance Index, there was an increase in the company market capitalization of approximately 8.6 percent, on average, of the

value of the company's book assets. As the study was not based in Kenya, and also considering that it was conducted more than 15 years ago, it is expected that the results may still not hold if a local study was conducted. The time which has elapsed is also a lot and much may have happened around corporate governance necessitating a fresh research.

In Kenya, Wanjiku et al. (2011 ) studied the influence of corporate governance on performance for NSE listed firms. The Dwelling was about corporate communication, technology use and leadership. The two were found to correlate positively. Similar finding were found by Ongore and K'Obonyo (2011) through a study in Kenya. Their study however focused on management characteristics, ownership and the board as the determinants to performance. There are other very important aspects of corporate governance like board composition which were missing in their studies. This study focused oin such missing aspects and sought to answer the question: what are the effects of corporate governance on the financial performance of companies listed in the Nairobi Securities Exchange?

### **1.3 Research Objectives**

#### **1.3.1 General Objective**

The objective of the study was to establish the effects of corporate governance on the financial performance of listed companies in the Nairobi Securities Exchange.

#### **1.3.2 Specific Objectives**

The specific objectives of the study included establishing:

- i. The effect of the board composition on the financial performance of listed companies in the Nairobi Securities Exchange.
- ii. The impact of board size on the financial performance of listed companies in the Nairobi Securities Exchange.
- iii. The effect of firm leverage on the financial performance of listed companies in the Nairobi Securities Exchange.

#### **1.4 Value of the Study**

The results of this study are beneficial in many aspects. The study will inform policy formulation so that policies are better placed to facilitate attainment of company objectives. Better governance policies in terms of number of directors and policies on composition of the board were formulated in light of the findings of this study. Other policies to be guided by this study are those from the Capital Markets Authority as a regulating body for listed firms. The findings will help in enriching the regulator policies especially on corporate governance.

This study would also facilitate the practice of company governance. Management, board of directors, regulators in CMA and NSE and other stakeholders, including lawmakers, would benefit, as they would understand the value of CG practices and how these practices can improve organizational efficiency. Lack of acceptable corporate governance practices can be attributed to the history of corporate failures in Kenya. The study also provides suggestions, recommendations, and findings on the impact of corporate governance mechanisms on the performance of NSE listed companies.

Future researchers, scholars, finance students and lecturers will also be other beneficiaries of the study. It will help them to expound more on the issue of corporate governance structures on the performance of entities. This was achieved through expansion of knowledge and gaining of insights on the subject matter which will enlighten them in preparing areas which need further attention and which are still to be investigated. By adding more literature around performance and CG, this study will also act as a reference study in future researches.

## **CHAPTER TWO: LITERATURE REVIEW**

### **2.1 Introduction**

The chapter cover a review of theories relevant to study variables, a review of empirical studies, a conceptual framework and a summary of the chapter.

### **2.2 Theoretical Literature Review**

In this section of the study, key theories that have been advanced in connection with the research variables were reviewed. In order to achieve the research objectives, theories like Agency theory by Meckling and Jensen (1975), Stewardship theory by Donaldson (1992), and Stakeholders' theory by Freeman (2010) were considered to be the main theories.

#### **2.2.1 Agency Theory**

This theory, which was advanced by Meckling and Jensen (1975) is based on the relationship that comes to exist when two groups of persons operate in a principal-agent relation within a company. The owners of the business assumed to be principals are not involved in the day to day operations but appoint managers as agents to oversee day-to-day operations on their behalf (Clarke, 2004). Agency theory points out that these agents in organizations may resort to pursuing their selfish desires by serving their interests instead of those of the principals interest. The principals, in general expect the best possible decisions that appeal to the principals interest to guide the decision making process of the agents. The agent may, however, act otherwise by choosing to pursue their agenda, which is not in the best interests of the principals (Padilla, 2000).

The agent may end up in self-absorbed, expedient activity and may fail to balance the interests of the principal with their own. The agents are governed by rules laid down by the principals in order to maximize the value of the shareholders. A more one-sided view is, therefore, applied

in this theory (Clarke, 2004). In the current study, the theory was considered relevant due to its ability to examine the relation that exist between the owners and the managers of a corporate. However, critique of the theory as quoted by Lan and Heracleous (2010) established that the role of the agents was now shifting from that of monitoring to that of mediating which implied more control had been taken by the shareholders making the agency problem not significant. Nevertheless, the Agency model can be used to focus on the objectives of the management and owners. In agency theory, rewards and penalties are prioritized in order to minimize the need for agents acting on their own accord instead of maximizing the value of the shareholders (Meckling & Jensen, 1975).

### **2.2.2 Stewardship Theory**

According to Donaldson (1992), a steward is a person who is committed to guard and maximize the wealth of the shareholders through the performance of the firm because this maximizes the utility function of the steward. In this situation, a steward can perceived as those who are mandated to run the daily activities of a business like the executives and managers who work for the owners, protecting shareholders interests and generating income for them. It is therefore quit important that the managers play the role of stewardship within the company by aligning the decision making with the firms objectives.

This concept implies that stewards are pleased when the success of organizations is accomplished. This emphasizes the responsibility of staff managers to function more effectively to optimize returns to its shareholders. This may lessen the costs of managing behavior associated with monitoring and control (Daly et al., 2003). However, Daly et al.(2003) proceeds to indicate that the corporation is inclined to function to optimize corporate efficiency, financial performance as well as shareholders' income to maintain its credibility as decision-makers in corporations. The performance of the company may have a direct effect on the

expectations of its success in this regard. In essence, stewardship theory recommends that the CEO can play the role of chairman of the board if expenses for the corporation are to be minimized and play a more critical position as organizational stewards. It became clear that the interests of the shareholders would be better served. The theory has been adopted for the current study as it supports the notion of the interest of the different stakeholders in the corporate governance vested in the hands of managers.

### **2.2.3 Stakeholder Theory**

This theory can be attributed to the great work of Freeman, as quoted by Freeman (1984). A stakeholder can be referred to or characterized as any section, groups or any other player in the business that can influence or be influenced by the accomplishment of the objectives of the organization. The theory assumes that each party who has an interest in the firm will have their interest achieved highly depending on the level of the responsibility of the management and who have the tendency of misusing the powers given to them. Wheeler et al. (2002) submitted that the theory of stakeholders was based on integrating the sociological and organizational fields.

Firms have responsibility of ensuring stakeholders interests are factored by the management during their decision making processes without discrimination which hence enhances accountability (Sundaram & Inkpen, 2004). Critiques of the theory argue that the stakeholders interests have never been unified and tend to contradict that of the other stakeholders pointing that ranking of priorities of this interest has never been established (Jamal & Stronza, 2009). The theory has been adopted due to its support of the corporate governance as individual responsibility is owed to every stakeholder in the firm.

## **2.3 Determinant of Financial Performance**

Every company operates intending to maximize the value of shareholders while at the same time, fulfilling the desires of its stakeholders. Consequently, companies' performance was assessed by evaluating other factors that influence the level of financial performance such as the size of the Board, the composition of the board and leverage.

### **2.3.1 Board Size**

According to the research by Hermalin and Weisbach(2003 ) it was realized that efficiency of board was a negative correlation to the size of the board. Agency problems may arise when the board consists of too many panelists. They argued that when the boards become too large, they often take on a more symbolic role instead of fulfilling their intended management function. However, on the other hand, small boards lack the benefit of getting the guidance and perspectives of experts compared to larger boards. Also, increased diversity in larger boards concerning education, expertise, gender, and nationality is more likely to occur (Dalton & Dalton, 2005).

It has been agreeable that firms registering a smaller figure of internal directors as compared to the independent directors tend to perform better. This is based on the independence of members which is seen to boost the decision making process hence increasing efficiency. Vafeas (2000) indicated that companies with the smallest boards with at least five members of the Board are more informed about the company's performance, and can, therefore, be considered to have better monitoring capabilities. Also, Mak and Yuanto (2003) established that most of the firms in Singapore and Malaysia had the highest valuation when they recorded fewer than five board members. In their study SMEs in the Danish economy, Bennedsen, Kongsted and Nielsen (2004), noted that the size of the Board was insignificant in terms of the influence they have on performance for board members below six, while on the other hand



found an inverse and significant linkage existing between the two variables when the size of the board increased to seven or more members.

In their study Bonn, Yokishawa and Phan (2004) sought to establish the relation between board structure and the Japanese and Australian firms performance. According to the research findings on board efficiency established negative correlation for Japanese firms, but for their Australian equivalent, there was no association between the two variables.

### **2.3.2 Board Composition**

In a normal firm, the board of directors has been known to constitute of executive and non-executive directors. Executives are dependent directors who have a lot of interaction with the business operations while on the contrary independent directors are non-executive directors and have less interaction with the business of the firm (Shah et al., 2011). With most of the firms acknowledging that a fair board constitutes one-third of the independent directors as a bear minimum in Board for efficient board operations and impartial supervision. Dependent directors are essential as they have organizational insider understanding that may not be available to outside executives. However, by transferring the resources of other security holders to themselves, they may abuse this expertise (Beasley, 2008). The autonomous board are composed of members who are not corporate executives, shareholders, blood relatives, or family members (Gallo, 2005)

Independent board is usually formed by members who lack associations with the company in such ways that lead to little or limited risk of breach of trust due to the fact that independent directors lack vested interests in a company. According to the study by Dalton, Daily, Ellstrand, and Johnson (2007) it is clear that non-executive directors are crucial, as dependent directors are unable to access the external knowledge and insights enjoyed by independent directors of the firm. Also, as a function of their employment with the company, dependent directors are

essential to the CEO for advice; they are not required to be elected to the Board of directors in order to fulfill this role. In terms of gender diversity of a board composition, the ratio of externally sourced directors and that of the female directors to overall board numbers has a positive effect on the Australian survey as opposed to the Japanese survey (Bonn, 2004).

### **2.3.3 Leverage**

Most influential investors, including banks, have committed their resources to the firm and want to watch their returns on their investments grow. They stand a control privilege based on the fact that in case of breach in utilization of credit advanced by businesses, they earn a range of control rights of enforcement against the companies, and in part as they usually lend short-term loans. For this reason, borrowers need to come back for more funds from time to time. As a result, large shareholders are in many ways, similar to banks and other large creditors.

Gilson (2000) report that when US banks change managers and executives, they play a crucial role in controlling bankruptcies. Weir, Laing and McKnight (2002) assumes that debt financing has been used by firms as an internal control process by which high debt reduces free cash flow and thus restricts management flexibility. Debt allows managers to use any surplus funds to fulfill the obligations of the company instead of investing in projects that may not be creating positive value to the business. Debt owed to major lenders, such as banks, is thought as a helpful tool in minimize the agency problems.

Creditors to the business are also interested in knowing the extent and efforts the managers are making to improve the performance of the business just like stakeholders. Scientific evidence has been seen to support that claim. In the review paper, Shleifer and Vishny (2007) established a higher incidence of management lay off resulting from their poor performance mostly in the context of Japan results that were in support of the findings of Kaplan and Minton (2004) as

well as those of Kang and Shivdasani (2005). Yet another study by Kyereboah, Coleman and Biekpe (2006) looked at the correlation between corporate governance and the level of financial performance. They have widely used leverage as a control variable. Such studies have reported that the debt influences the financial results of the company in their efforts to justify the use of leverage as a control variable.

Other factors that have been thought to affect the financial performance other than the ones that were considered in the current study include; liquidity of the firm, firm size, the level of risk associated with the firm industry and environmental factors which have been found to have diverse impact on the financial performance varying from one industry to another (Batchimeg, 2017).

#### **2.4 Empirical Literature Review**

In respect of the study topic, some studies have so far been done both in the global and in the local context concerning the variables under study.

Marek (2006) presented his work on the how corporate governance and the level of business performance relates in the context of Poland. The results of the 2003 ratings carried out by the Polish Corporate Governance Forum demonstrate a bit of corporate governance. The patterns sought are in an orderly multinomial form. The forecast variable reflects the results of the ranking, while the predictor variables include the financial metrics calculated based on the 2002 financial statements. The approximate ordered logistic regression models suggest that the extent of corporate governance of Polish firms is correlated with their capacity to adapt to financial distress as measured by the study variables but which failed to address the magnitude of the relationship.

Enilolobo, Adesanmi, and Aigbe (2019) studied the corporate governance and financial performance of listed companies with a focus on the food and petroleum industries. For more

than seven years (2011-2017), secondary data was used as a data collection tool with a sample of 10 food and petroleum companies identified. Variables for corporate governance included; the size of the Board, the audit committee, the board independence, and the ownership structure while financial performance was indicated by (ROA). The regression model was the analytical technique used to monitor the data. The Hausmann specification test was carried out for the panel method to be used. The findings indicated a positive effect on the financial performance of food and petroleum companies in Nigeria on the governance mechanisms of the Board of Independent Experts, the Audit Committee, and the ownership. However, the size of the Board hurts Nigeria's food and oil companies ' financial output. The researcher, therefore, recommended that the number of boards of directors should be manageable in size for the effective and efficient management of the organization, the autonomy of the board of directors consideration should be given to ensure better financial performance and the diversification of boards of directors concerning gender, skills, and expertise.

Irine and Indah (2017) investigated the impact on the FP of the manufacturers listed on the Indonesian stock exchange with the size of the Board of directors, the audit committee, institutional ownership, and management ownership as predictor variable. 156 The researchers analyzed the Indonesian companies stock exchange which adopted a linear regression analysis. From the findings, it is clear that the size of the Board, institution ownership, management and Audit Committee impacted on performance, implying an improving financial performance due to corporate governance mechanism.

Bhattra (2017) looked at the linkage between the financial performance of banks and corporate governance which was measured using the size of the Board, the audit committee, and a portion of independent directors on equity returns and non-performing loans. Samples were obtained from 65 submissions from 2010 to 2015. The results of the studies showed that the size of the

committee negatively affected the financial performance of commercial banks in Nepal, the size of the audit committee, and the share of independent directors had a positive impact on their financial performance.

Tamer (2015) made a study that sought the relationship existing between the quality and impact it has on corporate governance practices in Egyptian listed companies and emerging markets on corporate performance and financial distress. The aspect of disclosure and transparency studies, the composition of the Board, the rights of shareholders, and the relationship between investors, ownership, and control structure. The population sample consisted of 86 Egyptian Exchange non-financial firms. Tobin Q is used as an indicator of financial distress to test corporate performance. The Altman Z-score provides an inverse measure of financial performance. The findings indicated a positive relationship even though they were not compatible with the positive relationship between CG and financial performance activities. There is also a negative relationship between corporate management practices and the probability of financial distress. The study demonstrates that company-specific characteristics can help to assess business performance and financial distress as a first-pass screen.

Makokha and Albert (2014) attempted to establish the linkage that existed between the aspect of corporate governance and the resultant effect on the level of performance of insurance firms in Kenya. The study which adopted a descriptive statistics approach found that the two variables were not only positively related but also statistically significant. The study however established that only 33% of the influence of financial performance could be explained by the variables under consideration and that calls for the current study to dig deeper to the factors affecting the financial performance.

Odiero (2018) sought to establish the effect of CG on the financial performance of companies listed in NSE, the study was for a period of 5 years from 2013 to 2017. Descriptive data analysis was used with a sample of 20 companies that are listed in NSE. Results found from Mean and F test computed at a 5% significance level with variables such as Board gender diversity, company size, audit committee, and leverage. The findings indicated insignificance levels in leverage audit committee and company size. However, there was a significant relationship with board gender diversity hence concluding that companies should adopt gender diversity on the management of companies, which improve performance and transparency.

Miniga (2013) on the correlation between CG practices and financial performance of regulatory state corporation in Kenya. The researcher used a descriptive research design. Primary data was collected through questionnaires. Secondary data was collected from audited financial statements. Eighteen regulatory state corporations in Kenya were used as the sample. Multiple regression model was used to determine the relationship between the variables. The study concurred that corporate governance practices influence the financial performance of regulatory state corporations in Kenya.

Moche (2014) in the context of Kenya aimed at investigating the correlation between the two variables of the study on the listed family owned enterprises. The study which adopted a descriptive statistics approach established the relationship even though positive, was found to be insignificant in statistics when it came to the financial performance. However, the study was seen to have a contrarily findings to previous studies calling for the current study.

Maryam (2018) who studied the effects of CG on the performance of commercial banks in Kenya confirmed the above findings. The researcher adopted a descriptive statistics approach using SPSS, where regression was run to establish a relationship between the variables at a 5% significance level. The target population was commercial banks in Kenya with a sample of

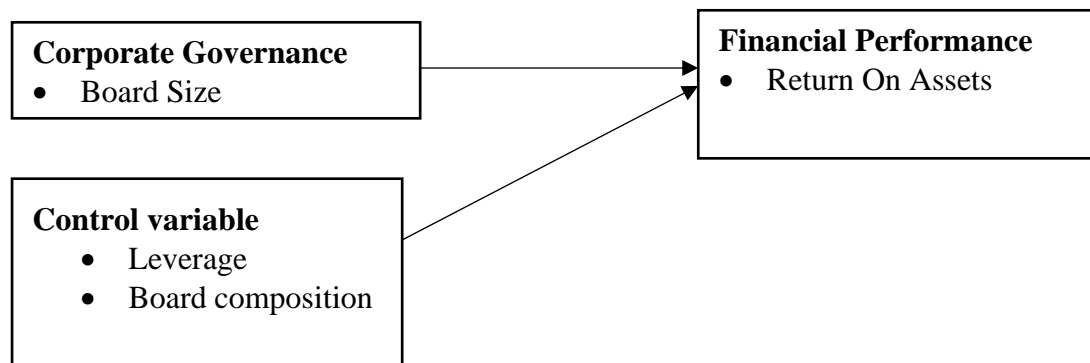
census targeting Kenya commercial banks for the year 2017. The researcher concluded that there was a positive correlation between CG and financial performance of the listed commercial banks though the study was limited to commercial banks neglecting other financial institutions. She also recommended banks to hold frequent board meetings and increase board size and encourage the culture of having independent directors, which increase bank size.

## 2.5 Conceptual Framework

Under this section a review of the relationship that exist between the study variables were reviewed in a pictorial diagram establishing the relation between the dependent variable, independent variable and the controlling variables of the study.

### Independent Variable

### Dependent variable



Source: Author (2020)

## 2.6 Summary of Literature Review and Research Gap

From a practical point of view, CG has been studied by different scholars from different angles as it relates to the financial performance. Some of the studies have established positive, negative or even no influence on the financial performance of firms in different market. Corporate governance's key tasks are thus to ensure corporate performance and minimise disputes that ensure openness and credibility of corporate operation, reduce investment risk, provide good returns for investors and provide a mechanism for managerial accountability

The study focused on theories such as Agency Theory, Stewardship Theory, and Stakeholder theory. The determinants of financial performance include; Board Size, board composition and Leverage. Many researchers like Moche (2014), Makokha and Albert (2014), Marek (2006), Miniga (2013), which found a positive relationship and which was termed to be significant which deviated from Odiero (2018) study which found that the relationship was insignificant while the study by Tamer (2015), established that a negative relationship existed between CG and the financial performance of firms. From this contradicting findings of the study that established positive significant, positive insignificant and even negative relationship, it is unclear on the kind of relationship that exist between the two variables calling for the current study to establish the actual relationship in the context of NSE.



## **CHAPTER THREE: RESEARCH METHODOLOGY**

### **3.1 Introduction**

In this chapter, techniques used in collecting data are analysed. The chapter also covers other areas like the research design, population of study, sampling design, data collection methods and data analysis.

### **3.2 Research Design**

A research design is a road map that guides the researcher throughout the research. It also forms a basis for evaluation of the study results and its conclusions. A research design directs all areas of research like data collection, type of data collected and also the method of analysis to be adopted (Bordens & Abbott, 2002). According to Myers, Well and Lorch (2010), different research questions should be answered differently and so research designs should be well selected in light of the research objectives.

Mugenda and Mugenda (2003) defines descriptive research design as a scientific way that entails observation and description of a subject behaviour without affecting it in any way. This design was used in the study because of its efficiency in obtaining data for the variables in this study. Linear regression and correlation findings helped in analysis.

### **3.3 Population**

Mugenda and Mugenda (2003) defined a population as the aggregate of all elements sharing a common characteristic. In this study, the common characteristic would be the listing in the NSE. The population of the research would therefore include all the companies publicly listed on the NSE. The companies are grouped under different groups depending on their industry and are currently 64 in number.

As the population is small and their data is readily available from secondary sources, a census study was adopted. All companies were analysed in terms of their corporate governance and financial performance. Studying all companies ensured proper coverage of the NSE market and ensured a comprehensive study with better results.

### **3.4 Data Collection**

Secondary information and data sources were used for this study as the data is publicly available in both the NSE and CMA websites. The data from these websites can be trusted in terms of being up to date and correct as they are the regulatory bodies for listed firms in Kenya. The data was collected for the 5-year period from 2014 to 2018. Board size, information on board composition was obtained from report to shareholders while performance was obtained from financial statements of the companies.

### **3.5 Data Analysis**

Data analysis can be defined as a process of breaking down data in a meaningful manner by the use of statistical tools. In this study, the data was analysed using both qualitative and quantitative techniques. Quantitative was through regression to identify the underlying relationship while qualitative was through content analysis.

#### **3.5.1 Diagnostic tests.**

In this study, diagnostic tests were used to test the validity and reliability of the data. These tests are expected to improve on the acceptability of study results as the data used would have been corrected of any anomaly.

The normality test was measured by skewness and Kurtosis to establish whether the data set is modeled for normal distribution. If skewness is not nearing zero, it indicates that the data set is not normally distributed. Graphical representation can help in identifying normality by use

of Histogram or normality plot. Remedy for otherwise occurrence can be corrected by the use of Natural logs to normalize data.

Multicollinearity was tested using the Variance Inflation Factor (VIF), which help in determining the correlation between the Independent variables and the extend of the correlation. Variance inflation factor from one to ten indicates no correlation, and anything above five would have indicated correlation hence the need to remove closely related independent variables.

Heteroskedasticitytest was also be done. The test help in determining variability in variables.It is carried out to ensure that there are no outliers, omitted variables, scale effects, among others. Ordinary least squares assume that all observations are essential; hence, the Breusch-Pagan test or White's Test may be carried out to test for heteroscedasticity.

The data was also be tested for autocorrelation and linearity. Linearity was tested as it is a key assumption in ordinary least square method. It was tested through plotting scatter diagrams and noting any observable trend. If missing, the situation were to be corrected through use of ratios or natural logarithms of the values instead of their absolute values. Autocorrelation was tested to determine the relationship between the error terms in successive years. It was tested by use of Durbin-Watson test and Breusch-Godfrey test for 1<sup>st</sup> order and higher order autocorrelations respectively. Correction was done by use of robust standard errors

### **3.5.2 Analytical Model**

The analytical model below was used to achieve the objective of the study;

$$Y_i = b_0 + b_1BS + b_2BC + b_4LEV + \varepsilon$$

$Y_i$  = Performance of companies as measured by ROA

$B_0$ , is the constant of the equation

$b_1, b_2, b_3,$  and  $b_4$  are coefficients of predictor variables

BS= Board Size

BC = Board Composition

LEV = Leverage

$\epsilon$ = Error terms

**Table 3.1 Operation of variables**

<b>Variables</b>	<b>Terms of measurement</b>	<b>Supporting Literature</b>
Performance	ROA	Mutua (2019)
Corporate governance	Board Size	Enilolobo, Adesanmi, and Aigbe (2019)
Board Composition	The ratio of Non-Executive directors to the total number of directors	Bhattraï (2017), Odiero (2018)
Leverage	Debt to Equity Ratio	Bragg (2018)

**Source: Author(2020)**

### **3.6.1 Significance Tests**

Significance in this study was tested at a 95% confidence interval. It was done by use of P-value, F test and also t-test. Testing at such a high confidence interval ensured that variables and values are really significant before they are determined to be so.

## CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSION

### 4.1 Introduction

This chapter elaborates on data collected characteristics and the results of the study. The chapter also indicates the various tests done on the data before running the tests on it and shows how the objectives of the study have been met. The chapter also discusses the implications of the study results based on the research questions.

### 4.2 Descriptive Statistics

In this study, data was collected for firm performance, corporate governance, board composition and leverage. Data was readily available through the Capital Markets Authority website and also from the company reports. Due to this availability, the researcher was able to collect 100% of the data required for firm performance and board composition. Data for corporate governance was 79.6% available while for leverage, it was 92.8% available. Since the lowest availability was at 79.6% which is above the minimum requirement of 70% as per Mugenda and Mugenda (2013), the data collected was found to be adequate enough to generate good results which would facilitate determination of the underlying relationship between the study variables.

**Table 4.1 Response Rate Table**

Variable	Firm performance	Corporate governance	Board composition	Leverage
Data collected	235	187	235	218
Unavailable data	0	48	0	17
Total	235	235	235	235
Response rate (%)	100%	79.6%	100%	92.8%

**Source: Author**

Summary statistics on the collected data have indicated that on average an investor in NSE would have a negative return of 1.24% which means that they will be losing money and their wealth would be decreasing. However, the return has a very high variability meaning that the

returns of the specific companies vary greatly as indicated by a 51.91 standard deviation. This indicates that with proper research, an investor would still be able to get positive returns by building a good portfolio of better performing companies. The minimum performance was a negative return of 76.3% while the best performing company had a return of 50.32% as measured by the firm return on assets.

On corporate governance, there is very little variation with a mean of 8.8 persons in the boards of the companies and a standard deviation of 8.87. The minimum board size was 5 while the maximum was 19 persons. This results indicate that board sizes, and thus corporate governance is almost the same in the companies listed in the NSE. In terms of the board composition, there is an average of 40.9% non executive directors in the listed firms with a standard deviation of 34.7%. there is a minimum of 0% composition of non executive directors meaning that there are some companies who have not had non executive directors for the study period. The maximum composition was rounded to 100% indicating that there are some firms which would rather have a board almost made up of non executive directors. On leverage, as measured by debt to equity ratio, the average ratio is 77.3 indicating that firms prefer having more debt than equity. The variability is very high with a standard deviation of 1,581.7. the range between the maximum and minimum ratios is huge with the minimum and maximum being -6,708 and 22,334.7 respectively.

**Table 4.2 Table for Data Summary Statistics**

Variable	Obs	Mean	Std. Dev.	Min	Max
Financial Performance	235	-1.242136	51.97266	-763.1614	50.3207
Corporate Governance	187	8.871658	2.82169	4	18
Board Composition	235	40.94613	34.68703	0	100
Leverage	218	77.32775	1581.701	-6708.075	22334.67

**Source: Test results**

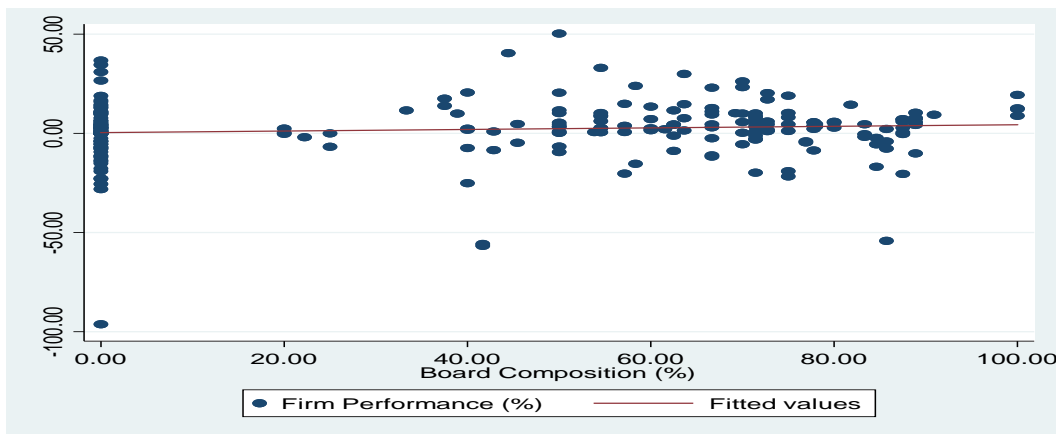
### **4.3 Diagnostic Tests**

Before analysis, data was passed through a series of tests to ensure that it was fit for regression and probably take corrective measures to avoid violating regression assumptions. This section

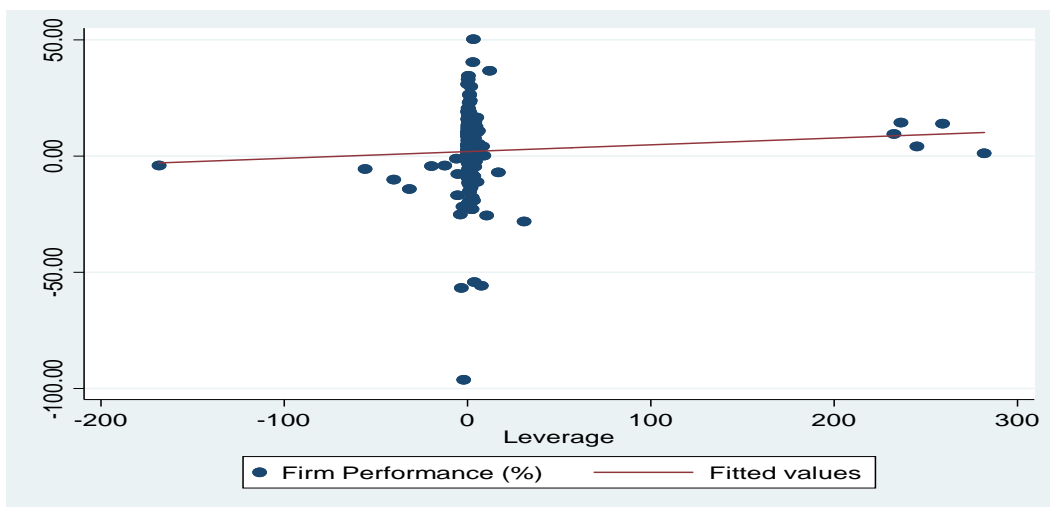
outlines the various tests which were performed to the data together with their results and conclusions.

### 4.3.1 Linearity

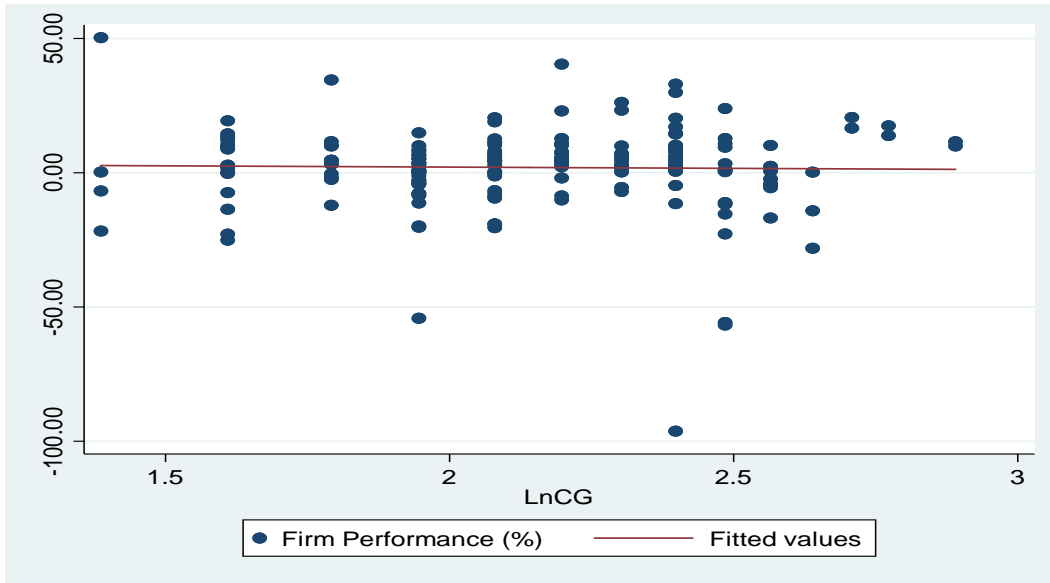
Linearity in this study was tested by plotting graphs of the independent variables against the dependent variable. A line of best fit was also drawn to have a clear view and understanding on the existence and the nature of the linearity. Corporate governance was found to have very little linear relationship coefficient as compared to the other variables. Leverage had the highest linear relationship coefficient indicating a greater change for every unit change in leverage.



*Fig 4.1: Linear relationship between board composition and financial performance*



*Fig 4.2: Linear relationship between leverage and financial performance*



**Fig 4.3: Linear relationship between corporate governance and financial performance**

### 4.3.2 Test for Omitted Variables

Omitted variables were tested to ensure that no variable with a potential of affecting the financial performance is left out of the regression model. The test was done using Ramsey RESET test and the null hypothesis tested was that the model had no missing variables. Results indicated that the model had not omitted any relevant variables as indicated by the insignificant p-value interpreted at a 95% confidence interval.

**Table 4.3 Ramsey RESET Test Table**

Ramsey RESET test
Ho: model has no omitted variables
$F(3, 176) = 1.07$
Prob > F = 0.3654

**Source: Ramsey RESET test results**

### 4.3.3 Test for Heteroscedasticity

Heteroscedasticity was tested to note the behavior of the variances and was done using the Breusch-Pagan test. Interpretation was done at a 5% significance level and the null hypothesis tested was that there was no existence of heteroscedasticity. The test results produces a significant p-value which meant a rejection of the null hypothesis and a conclusion that there



was existence of heteroscedasticity. The anomaly was corrected by differencing in running the regression.

**Table 4.4 Breusch-Pagan Test Results Table**

Breusch-Pagan / Cook-Weisberg test for heteroscedasticity	
Ho: Constant variance	
chi2(1)	= 111.50
Prob > chi2	= 0.0000

**Source: Breusch-Pagan test results**

#### 4.3.4 Hausman Test

Hausman test was done to determine the more efficient model between the fixed effects and the random effects models. Each of the two models were regressed and the results tested for hausman test. The test was based on the null hypothesis that random effects model was efficient. As the test returned a significant p-value at 5% significance level, the null hypothesis was rejected and the alternative, which is that fixed effects model is efficient, was adopted.

**Table 4.5 Fixed Effects Model Results**

Fixed-effects (within) regression			Number of obs = 183			
Group variable: Company			Number of groups = 46			
R-sq:			Obs per group:			
within = 0.0762			min = 1			
between = 0.0000			avg = 4.0			
overall = 0.0002			max = 5			
			F(3, 134) = 3.68			
corr(u_i, Xb) = -0.5190			Prob > F = 0.0137			
Financial performance	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]	
Board composition	-0.0434827	0.0351498	-1.24	0.218	.113003	.0260376
Leverage	-.0198261	.0611807	-0.32	0.746	.1408309	.1011786
Ln Company governance	-22.096	6.994667	-3.16	0.002	35.93023	-8.261766
_cons	51.60583	15.24184	3.39	0.001	21.46013	81.75153
sigma_u 16.173858						
sigma_e 10.560599						
rho .70109812 (fraction of variance due to u_i)						
F test that all u_i=0: F(45, 134) = 5.54 Prob > F = 0.0000						

**Source: Fixed effects regression results.**

**Table 4.6 Random Effects Results Table**

Random-effects GLS regression				Number of obs = 183		
Group variable: Company				Number of groups = 46		
R-sq:				Obs per group:		
within = 0.0646				min = 1		
between = 0.0026				avg = 4.0		
overall = 0.0005				max = 5		
				Wald chi2(3) = 4.58		
corr(u_i, X) = 0 (assumed)				Prob > chi2 = 0.2051		
Financial performance	Coef.	Std. Err.	z	P> z	[95% Conf. Interval]	
Board composition	-.0057044	.0333522	-0.17	0.864	-.0710735	.0596647
Leverage	.0197611	.0416575	0.47	0.635	-.0618862	.1014083
Ln Corporate governance	-10.02537	4.780791	-2.10	0.036	-19.39555	-.6551941
_cons	23.21973	10.38176	2.24	0.025	2.871853	43.56761
sigma_u 12.493695						
sigma_e 10.560599						
rho .58326428 (fraction of variance due to u_i)						

**Table 4.7 Hausman Test Results Table**

	Fixed effects	Random effects	Difference	S.E.
Board composition	-.0434827	-.0057044	-.0377783	.011097
Leverage	-.0198261	.0197611	-.0395872	.0448077
Ln Corporate governance	-22.096	-10.02537	-12.07063	5.10582
Test: Ho: difference in coefficients not systematic				
chi2(3) = 13.35				
Prob>chi2 = 0.0039				

**Source: Hausman test results**

#### 4.3.5 Test for Multicollinearity

Variance inflation factor was used to test for multicollinearity in the model variables. The results were interpreted by comparing with 5, and aimed at omitting those with a factor higher than 5 as it would be closely related with other variables in the study and would mislead the conclusions. The variables were found to have very low levels of multicollinearity and

therefore, they were all included in the regression. The average VIF was found to be 1.01 which was very low indicating that the variables were not much correlated with each other.

**Table 4.8 Multicollinearity Test Results**

Variable	VIF	1/VIF
Ln corporate governance	1.01	0.986128
Board composition	1.01	0.991142
Leverage	1.01	0.992180
Mean VIF	1.01	

**Source: VIF test results**

#### 4.3.6 Test for Stationarity

Hadri LM test was used to determine stationarity in the variables. The test was based on the null hypothesis that the panels were stationary. Interpreting at a 5% significance level, it was determined that the variables were stationary as indicated by the significant p-value.

**Table 4.9 Hadri LM Test Results**

Hardi LM test
Ho: All panels are stationary
z = -0.5404
p-value = 0.7055

**Source: Hadri LM test results**

#### 4.3.7 Normality test

To test whether the data was well distributed, the skewness and kurtosis tests were performed on the data. Financial performance and leverage were found to be well distributed while board composition and board composition were found to be skewed towards the right.

**Table 4.10 Normality Test Results Table**

Variable	Obs	Pr(Skewness)	Pr(Kurtosis)	adj chi2(2)	Prob>chi2
Financial Performance	235	0.0000	0.0000	.	0.0000
Board composition	235	0.5603	.	.	.
Leverage	216	0.0000	0.0000	.	0.0000
Ln Corporate governance	187	0.3015	0.0675	4.46	0.1073

**Source: Normality test results**

#### 4.4 Correlation Analysis

Correlation was used to determine how the variables were correlated with each other. The test was performed using the Pearson Correlation Coefficient test on all the variables. Financial performance was found to be positively correlated with both board composition and leverage but negatively correlated with corporate governance. Their coefficients were 0.0944, 0.0774, and -0.0200 for board composition, leverage and corporate governance respectively. Board composition was found to be positively correlated with corporate governance but negatively correlated with leverage. On leverage, it was found to be positively correlated with corporate governance. The factors indicate the possible relationships between every two variables in isolation.

**Table 4.11 Correlation Analysis Results Table**

	Financial performance	Board composition	Leverage	Ln corporate governance
Financial performance	1.0000			
Board composition	0.0944	1.0000		
Leverage	0.0774	-0.0399	1.0000	
Ln corporate governance	-0.0200	0.1232	0.0818	1.0000

**Source: Pearson correlation coefficient test results**

#### 4.5 Regression Analysis and Hypotheses Testing

Regression was used to determine the relationship between the dependent and the independent variables. The regression indicated that the variables actually influence financial performance of companies though to a very less extent. The three factors studied were found to affect financial performance by 6.46%. This indicates that financial performance is very diverse and is affected by so many other factors which would determine the remaining 93.54%. The results were however not significant as indicated by a p-value of 0.2051 at a 5% significant level.

**Table 4.12 ANOVA**

Random-effects GLS regression	Number of obs = 183
Group variable: Company	Number of groups = 46
R-sq:	Obs per group:
within = 0.0646	min = 1
between = 0.0026	avg = 4.0
overall = 0.0005	max = 5
	Wald chi2(3) = 4.58
corr(u_i, X) = 0 (assumed)	Prob > chi2 = 0.2051

**Source: Panel regression results**

Results of the study have also established that both board composition and corporate governance affect negatively while leverage affects it positively. This indicates that it is beneficial to have more debt in the capital structure and detrimental to have big board sizes and more non executive directors in the board structure. The results were significant for corporate governance but insignificant for both board composition and leverage. The results indicate that financial performance increases by 0.0197 for every unit increase in leverage but reduces by 10.02 for every unit increase in corporate governance. For an increase in a unit proportion of non-executive directors, financial performance reduces by 0.0057. These results indicate that corporate governance has a very great potential of affecting performance compared to its composition and leverage. Companies need therefore to be aware of this impact and take appropriate measures as advised by the identified relationship.

**Table 4.13 Regression Analysis**

Financial performance	Coef.	Std. Err.	z	P> z	[95% Conf. Interval]	
Board composition	-.0057044	.0333522	-0.17	0.864	-.0710735	.0596647
Leverage	.0197611	.0416575	0.47	0.635	-.0618862	.1014083
Ln Corporate governance	-10.02537	4.780791	-2.10	0.036	-19.39555	-.6551941
_cons	23.21973	10.38176	2.24	0.025	2.871853	43.56761
sigma_u	12.493695					
sigma_e	10.560599					
rho	.58326428 (fraction of variance due to u_i)					

**Source: Panel regression results**

#### **4.6 Discussion of Research Findings**

The research findings, having established a negative influence on performance by corporate governance and board diversity finds that there is an agency problem in Kenyan listed firms. This is because of the fact that the more the number of board members, the worse off the company becomes. Although it was expected that this would have generated new ideas and expertise leading to a competitive advantage. As agents, board members in Kenya have thus defied the Agency Theory. These observations agree with those of Padilla (2000) that agents ends up pursuing their agendas instead of those of their principals, who are shareholders in this case. The management have also failed in their steward responsibilities as they ought to have established through research that big boards in Kenya are not translating to improved financial performabnce and took corrective measures.

The study agress with the findings of Hermalin and Weibach (2003) that efficiency of the board is negatively correlated with the size of the board as indicated by the reduction in financial performance. Although according to Dalton and Dalton (2005), the bigger sizes should result to diversity in expertise and ideas, this has not materialized and smaller effective boards may be better. The study supports the recommendation of Vefas (2000) that smaller boards of approximately 5 board members may be better than bigger ones like in Kenya where the average is 8.8 members.

The study has also established that non executive directors do not contribute to superior performsnce of the firm. These results agree with those of Shah et al. (2011) who observed that non executive directors have little interaction with the business operations and therefore a bigger proportion of them is not beneficial. This finding however does not undermine the role non executive directors play in oversight and also in bringing external knowledge and insights, which are beneficial.

On leverage, the study findings show that leverage is good for businesses. Previous researchers have attributed this to control effects which result to less need for monitoring of managers. This is because creditors monitor managers to know how they are improving the performance of their firms and hence there is overall improvement in the performance of the firm which also benefits other stakeholders. The study therefore suggests more, but careful use of debt to improve financial performance. Based on the low R<sup>2</sup>, the study also finds that there are so many other factors which affect financial performance and thus managers need to take measures to be aware of these factors to perform better and create wealth for their shareholders and also benefit other stakeholders.

## **CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS**

### **5.1 Introduction**

This section of the study focuses on the summary of the research findings based on the study objectives. The chapter covers conclusions of the study, recommendations for the study based on the findings. The chapter also concentrates on the limitations of the study encountered in the course of research and suggestions for future studies in the area of the study.

### **5.2 Summary of Findings**

The research had its main objective being to establish the impact of corporate governance on financial performance of listed firms in the NSE stock market. In the attempt to realize this objectives, the researcher considered some other variables to be relevant for the study. This variables included the board size as measured by the number of directors in the firms, the board composition which was measured using the ratio of non-executive directors and the leverage levels. The research obtained secondary data from the listed firms which is readily available from the capital markets authority and the specific firms website. Audited financial statements were highly preferred based on the level of their assurance as they are confirmed by competed auditors and which are mostly published during the annual general meetings for each listed firm. The firms that are listed in the NSE as non financial where 47 and whose data was collected for five years giving rise to a total of 235 possible data points. With most of the variables recording 100% response rate, corporate governance recorded the lowest response rate with 187 data points which translates to 79% response rate and which was deemed sufficient to form a basis for making research conclusions.

The research findings established that all the variables under consideration had a normal distribution trend apart from the board composition which was skewed at 0.5603 skewness or and the log of corporate governance which was not only skewed but peaked as well with pr for skewness and kurtosis being 0.3015 and 0.0675 respectively. The multicollinearity test indicated that the data was from multicollinearity with the VIF recorded at 1.01. The



autocorrelation results indicated that all the variables influenced the financial performance in a position way apart from the log of corporate governance which had a negative influence. Leverage also was found to have a negative relationship with the board composition while all other variables exhibited a positive relationship. From the summary of statistics, the financial performance recorded a mean of -1.2421 million which was an indication that most firms were making losses, corporate governance as measured by the number of directors had a mean of 8.87. Board composition recorded a mean score of 40.95% of the non-executive directors while the leverage level had a mean of 77.32.

The research regression results indicated that the R-sq 6.46% which was based on the random effect model as determined by the hausman test. On the study variables, the regression indicated that financial performance was having an inverse relationship with the corporate governance which was also established to be statistically significant at the 95% confidence level. On the board composition, results indicated that the board composition was negatively related to the financial performance but which was established to be statistically insignificant. The results also indicated that leverage levels was positively related to the financial performance of the listed firms which the NSE market.

### **5.3 Conclusions**

Based on the study results discussed above, the researcher arrived at a number of conclusions as guided by the research objectives. The following are the conclusion. Based on the negative relationship that was established between the financial performance and the corporate governance, the researcher therefore concludes that a high number of directors was unfriendly to the financial health of a business based on the increased management cost and the extended decisions making process which at times ends up causing sub-objectives in the business and which have less focus to the main objective for the firm. From the statistics results on the board composition which was established to be having a negative relationship with the financial

performance, the researcher concluded that lower proportion of non executive director was favorable to the business. This could be because of the time devorted into the business and which was limited for non executive director as compared to that of the executive director. The study results on the leverage level showed a positive impact to the financial performance. This then leads to the conclusion that firms with higher leverage were found to be doing better than those with lower leverage. This could be attributed to the increased level of management as the debt providers normally introduce an extra monitoring to the firms to secure their credit. Also the tax shield obtained from interest expense as an allowable expense in taxation increased the returns to the share holders. From the R sq value of 6.46%, the study derives a conclusion that the variables under the study explained a less proportion of the factors that influence the financial performance which means there are other contributing factors and which need to be established.

#### **5.4 Recommendations**

Based on the research findings, the researcher makes a number of recommendations to both the shareholders and other stakeholders in the industry. On the issue of corporate governance that has been found to be having a negative influence on the financial performance of firms listed in the Nairobi Security Exchange, the researcher recommends that the firms should try to minimize the number of directors while at the same time not compromising the quality of the roles they play. This can be achieved through having qualified directors who meet the state of the art requirements and motivating them to offer their best. This will allow for faster decision making that allows the firms to take opportunities as they arise, lower the cost of management and avoid duplication of duties which lowers efficiency of a firm.

On the other variables, the study established a negative relationship between the board composition and the financial performance which indicates that the higher the percentage the lower the financial performance. Therefore, the study recommends that the ratio of the non-

executive directors to the total directors should be maintained at a desirable level and considerable at lower level. On the level of leverage, the study established that there was a positive relationship between the leverage level and the financial performance of firms in the NSE. Based on this observation, the study recommends that firms should not fear the use of debt as it is to some extent considered to be less costly as compared to the equity financing. Also the tax shield and extra management offered on debt is something which should not be overlooked.

### **5.5 Limitations of the Study**

The study was faced with a number of limitations, for instance, the study was only conducted in the context of the Kenyan market and which limits the results applications to the state economic conditions or to only countries that have similar economic structure like the Kenyan market. Therefore, the results may not be applicable to nations that may be having different economic structure or political arrangements. Also the study was conducted in the Kenyan market during a time when the country was having the interest rates capping. This means that the influence of the leverage on the financial performance may vary in those countries that have not been practicing the capping policy. Again in a fair market, interest rates may be higher than the cushioned case of Kenya and hence the results may be different from those of the cushioned years.

The data analyzed for the five years may also be a limiting factor as the time is shorter to establish some seasonal variations which may be exhibited in different economic states. This means that more years would cater for the economic cycles which may favor the performance of firms at one point or other time is unfavorable to the performance of the firms. The study may also have been limited in the scope as it only factored listed firms and which is not the only player in the market as the small and medium enterprises may be contributing to the economic performance and which were not factored in the current study.

## **5.6 Suggestions for Further Research**

Based on the limitation of the study, the researcher makes the following suggestions to future researchers so as to build on the body of knowledge in the field of the study. More studies need to concentrate on the other non listed firms and SMEs to establish if a similar relationship exists in their case. Also more studies need to be considered in other countries and that may be having different economic and political structures to establish if similar relationship to the variables still existed. Again with the fact that the interest rates capping has been lifted, more studies need to be conducted and track the change of the trend in the coming years after the lifting has been put in place.

More studies need also to be conducted on the listed firms for more years and establish if there might have been some cyclical factors that influenced the current study results. Also, more insight need to be developed on the other factors that may be affecting the performance of the firms in the stock market as the current factors explained a less proportion of the changes in the financial performance.

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## APPENDICES

### Appendix I: Data Collection Sheet

Company .....				
Year	Financial Performance	Board Size	Board Composition	Leverage
2014				
2015				
2016				
2017				
2018				