THE RELATIONSHIP BETWEEN BOARD ACTIVITY AND FIRM PERFORMANCE:

A STUDY OF FIRMS QUOTED ON THE NAIROBI STOCK EXCHANGE

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A project submitted in partial fulfillment of the requirements for Master of Business Administration degree, University of Nairobi

By

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DECLARATION

THIS PROJECT IS MY ORIGINAL WORK AND HAS NOT BEEN PRESENTED FOR A DEGREE IN ANY OTHER UNIVERSITY

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THE PROJECT HAS BEEN SUBMITTED FOR EXAMINATION WITH MY APPROVAL AS THE UNIVERSITY SUPERVISOR MR. LISHENGA

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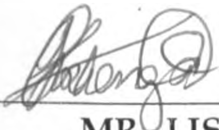

MR. LISHENGA

10-11-05

DATE

DEDICATION

To my family

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ABBREVIATIONS

CACG	Commonwealth Association for Corporate Governance
CBK	Central Bank of Kenya
CCG	Centre for Corporate Governance
CMA	Capital Markets Authority of Kenya
NSE	Nairobi Stock Exchange
PSCIT	Private Sector Corporate Governance Trust

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ABSTRACT

Corporate governance, the manner in which companies are controlled and evaluated continues to attract intense interest in emerging and developing economies as the link between good corporate governance and national economic development becomes clearer. Furthermore, investors have become more discerning and insist on high standards of corporate governance in companies in which they invest and shareholders are more demanding that they receive maximum value for their investment. The monitoring role of the board of directors has long been recognized as a crucial component of corporate governance. In practice however, the board of directors is often criticized as a toothless bulldog characterized by dysfunctional behaviour and largely ineffective in overseeing top management.

This study, using secondary data from the quoted companies in the Nairobi Stock Exchange established that board activity as measured by the frequency of board meetings is influenced by factors such as board size, the number/ percentage of shares held by offices and directors (inside ownership); the number of executive and independent directors serving in the board; the number/ percentage of total shares held by unaffiliated block holders and the number of standing board committees in a manner that is consistent with the contracting and agency theory.

The study using regression analysis further finds that board activity is positively related to the financial performance of firms suggesting that board activity is a value relevant attribute in corporate governance in that board activity increases when a firm's financial performance is poor and there is improvement following intense board activity.

These results suggest that board meetings are an important dimension in board operations and particularly in the boards' ability to effectively monitor management and improve firm's performance thereby benefiting shareholders.

CHAPTER ONE

INTRODUCTION

The Cadbury Committee Report (1992) and the Capital Markets Authority of Kenya (2002) have recommended certain basic principles of what constitutes good corporate governance practices. These include board size, board composition, establishment of board committees, board leadership, and the number of other directorships that the chairman and other members of the board can hold in other public companies and remuneration of directors (which are in this study referred to as the corporate governance mechanisms.)

This study was concerned with identifying the corporate governance mechanisms that mostly influence board activity as measured by board meeting frequency (the determinants of board meeting frequency) and specifically sought to examine the nature of the association between board meeting frequency and corporate governance mechanisms of public listed companies in Kenya.

The study also sought to determine whether board activity as measured by board meeting frequency had any significant effect on the financial performance of companies.
The study focused on those companies listed on the Nairobi Stock Exchange (NSE) because they have a wide and diverse range of shareholders who are not involved in the day to day management of the companies hence propelling the issue of corporate governance to the fore front. Forty eight (48) companies quoted on the NSE were studied.

The study established that board meetings were held quite frequently (over 75% of the companies had nine (9) meetings in a year during the period of 1998-2003. This period was characterized by poor economic performance nation wide and it is likely that the board of directors had to devote more time to company affairs to guide the companies through those tough years of operations. With regard to the association between board activity as measured by board meeting frequency and corporate governance mechanisms the study found that the number of board meetings is significantly positively related to board size, the number of board committees, the number of non-executive directors and the number/ percentage of shares held by officers and directors (inside ownership).

The analysis of the interaction between board meeting frequency and the value of the firm shows a lagged positive relationship between the number of board meetings and firm value implying that the value of a firm positively responds to changes in board meeting frequency and using the price to book ratio confirms that indeed low price to book ratio triggers the intervention of the board of directors through increased meeting frequency presumably to steer the company out of the crisis.

The premise of this study was that the association between board activity and corporate governance variables were complex and unclear. The two testable propositions in this study were that: an association exists between a board activity and an array of corporate governance variables; and that board activity adds value to the firm. If board activity is proved to add value to the firm then an inference that it adds value to the shareholders is logical.

Chapter 1 of the study gives a background to corporate governance explaining why it has become a prominent issue for both companies and countries. The role of the board of directors in monitoring management for the benefit of shareholders is also discussed.

Chapter 2 provides a review of studies that have been done in the area of corporate governance and in particular reviews the attempts made by various scholars to relate the ability of boards to effectively monitor management and firm performance to board characteristics such as board size, ownership structure, board composition and board meeting frequency.

Chapters 3 and 4 present the research methodology as well as the findings of the study.

Chapter 5 presents the conclusions and recommendations.

1.1 Background to the study

Around the world, the frontiers of corporate governance are expanding rapidly, just as the seriousness of governance issues increasingly challenge directors, boards, investors, management, regulators and academicians.

Corporate governance has been practiced for as long as there have been corporate entities. Governance issues arise whenever a corporate entity acquires a life of its own, that is whenever ownership of an entity is separated from its management. (Tricker (2000)). Indeed, Adam Smith shows that he understood the issue of corporate governance, even though he did not use the phrase:

> Directors of companies, being managers of other people's money, it cannot well be expected that they will watch over it with the same anxious vigilance with which partners in a corporate company watch over their own (Smith 1776 edn 1976; p 264).

It was not however until the 1980's that the topic received much attention.

"The proper governance of companies will become crucial to the world economy as the proper governing of countries". (Bowes, 2000: p 1).

A decade earlier Peter Drucker, when examining the challenges managers would face in the 1990's predicted that: "The governance of business is likely to become an issue throughout the developed world". (The Economist, 21st October 1989: p 26).

These predictions have come to pass as evidenced by the interest that the subject of corporate governance has generated in the media, professional, academic literature and society at large. Several reasons can be advanced for this interest in corporate governance.

Firstly, the interdependence between the society and business demand that companies be accountable to the society as company decisions have far reaching effects on the society and the environment. Companies not only provide essential goods and services, they pay taxes, create employment and engage in community-based activities and have thus become development

partners with the society. As society becomes increasingly dependent on companies it (society) becomes more concerned with corporate activities and their governance as they (companies) play a key role in the creation of wealth both at the national and the corporate level. Drucker (1974) says that society will scrutinise company activities and especially those of large and visible business so as to ensure accountability.

Secondly, public attention following high profile corporate scandals and collapses in recent times of companies such as Enron, Parmalatt, WorldCom, the Maxwell Corporation, the Bank of Credit and Commerce International (BCCI) have shocked the world because their fall was not preceded by any warnings and their managers were known to be the experts of the day. In Kenya the collapses of Lonrho, Trust Bank, Euro Bank, Kenya Finance Trust are proof of the implications where the principles of corporate governance are not observed. Stiles (1993) explains that the spectacular company collapse is as a result of lack of preventive measures within corporate control.

Thirdly, the hard economic times all over the world have exposed corporate weaknesses. The volatility of the world economy has significantly increased the risks faced by companies today. Stiles (1993) asserts that in such a non-compromising environment we can no longer afford to overlook corporate fraud, mismanagement and unjustified executive pay awards among other irregularities (Demb and Neubauer; (1992); Dimsdale and Prevezer; (1994)).

Finally, the globalisation of economies and the growth of financial and investment markets in the 1990s has presented an opportunity for institutional investors to deploy their massive funds internationally. As they seek to do so, they are insisting on high standards of corporate governance in the companies in which they must invest. (CACG; 1999). Investor confidence can only be enhanced with good corporate practices where there is accountability and transparency. After all, an investor can only trust management once the objectives and the return on their equity has been stated hence the demand for accountability from the directors.

Consequently governments and boards of corporations have been forced to pay attention to fundamental issues of corporate governance as essential for public economic interest for without efficient companies or business enterprises, the country will not create wealth or employment. Without investment, companies will stagnate and collapse. If business enterprises do not

prosper, there will be no economic growth, no employment, no taxes paid and invariably the country will not develop. The country needs well-governed and managed business enterprises that can attract investments, create jobs and wealth, remain viable, sustainable and competitive in the global market place.

"Good corporate governance therefore becomes a prerequisite for national economic development". (CACG; 1999).

In Kenya, the institutions that have been at the forefront in sensitizing the corporate sector in Kenya on corporate governance are The Capital Markets Authority (CMA), the Nairobi Stock Exchange (NSE), the Center for Corporate Governance (CCG) and the Central Bank of Kenya (CBK) which regulates the banking industry.

The CMA created a major impact in the development of corporate governance guidelines in Kenya when it issued in 2002 the Capital Market guidelines on Corporate Governance Practise by public listed companies. These guidelines were published under a gazette notice No. 369 of 25th January 2002 and not a legal notice and therefore do not have the force of law. However, certain of the guidelines have subsequently been incorporated into legal notice No.60 of 3rd May 2002 as part of the Capital Markets (Securities) (Public offers, Listing and Disclosure Regulations) 2002 and are enforceable in law. The stated objective of the CMA guidelines on Corporate Governance is to strengthen and promote the standards of self-regulation and bring the level of governance practices in line with international trends.

The NSE has amended its Listing Manual and incorporated the CMA guidelines on corporate governance into the continuous obligations of listed companies and it continuously monitors compliance by listed companies with these obligations.

In Kenya the emphasis on good corporate governance and accountability to shareholders and stakeholders has been on public listed companies. The potential for listed companies being subjected to sanctions for non-compliance by either the CMA or NSE has played an important role in encouraging compliance with the guidelines.

The Institute of Certified Public Accountants (Kenya) encourages its members to report on the corporate governance practises of companies they audit and the Institute of Certified Public

Secretaries (Kenya) also encourage its members to ensure compliance with the corporate governance guidelines. Both institutions train their members on corporate governance issues.

1.2 Corporate Control and the Board of Directors.

The corporation is a nexus of contracts among self-interested and potentially opportunistic parties. (Jensen and Meckling (1976)). Contracts among corporate managers and residual risk bearers provide the main focus in most discussions of corporate governance. Recent advances in economic theory suggest that the board of directors is an important part of the governance structure of large business corporations (Fama and Jensen, (1983); Willamson, (1983, 1984)). The board of directors which has the power to hire, fire and compensate senior management teams, serves to resolve conflicts of interest among decision-makers and residual risk bearers. This economizes the agency cost associated with the separation of ownership and control and facilitates the survival of the corporation as an organizational form (Baysinger and Butler; (1985)). Thus it is not surprising that the corporation laws require that the affairs of business corporations be managed under the guidance of a board of directors. (Cary and Einsberg (1980)).

In Kenya, the Companies Act (Cap 486, Laws of Kenya) whilst investing the management of the business of a company in its board of directors is generally silent on matters concerning the size (it sets a minimum of two directors), composition and structure of boards, directors' compensation; place, time and frequency of board meetings. These governance issues have been left to the discretion of the board by both economic theory and corporate law.

Within the context of the numerous corporate governance mechanisms the board of directors is properly viewed as the solution to the problematic aspects of a particular set of manager-shareholder interactions.[1]

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[1] *Other mechanisms include the easy alienability of shares (facilitated by limited liability); product and capital market competition, the market for corporate control, the managerial labor market, company law (Baysinger and Butler (1985), Jensen and Meckling (1976), Manne (1965), Scott (1983), Williamson (1981), Wolfson (1980), Fischel (1982), Fama (1980), Faith et al (1984).*

It is therefore not surprising that the CMA corporate governance guidelines place great emphasis on the role of the board of directors based on the notion that shareholders welfare is enhanced by boards of directors which are capable of monitoring management, rendering independent judgments on managerial performance and meting out rewards on the basis of these evaluations. *Ceteris paribus*, firms with more independent boards should perform better; changes in board composition to encompass an optimal balance between inside and outside directors, separation of roles of board chairman and chief executive officer, an optimal board size and board meeting frequency should improve firm performance.

Research in other countries has focused on board composition and has underlined the important role of outside directors in protecting shareholders' interests in settings requiring good decision control (Weisbach (1988) and Cotter et al (1997)). Other studies have explicity recognized that in addition to a director's affiliation, a director's reputational capital (e.g. Shivdasani, (1993)) and incentive compensation (Perry,(1996)) may guide the director's decisions.

Jensen (1993) suggests that a value relevant attribute of corporate boards is their size and Yermack (1996) documents that the market values firms with smaller boards more highly.

Vafeas (1999) finds that the annual number of board meetings is related to firm value and that operating performance improves following years of abnormal board activity.

1.3 The Research Problem

The monitoring role of the board of directors has long been recognized as a crucial component of corporate governance. Shareholders with their diversified interests do not necessarily have the professional capacity to run the organization. They appoint directors entrusting them to run the organization fairly, transparently and efficiently to enhance shareholders' value through well defined objectives. The directors in turn delegate the day-to-day operations of the organization to management who establish a system of structures for the efficient operation of the organization. The directors and management are therefore agents of the shareholders. Effective communication, transparency and accountability are the cornerstones in governance in order to achieve profitability and sustainability. Directors can only make good policy decisions if they are provided with timely and correct information by management. Management in turn has to ensure that the structure and systems within the organization are well laid out to achieve this

objective. It is the effectiveness of this framework that adds value and gives meaning to the core objectives of corporate governance.

Corporate governance guidelines such as those proposed by the Cadbury Committee report (1992) and the CMA (2002) recommend a number of principles that are essential for good corporate governance practices such as among others, a balanced board of directors to lead and control the company and be accountable to its shareholders, the establishment of board committees particularly audit and nomination committees; directors remuneration, the supply and disclosure of information, appointments to the board, the number of directorships a person can hold in public listed companies at anyone time, the separation of the role of the chairman and the chief executive officer, the number of chairmanships a person can hold in public listed companies at any one time. (The CMA guidelines on corporate governance practices of public listed companies in Kenya, 2002).

The said CMA guidelines go further and define the role and responsibilities of the board of directors which include, the fostering of long-term business of the corporation, defining the company's mission, its strategy goals, plans and objectives including approval of its annual budgets, overseeing the corporate management and operations, management accounts and review of corporate performance and strategies at least on a quarterly basis identifying the corporate business opportunities and the principal risks in the company's operating environment, developing staffing and remuneration policies, reviewing the adequacy and integrity of the company's internal control and management information system on a regular basis and establishing and implementing systems that provide information to the shareholders.

Needless to say, in order to fulfill its responsibilities the board of directors would be required to devote a considerable amount of time to the company's affairs if it is to be effective in its monitoring role and enhance or improve the operating performance of the company. However as earlier stated neither economic theory nor corporate law in Kenya address the issue of the frequency of board meetings, their length, quality and content.

Based on the foregoing, an understanding of the frequency of board meetings and its determinants should presumably shed light on the board's ability to monitor management and hence improve firm performance. Prior research on corporate governance in Kenya has focused

mainly on compliance with or the state of the principles of corporate governance best practices. Jebet (2001), on the corporate governance structures prevalent in public listed companies in Kenya; Kitonga (2002) on the need for corporate governance audit in Kenya; Mwangi (2002) on corporate governance practices among insurance companies in Kenya, Mucuvi (2002) on corporate governance practices in Kenya motor vehicle industry; Wainaina (2002) on corporate governance practices in micro-financial institutions in Kenya; Gakuo (2003) on corporate governance practices in non-governmental organizations in Nairobi, Wangombe (2003) on corporate governance practices in co-operative SACCO's in Nairobi and Mwangi (2003) on the determinants of corporate board composition in Kenya – an agency perspective.

Considering therefore the pivotal role that corporate governance plays in creating value for the shareholders of corporations and society at large and the lacuna in both economic theory and corporate law on the level of board activity that would render the board of directors effective in their monitoring role, this paper proposes to study the corporate governance mechanisms, and in particular board size, ownership structure, board composition, leadership structure, director incentive plans, the number of other directorships held by the directors and the number of standing board committees. The paper seeks to establish whether among the public listed companies in Kenya board meeting frequency is related to these corporate governance and ownership characteristics in line with contracting and agency theory. The paper also proposes to determine if such board activity has any effect on the performance of public quoted companies in Kenya.

1.4 Objectives of the study: -

1. To examine the association between board activity as measured by the frequency of board meetings and corporate governance mechanisms;

2. To determine the interactions between board meeting frequency and firm value.

1.5 Importance of the study: -

This study is expected to be of interest to the following groups of people: -

1. Shareholders and investors: the study is expected to offer an insight to shareholders on how often boards of directors meet and the implications thereof in terms of their effectiveness in their monitoring role. They can therefore gauge whether boards of directors are effective or merely rubber stamps of management.

2. Management: the study will be of benefit to management as, if we do find that board meeting frequency is a value relevant attribute, then managers will plan board meetings better, giving the boards adequate relevant and timely information well in advance and hopefully view such meetings as an opportunity for meaningful interaction and exchange of ideas and not an obligation that they have to suffer.

3. Regulators: the research will offer the Regulators a basis for the assessment and refinement of board characteristics that may help improve the efficacy of corporate governance.

4. Researchers: the research will offer a basis for further academic investigation into the value relevance of other board attributes such as board composition, board size, ownership structure and director incentive compensation in Kenya.

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CHAPTER TWO

LITERATURE REVIEW

The primary focus of this study is to understand the role of board activity in corporate governance and to determine if board activity is a value relevant board attribute.

This section examines the empirical studies that have been conducted in the area of corporate governance and more particularly the attempts made to relate the ability of boards to effectively monitor management and firm performance to board characteristics namely board size, ownership structure, board composition, leadership structure, director incentive plans, the number of other directorships held by the directors, the number of standing board committees and the number of board meetings and which constitute the variables of this study.

2.1 Corporate Governance:

Tricker (2000) observes that corporate governance as yet does not have an accepted theoretical base or commonly accepted paradigm. He adopts the words of Pettigrew (1992), that corporate governance lacks any form of coherence, either empirically, methodologically or theoretically, and therefore there have been piecemeal attempts to try to understand and explain how the modern corporation is run.

Hence despite the common use of the term corporate governance there is no one universally accepted definition of the term but some of the more common definitions include:-

"Whilst management processes have been widely explored, relatively little attention has been paid to the processes by which companies are governed. If management is about running business, governance is about seeing that it is run properly. All companies need governing as well as managing". (Tricker, 1984 as quoted in the CACG Guidelines, 1999, p 1).

"Corporate governance is the system by which companies are directed and controlled". (Cadbury, (1992) as quoted in Corporate Governance: Workshop Seminar and Report Vol.2, p 32).

"Corporate governance can be thought of as "the way in which managers are made responsible to boards of directors and they in turn to the shareholders". (Dimsdale, (1994) p 13)).

"Corporate governance is the set of institutional arrangements governing the relationships among several stakeholders (investors, both shareholders and creditors; managers and workers) in order to realise economic gains from such a coalition. These institutional arrangements serve to bridge the divergent interests that arise between investors and managers and therefore ensure that directors and management act in the interest of all stakeholders and in particular the shareholders to whom they owe a duty". (Aoki and Kim, (1995, p 235)).

"Corporate governance is the process and structure used to direct and manage business affairs of the company towards enhancing prosperity and corporate accounting with the ultimate objective of realizing shareholders long-term value while taking into account the interest of other stakeholders. (CMA Guidelines on Corporate Governance Practises by Public listed companies in Kenya, (2002, p 123)).

From the aforegoing definitions, it is common ground that the board of directors is ultimately responsible for the organisation's decisions and performance. It is the board that is accountable to the owners and other stakeholders. The directors should provide direction and supervise the work of executive management. Corporate governance is therefore about the exercise of power over corporate entities. (Tricker (2000)).

For the purpose of this study, the term corporate governance will be defined as the manner by which companies are directed and controlled.

In Kenya, Jebet (2001) found that most public quoted companies complied with the corporate governance structures and systems recommended by the CMA. A survey of

corporate governance practices in the Co-operative SACCO Societies in Nairobi by Wangombe (2003) and by Wainaina (2002) on governance practices in micro-finance institutions in Kenya found that corporate governance structures were weak in such organizations and accountability of management was therefore weak. Studies by Mwangi (2002) on the corporate governance practices among insurance companies in Kenya and by Mucuvi (2002) on corporate governance practices in the motor vehicle industry in Kenya indicated a high level of awareness about corporate governance issues and that steps were being taken to set up effective corporate governance structures in those industries. Kitonga (2002) found that there was a need for a corporate governance audit by external auditors in public quoted companies in Kenya. The implication of this study is that management cannot monitor itself and the board and the CMA are not a strong enough watchdogs.

An empirical study by Karpoff et al (1996) found that firms in the United States of America attracting governance proposals by shareholders had poor prior performance as measured by market-to-book ratio, operating return and sales growth thus giving credence to the argument that shareholders believe that corporate governance increases firm value. The study however found little evidence that operating returns improve after the proposals and that the proposals had negligible effects on company share values and top management turnover and that even proposals that received a majority of shareholder votes did not engender share price increases or discernible changes in firm policies.

Corporate governance continues to attract the attention of shareholders, directors, boards, management, regulators and scholars and continues to evolve towards more effective corporate governance structures.

2.2 The role of the board of directors.

In common law countries, the board of directors is the primary internal control mechanism through which shareholders exercise control over management. Its principal functions are to "hire, fire and compensate the CEO, and to provide high level counsel". (Jensen; (1993), p 862)). In practice however, the board is often critized as a toothless bulldog, characterized by norms of dysfunctional behaviour, and largely ineffective in overseeing top management.

In Kenya, the board of directors is legally the highest authority in the company and obtains its mandate from the Companies Act which provides that the business of the company shall be managed by the directors who may exercise all powers of the company subject to the limitations contained in the Companies Act, the Memorandum and Articles of Association and to any directions given by special resolution. The powers of the directors are vested in the board (the directors acting as a collective agency) and not on the individuals.

As earlier intimated, the Companies Act is generally silent on matters concerning the size (it sets a minimum of two directors), composition and structure of the boards, director's compensation, place, time and frequency of board meetings. These issues have been left to the discretion of the board. The CMA guidelines on corporate governance practices by public listed companies in Kenya (2002; p 125) have attempted to fill the lacuna left by the Companies Act by clarifying the role and responsibilities of the board of directors as earlier discussed.

For a board of directors to effectively discharge its functions in line with these guidelines, requires, in my assessment, that directors devote a considerable amount of time to the company's business notwithstanding the part-time nature of non-executive directors which makes it difficult for them to exercise control over management where needed.

Pfeffer, (1972) decried the lack of management literature pertaining to corporate boards of directors although admittedly there were books and legal treatises on the duties and functions of directors most research had been non quantitative (Baker, (1945)) and prescriptive – this he argued would reinforce the common notion that boards were unimportant. There has however since then been tremendous interest in the role of the board.

Mace (1972) conducted a non-quantitative study involving in-depth interviews and held several hundred shorter discussions with top business executives on the role of directors. He found that in most companies management manages the company, and the board members serve as source of advice and counsel to the management and not a decision-

making nature and that "occasionally, but only very rarely, the advice and counsel of a board member leads to a reversal of a management commitment or decision". He also found that boards of directors serve as some sort of discipline for management and that "even in those situations where top management know from previous experience the members of the board will not ask penetrating, discerning and challenging questions considerable care is taken in preparing figures and reports for board meetings."
Something in the way of discipline results simply from the fact that regular board meetings are held – managers do a better job of thinking through their problems and of being prepared with solutions, explanation or rationales.

Mace (1972) also finds that the board of directors acts in "crisis situations" – if the chief executive officer dies suddenly or is asked to resign because of unsatisfactory management performance, the board has the decision making responsibility to decide on his successor. He further found that board members were more willing to devote more time to the company in times when the company was in distress.

Contrary to business literature describing the functions of the board Mace (1972) found that boards of directors do not:-

(i) establish objectives, strategies and policies however defined. "These roles are performed by management and the board gives approval based on scanty facts and recommendations by management not on time-consuming analysis".

(ii) ask discerning questions – He finds that board members feel that board meetings are not intended as debating societies and that in any event many board members lack of understanding of the problems and the implications of topics that are presented to the board and thus to avoid "looking like idiots" they refrain from questioning or commenting. He says that as a result most board meetings resemble "the performance of traditional and well-established almost religious rituals and that in most companies, it would almost be possible to write the minutes of a board meeting in advance .... only the financial figures are different".

(iii) select the Chief executive officer except in crises situations earlier referred to. Mace quotes a company vice chairman who stated that:

> "the old concept that the stockholders elect the board, and the board selects the management is a fiction .... The board does not select the management, the management selects the board".

However, in today's competitive corporate world and more recently in Kenya in public companies board members are elected on the basis of skills or expertise and most companies train their board members on their roles and involve them in establishing strategies, objectives and plans. Management however continues to set the agenda, draw the strategies, objectives and plans for the corporation.

In a study of corporate governance practices among non-governmental organizations in Nairobi, Gakuo (2003) found that the balance of power was skewed in favour of boards and management with management being a strong influence on decision making with little or no input from other stakeholders.

However the role of the board varies from firm to firm as a function of organization structure (Williamson 1983) and corporation law (Baysinger & Butler (1985). Rajesh et al (2002), Eistenhardt, (1989) and Jensen and Meckling (1977) document that from an agency theory perspective, boards of directors are put in place to monitor managers on behalf of shareholders.

2.3 Separation of ownership and control and the extent of ownership dispersion

Berle and Means (1932) were the first to observe that the separation of ownership and control had become a common feature of large non-financial corporations in the United States of America during the 1930s. Their study of the 200 largest U S non-financial corporations sought to classify them on the basis of who controlled the corporations - owners or managers. By control they meant the individual or group within the company that had the power to select the board of directors or to dictate the policy of the company to management and not necessarily the group or individual making normal day to day

decisions in the operations of the company. To determine the extent to which voting rights were concentrated in a single party, they used a 20 per cent voting concentration as the minimum concentration necessary for owner control. They concluded that 44 per cent of the firms they studied were manager controlled.

Larner (1966) and Vernon (1975) also conducted similar studies and they too concluded that management control was dominant in US companies. A similar finding was made by Mayer and Alexander (1991) (as quoted in Dimsdale & Prevezer; 1994) on quoted companies in Britain.

Jebet (2001) finds that in public quoted companies in Kenya the share ownership of the companies is not widely dispersed and hence the largest shareholder is able to easily control the board. She concludes that the directors elected by the majority shareholder may not necessarily represent the interests of the small shareholders.

These studies only indicated the extent to which shareholding was dispersed but did not indicate the effect of such separation of ownership on the performance of companies.

The separation of ownership and control has attracted attention primarily because it may influence the performance goals to which firms address themselves. According to Vernon (1975) profit maximazation may be pursued vigorously where firms are management controlled rather than owner controlled because it may be more consistent with the interests of managers than the interests of owners. There may also be different attitudes of firms with the two control types towards growth rate, risk, acceptance, efficiency, management remuneration, research expenditure and other performance goals.

2.4 Board Meetings

Demb and Neubauer (1992) recommend that board meetings should be frequent. Conger et al (1998) suggest that board-meeting time is an important resource in improving the effectiveness of a board. Lipton and Lorsch (1992) observe that the most widely shared problems directors face is lack of time to carry out their duties. This view is reinforced by recent criticism in both the financial and academic press of directors and who spread their time too thin by taking on too many outside directorships, confounding their ability

to attend meetings regularly and, therefore, to monitor management well (e.g. Byrne 1996; NACD; 1996).

The implication of these articles is that directors in boards that meet more frequently are more likely to perform their duties in accordance with shareholders interests. This I submit may be the rationale for the restrictions placed by the CMA guidelines on corporate governance in public listed companies in Kenya (2002) on the number of directorships and chairmanships one person can hold in a public listed company at any one time.

An opposing view is that board meetings are not necessarily useful because the limited time outside directors spend together is not used for meaningful exchange of ideas among themselves or management. This problem is a by product of the fact that chief executive officers almost always set the agenda for board meetings (Jensen, 1993). Moreover, routine tasks absorb much of the meetings time, limiting opportunities for outside directors to exercise meaningful control over management. In fact Jensen (1993) suggests that boards should be relatively inactive, and that boards are usually forced to maintain higher activity levels in the presence of problems. In this view, board meetings serve as a fire-fighting device rather than as a proactive measure for improved governance. Thus while the consequences of higher board activity are unclear, higher board activity is a likely corporate response to poor performance (Vafeas, 1999).

Donaldson & Davis (1994) argue that inherent problems with board design may render the board unable to check management. They quote an empirical study by Bacon (1993) on the frequency of board meetings in which Bacon found that in the U.S. the full board of directors meets an average 7.3 times a year for 3 hours each meeting. Such full board meetings occupy 70 per cent of the time that directors spent on board duties on average. The other 30% per cent of the time is spent in committees of the board (e.g. audit, nominating). Thus full board committees total 31 hours a year, an average, of 2.6 hours a month. They pointed that even if one were to add to that an equal amount of time for the director to read his/her board papers and handle board business between meetings, then the non-executive director would spend a total of about five hours each month on their board activity. Such a small amount of time, they argue, makes it difficult for any

outside, non-executive director to be fully informed about the affairs of a large complex fast moving corporation. The time problem alone makes it infeasible that non-executives can control much better informed executives who are full – timers, frequently with years of experience in the corporation.

Vafeas (1999) conducted an empirical study of 307 firms in the U.S to examine the importance of board meeting frequency by testing whether boards of firms that meet more frequently outperform firms with inactive boards. He investigated the determinants of board meeting frequency and the association between this frequency and firm value for the sample firms over 1990 – 1994, both in independently estimated equations and in a simultaneously determined system. He further examined the relationship between changes in board meeting frequency and prior, contemporaneous and subsequent firm performance. He found that board meeting frequency is related to corporate governance and ownership characteristics in a manner that is consistent with contracting and agency theory and that the annual number of board meetings is inversely related to firm value, a result that was driven by increased board activity following share price declines. He further found that operating performance improves following years of abnormal board activity and that the improvements were most pronounced for firms with poor prior performance and firms not engaged in corporate control transactions. He concludes that the results of his study suggest that board activity, measured by board meeting frequency is an important dimension of board operations and that on balance, frequent board meetings are one way the board responds to tough years of operations.

2.5 The Determinants of Board Activity

Several factors are known to affect the level of board activity. (Vafeas; (1999)).
The empirical studies on these factors are discussed below.

2.5.1 Board Size

Organizational theory suggests that larger groups take more time to make their decisions. Steiner (1972) documents that process losses increase rapidly with group size. Thus for a given level of output a large group will therefore require more input time. Lipton and Lorsch (1992) suggest an optimal board size of between seven and nine directors.

Demb and Neubauer (1992) propose that boards of eight to ten create informed environments where more forceful discussions can be sustained.

Yermack (1996) documents an inverse relation between board size and firm value.

Jebet (2001) found that most public quoted companies in Kenya had between 5 and 10 directors.

Chagnati et al (1985) found that the likelihood of a company going bankrupt was lower for companies with larger size boards i.e. ten or more directors (whether executive or non-executive). Pearce and Zahra (1992) found that larger sized boards led to greater subsequent performance. These two findings support the notion that boards need to be of sufficient size to have wide enough expertise.

On the other hand Vafeas (1999) finds that the size of corporate boards is positively related to board activity, consistent with larger groups requiring more time to attain a given level of output. In firms with large boards, board meeting time seems to be partly wasted due to inefficient board sizes. He argues that this evidence is in line with Yermack (1996) suggesting a lower valuation of firms with larger boards. Olubunmi (2003) also finds that a large size board hinders the board's ability to perform its monitoring functions and suggests that this lends additional support to the current drive toward smaller boards.

2.5.2 Inside ownership

Jensen and Meckling (1976) note that as the proportion of equity held by the manager increases, his propensity to undertake excessive perquisite consumption declines thereby aligning managerial and shareholder interests. It is hypothesized that the monitoring role of external board members would be less critical for firms with higher proportions of inside ownership. Morck et al (1988) and McConnel and Servaes (1990) show that an important control mechanism is inside ownership, which is positively related to firm value albeit in a non-linear fashion. Fama and Jensen (1983) suggest that inside directors are important to effective governance because they provide valuable information to outsiders regarding the criteria necessary for evaluating the performance of senior managers. They also provide an experienced pool of senior level managers ready to step in if the incumbent CEO proves unsatisfactory (Fama, (1980)).

Mace (1972) finds that directors who serve on corporate boards because they own or represent the ownership of substantial shares of stock generally do in fact take a deep interest in the operations of the company and spend considerable time in learning this business and being involved in major company decisions.

Vafeas (1999) finds that the percentage of inside ownership is inversely related to board activity consistent with the notion that active boards and high insider ownership help to align the interests between managers and shareholders. He concludes that the level of inside ownership appears to substitute for board monitoring activity.

Prevost et al (2002) also find consistent with the findings of Bathala and Rao (1995) that higher inside ownership is associated with a smaller proportion of outsiders on the board supporting the substitution hypothesis that board composition and insider ownership are substitute mechanisms in mitigating agency problems.

2.5.3 Outside Directors

The main premise of studies focusing on the role of outsiders is that board independence is the critical element determining the ability of a board to monitor management. In particular, boards with a majority of members not directly beholden to management are seen to be more likely to act in shareholder's interest. In this sense more outside board members should be related to enhanced firm performance.

Outside directors, presumably, enhance the board's effectiveness through increased objectivity and by serving as a reservoir of independent expertise upon which the board can draw as the need arises. In addition, independent directors are usually people with significant reputational capital acquired in other contexts. Sheppard (1994) proposes that outside directors "provide an indicator of the board's orientation towards its external environment and thus its ability to respond to change". The inability to respond to change is one of the major causes of corporate decline.

For these reasons it is suggested that boards dominated by independent directors are more likely to act in the best interests of shareholders and that they will safeguard the interest

of owners against managers who will serve their own interests at the expense of the owners (Berle and Means, (1932) and Williamson, (1935)).

The presence of outsiders on the board also serves to prevent collusion (among top managers on the board) and thereby increases the effectiveness of the internal managerial labour market.[2]

Consequently better board monitoring brought by more outside board members may be necessary to compensate for a lack of effective monitoring by the external corporate control market. (Prevost et al (2002)).

However, there is only marginal empirical evidence of a board composition – performance relationship (e.g. Hermalin and Weisbach (1991) and Baysinger and Butler (1985)) for US based firms. On the other hand, Lawrence and Stapledon (1999) fail to find consistent evidence that a direct relationship exists between the proportion of independent outside directors and firm performance in a sample of listed Australian firms.

Other work has suggested that there is a relation between outsiders and decreased firm performance. Agrawal and Knoebs (1996) surmise that boards of US firms may be expanded for political reasons (politicians, environmental activists) and that these "outsiders" either reduce performance directly or by proxy for the underlying political constraints that led to their receiving board seats. There is also evidence that insider representation is associated with higher levels of performance (e.g. Baysinger and Hoskinsson (1990) and Hoskinsson et al (1994) on the basis that insiders have firm-specific knowledge and expertise unavailable to outsiders.

In an attempt to clarify and condense these apparent inconsistencies meta-analyses were conducted by Wagner, et al (1998) and they found a positive significant correlation between board composition and performance from a sample of 29 empirical studies.

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[2] *Fama, 1980; Weisbach, 1988; Byrd and Hickman, 1992; Brickley et al, 1994; Borokovich et al, 1996; and Cotter et al (1997) document the monitoring role of outside directors.*

However, they also found similar effects for the presence of insider directors and concluded that performance is enhanced by the greater relative presence of either insider or outside directors. On the other hand, meta-analyses by Dalton et al (1998) of 54 empirical studies found that there was little evidence of a systematic relationship between board composition and performance. These performance-related studies remain inconclusive.

In contrast, non-performance related studies document a significant relationship between outside board representation and the incidence of particular corporate events that affect shareholders wealth. Weisbach (1988) reports a significant association between board composition and the likelihood of CEO turnover. Specifically, he finds that turnover is more sensitive to performance for companies with outside dominated board than for companies with insider dominated boards.

Hermalin and Weisbach (1988) also find that insiders (outsiders) are more likely to leave (join) the board after a firm performs poorly and when a firm discontinues a business. Borokhovich et al (1996) find the likelihood that an executive from outside the firm is appointed CEO increases with the percentage of outside directors. These studies provide strong evidence that greater outside representation increases (limits) shareholder gains (losses) resulting from value-changing events (Prevost et al (2002).

Mayers et al (1997) document empirical evidence that in mutuals where ownership rights are non-transferable, monitoring by the board's outside directors becomes more important.

Stronger support for the impact of non-executive directors comes from event study analysis which has tended to show that the appointment of non-executive directors increases company value. (Rosenstein and Wyatt (1990) and (1997) and Shivadasani and Yermack (1999)).

Vafeas (1999) finds that board meetings frequency is unrelated to the representation of outsiders on the board and thus fails to find support for the notion that outside directors require more opportunities (meetings) for keeping up with corporate affairs.

2.5.4 Unaffiliated Owners of large equity blocks

From an agency perspective where an individual shareholder owns a large equity stake in a firm, that shareholder has an increased incentive to monitor managerial behaviour since he will receive a greater share of any benefits resulting from discouraging mismanagement (Shleifer and Vishny, (1986)).

Vafeas (1999) suggests that unaffiliated owners of large equity blocks could facilitate corporate governance since they are in a better position to monitor management and mitigate agency problems in the firm. Denis et al (1997) discuss how a firm's equity ownership structure affects the incidence of CEO turnover. They show that the likelihood of top executive turnover is significantly negatively related to managerial ownership and positively related to the presence of an unaffiliated block holder. They also show that CEO turnover is less sensitive to a firm's performance when inside ownership is large. Prevost et al (2002) propose that high ownership concentrations are likely to shield management from the discipline of the external control market.

The effect of large shareholders or block holders on mitigating agency problems in the firm has been recognized by scholars.[3] A large body of strong evidence has developed which shows that shareholder wealth increases when large blocks of equity are acquired by outside shareholders owing to their monitoring role (Grossman and Hart (1980)) and Shliefer and Vishny (1986) Bethel et al (1998) in the US and Craswell, et al (1997) in Australia. Li (1994) finds that outside board proportion and ownership concentration are substitutes i.e. inversely related. Hossain et al (2001) observe that the extreme1y high ownership concentrations documented in New Zealand make takeovers very difficult thus compromising the potential role of takeovers as a disciplining mechanism. They also find an inverse relationship between ownership concentration and firm performance especially at high levels of ownership concentration (Prevost et al (2002)). Rediker and Seth (1995) examine the relationship between outside board representation and alternative internal governance mechanisms including stock ownership by top managers

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[3] *Grossman and Hart (1980) and Shliefer and Vishny (1986).*

and monitoring by large shareholders and they find a substitute effect between outside board representation and blockholder equity stakes, managerial shareholdings and stock ownership of inside directors.

A study by Weir et al (2002) on UK public companies finds that external shareholdings did not have a significant monitoring effect inconsistent with the finding by Shivdasani (1993) that unaffiliated blockholders monitor sufficiently to prevent firms from deteriorating enough to become a hostile takeover target.

Overall these studies suggest that there is a substitutional relation between ownership concentration and outsider representation thus when the level of ownership concentration increase, the proportion of outsiders on the board decreases. Vafeas (1999) finds that the presence of an unaffiliated blockholder in the firm is insignificant in explaining board meeting frequency and suggests that external blockholders may monitor management through informal means outside the boardroom as in take-over type scenarios.

2.5.5 Board Committees

Corporate boards often delegate tasks under their responsibility to standing board committees. Demb and Neubauer (1992) propose that committees should be established to provide both more in-depth exposure and better control. Committee structures provide opportunities for outsiders to understand the company, its executive talent pool, business and industry better. Further, considering the proposition that as board size increases board activity is likely to increase to compensate for increasing process losses I submit that committees being smaller in size would reduce process losses and enable more responsive decision-making.

Cadbury (1992) recommends that all quoted companies should establish internal board-subcomittees. Consistent with the agency models, the Cadbury report argues that audit committees are an additional control mechanism that ensure that shareholders interests are being safeguarded.

Relatively little empirical study has been done to assess the impact of sub committee structure on performance (Bhagat and Black (1998); and Dalton et al (1998)). Klein

(1996) studies the use of standing board committees for S&P firms and provides some evidence that director affiliation plays a different role in committees focusing on decision management tasks than in monitoring committees. Specifically, Klein (1996) documents a positive relation between the percentage of inside directors in investment and finance (decision management) committees with accounting and stock market performance measures.

Vafeas (1999) finds that boards forming more monitoring committees meet significantly more often, which suggests that the coordination and supervision of more board committees require substantially more time. Thus decentralized boards need to spend more time controlling board operations. This result he concludes does not support the proposition that delegating board tasks reduces the need for the board to meet as a whole because the work load is shifted to board committees. He concludes however that subcommittee structure and quality provide insights to those responsible for undertaking the monitoring roles within companies. Wild (1994) shows that the market reacted more favorably to earnings reports after an audit committee had been established. Klein (1998) reported that neither the presence of an audit committee nor its structure had an effect on the range of accounting and market performance measures. Vafeas and Theodorou (1998) also found no evidence to support the view that the structure of board subcommittees significantly affected performance. Weir et al (2002) however find that the structure and quality of board subcommittees have little impact on performance but found a weak relationship between committee director quality and performance.

2.5.6 Leadership Structure

There are two key tasks at the top of the company. That of running the Board and that of the CEO responsible for running the company. Several authors including Jensen (1993) and Cadbury (2002) argue that combining the positions of CEO and board chairman entrenches the CEO and hinders the firm's ability to perform its monitoring functions. Cadbury (2002) proposes that the roles of CEO and Chairman of the board should be separated to contain CEO dominance over other board members. The CMA corporate governance guidelines (2002) recommend a clear separation of the roles and responsibilities of the Chairman and CEO to "ensure a balance of power of authority and provide for checks and balances such that no one individual has unfettered powers of

decision-making". The guidelines further recommend that where the roles are combined a rationale for the same should be disclosed to the shareholders in the company's annual report.

Shareholder's activists argue that the board chair should be granted to an outside executive to make the board as a whole more effective as a monitor. Dominant CEOs are likely to entrench their positions by stacking the board with more insiders (Weisbach, 1988; Bacon and Brown, 1973). In this case the board would be a rubberstamp of management as they owe their position to the CEO and are unlikely to be critical of their (management's) performance.

On the other hand, Allen and Berkley (2003), argue that separating the roles of CEO and Chairman may in fact harm the very stakeholders advocates hope to protect as effective firms lodge ultimate leadership and accountability in a single place. A split power structure, in their view, would reduce the authority of the CEO and would introduce a complex new relationship into the center of the firm's governance and even into its operations. They base the thrust of their argument on the rationale that firstly, the CEO's power would be shared with a person who is less informed and whose principal concern would tend to be risk avoidance and secondly that two centers of authority in a business would create the potential for organizational tension and instability and that even the threat of such conflict would produce a costly diversion of attention from more productive areas thus hindering management's effectiveness in creating value.

Taking an agency theory perspective, Dalton et al (1998) propose that the separating of the roles of the CEO and chairman "reduces the opportunity for the CEO and inside directors to exercise behaviours which are self-serving and costly to the firm's owners".

Studies of the board chair have produced mixed findings about whether a non-executive chair is superior to an executive chair with no consistent overall pattern. Two studies show that having the board of directors chaired by a person who is independent of the executive management leads to higher performance than when the board is chaired by the top executive (Rechner and Dalton (1991); Berg and Smith (1978)). However, the findings of Rechner and Dalton (1991) study hold only for accounting measures of

performance but not for stock market measures of returns to shareholders (Rechner and Dalton (1991)). The Berg and Smith (1978) results suffer from inconsistency in the findings as between the text and the tables (reporting a negative effect of an executive chair in the text (Berg and Smith (1978) Table A1)) and is therefore equivocal.

Donaldson and Davis (1991) show the opposite that is, superior performance of boards with executive chairs (though this is significant only for accounting measures). Chagnati et al (1985) find a nil effect of the non-executive chair on the probability of the firm going bankrupt.

Strickland et al (1996) and Wahal (1996) report cases in which shareholder activists targeted firms for a split in the CEO/Chairman roles. Brickley et al (1997) do not discern a statistical link between a firm's leadership structure and its performance. They argue that there are costs to abstracting from a unitary leadership structure, firms do place less emphasis on alternative incentive – alignment mechanisms. Furthermore, as in the case of outside directors, an outside board chairman needs to be informed more frequently. (Vafeas (1999)).

Prevost et al (2002) in a New Zealand study found that many boards were headed by a dual CEO Board chair who often stacked the board with ineffective corporate insiders. According to Mackey (1993 p 24): " Many of the companies which crashed spectacularly in recent years had the same person occupying the position of chairman and chief executive and had few if any independent directors".

Prevost et al (2002) further found that the number of outside directors inversely correlated with the incidence of CEO duality, which implies that greater outside representation is consistent with a higher level of board independence.

Li (1994) finds that CEOs in dual leadership positions are associated with a greater percentage of outside directors across a 10 country sample suggesting that CEOs in dual leadership positions are less able to dominate board member selection in these countries.

Boyd (1995) found that Chairman/CEO duality actually leads to better performance. In contrast, Baliga et al (1996), Brickley et al (1997) and Dalton et al (1998) all found that it had no effect on performance. Vafeas and Theodorou (1998) and Weir and Lang (1999) found that CEO duality did not harm performance neither did it improve it.

Vafeas (1999) finds no evidence that an independent chairman promotes better monitoring by calling more meetings.

Jebet (2001) finds that all public quoted companies in Kenya have a separate leadership structure but does not examine the effect on firm performance. The Centre for Corporate Governance (2002) finds that in the banking industry in Kenya, in eighty percent of the banks the position of the Chairman and CEO were occupied by a separate person and in twenty percent the positions were held by the same person. It was further found that in all the banks except two, there was a clear distinction of the responsibilities of the chairman of the board and the CEO. The study did not however examine what effect if any, the separation of the roles had on firm performance.

2.5.7 Director Incentive Plans

Mace (1972) suggests that one reason for the passivity and the lack of involvement by outside directors is that the relatively modest compensation provides limited monetary incentive to devote time and energy to a company's problems.

Borokhovich et al (1996) argue that the board of directors is charged with representing shareholders interests. However, the board does not always use its authority to advance those interests particularly when the incentives of individual board members differ from those of shareholders.

A number of studies suggest that the degree of alignment between board and shareholder incentives varies with the composition of the board. Fama and Jensen (1983) argue that outside directors, who tend to be major decision makers at other organizations have incentives to signal to the labour market that they are experts in decision control by acting in shareholders interests. Inside directors on the other hand, are more likely to be concerned about maintaining their current position in the firms and as noted by Weisbach

(1988) they are less likely than outside directors to challenge the CEO to whom their careers depend on. Inside directors including the CEO have incentives to protect any above-market compensation or excess non pecuniary benefits that they receive through their position as managers. Vafeas (1999) finds that the presence of director incentives plans does not affect the level of board activity. He attributes this finding to the fact that these plans are a fairly new tool and their antecedents and consequences are not well understood. He further finds that directors' fees are not an important determinant of the intensity of board activity and suggests that this may be due to the fact that meeting fees are small and not enough to change directors behavior. Mace (1972) suggests that directors "are generally overpaid for that they do and underpaid for what they should do'. Mace (1972) also suggests that high director's fees would motivate able and responsible directors to devote commensurate time and energy to the affairs of the corporation they serve.

A Kenyan study by the Centre for Corporate Governance (2000) in the banking industry found that in all the banks directors receive compensation (director fees, bonuses, sitting allowances, loans at subsidized rates, car mileage, housing, entertainment and travel allowances) for their services. The study also found that in eight banks the remuneration was determined by the shareholders at the Annual General Meeting, but in two banks the remuneration was determined and approved by the board itself. The study did not however establish whether the presence of the plans motivated directors to devote time and energy to the companies.

2.5.8 Other directorships held by outside directors

The external labour market provides a measure of the returns earned by directors. One way of measuring these returns is by the number of additional directorships held by a director. The greater the number of additional boards a director is asked to serve on, the greater the reputation and standing of that director. Additional directorships may therefore be regarded as a proxy for director quality. Thus assuming that the market for directors is efficient, higher quality directors should be more closely associated with the promotion of shareholder interests and better company performance (Weir et al, 2002)).

Vafeas (1999) suggests that the number of other directorships held by outside directors may proxy for the value of their reputation capital. The threat of damaging this reputation capital he argues, is likely to prevent outside directors from colluding with management. Shivdasani and Yermack (1999), however suggest that the benefits of outside directorships may be non-linear, declining for the highest directorship levels as busy directors have less time available to monitor management properly.

Fama and Jensen (1998 p 325) argue that outside directors have a particular incentive to monitor managers on behalf of shareholders because their reputation and in turn the value of their human capital depends on their acumen as decision control specialists.

There is some evidence that director quality as measured by the average number of additional directorships held by board members has a positive (though weak) effect on performance. Dowen (1995) found this measure of directorship quality insignificant that is, it played no part in determining company performance. In contrast, Weir et al (2002) Gilson (1990) and Kaplan and Reishus (1990) report evidence consistent with a link between an outside director's reputation and the overall value of his or her human capital. Gilson (1990) finds that outside directors who resign from the boards of financially distressed firms subsequently hold fewer positions as outside directors of other firms. Kaplan and Reishus (1990) found that executives of firms that reduce dividends also subsequently hold fewer outside board positions.

Mace (1972) found that many companies in selecting directors regard the titles and prestige of candidates as of primary importance. Vafeas (1999) finds that the average number of directorships (which he uses as a measure of director reputation) is positively related to board activity at the 0.10 level, in line with director reputation leading to higher board activity. He concludes that the intensity of board activity is determined by the reputation and not by the population of outsiders who serve on the board. He suggests that the weak evidence on directorships may be explained by the fact that directorships are not linearly related to reputation, directors holding more than three directorships may be overextending themselves at the expense of their monitoring ability (Shivdasani and Yermack (1999)).

2.5.9 Firm Size

Vafeas (1999) finds that firm size is unrelated to board activity inconsistent with the notion that organisational complexity is reflected on the level of board activity. Prevost et al (2002) however find that firm size appears to be an important control variable with respect to board characteristics that is, it is significantly positively correlated with the number of outside directors and board size and is negatively correlated with CEO duality.

2.6 Summary and Conclusion

The above studies show that the relationship between governance mechanisms and firm performance is a complex one and that the value of corporate governance mechanisms stems more from non-performance related measures as seen from the perspective of how they are perceived to affect shareholders wealth rather than from firm profitability.

However, the dearth of quantitative literature on the value relevance of board characteristics in Kenya gives further justification for this study.

CHAPTER THREE
RESEARCH METHODOLOGY

This study sought to examine the association between board activity as measured by the frequency of board meetings and corporate governance mechanisms. It also sought to determine the interactions between board meeting frequency and firm value. The study focused on the companies listed on the NSE given that the separation of the ownership from the day to day management of the affairs of these companies, makes it imperative that issues of good corporate governance are addressed. Further the requirement by the CMA that public companies report on the extent of their compliance with the CMA's corporate governance guidelines made these companies an obvious choice for the study.
In terms of corporate governance mechanisms the study focused on the composition on the board of directors, the board size, the leadership structure, the number of board committees and how often they meet, the shareholders and the extent of their shareholding. This information was sought from the financial statements of the companies, the NSE and the CMA. The rationale for this was that good corporate governance is ultimately about ensuring that the board and management are taking care of the shareholders interests. The company's financial report is the only source of information that the shareholder has to enable them to judge how the company is managed.

Information on the number of board meetings, the number of board committee meetings and the number of other directorships held by outside directors which was not readily available in the financial reports was obtained from the company secretaries as such information is by law in their custody.

To determine the interaction between board meetings frequency and financial performance, the study reviewed the financial performances of the quoted companies from the period 1998 to 2003. Statistical analyses were conducted using the corporate governance mechanisms as independent variables and price book ratio as the dependent variable (as a proxy for firm value). It was expected that the frequency of board meetings would increase as the firm value declined and that following intense board activity the

firm value would increase due to the active interest of the board of directors in line with the contracting and agency theory.

The following describes in detail how the study was conducted.

3.1 Population

A list of all companies listed on the Stock Exchange as at 31st December 2003 was obtained from the Nairobi Stock Exchange as per Appendix 1. This list had 48 companies whose equity was quoted and actively traded on the NSE in both the main investment market segment and the alternative investment market segment. All the 48 companies formed the population of the study.

3.2 Data and Variable Definitions:

To explain the role of board activity in corporate governance I relied on the notion (advanced by Vafeas, (1999); Weir et al (2002)) that governance mechanisms are substitutes or complements, their levels being determined by each firm's broader control environment. It should also be recognized that not all board activity will be productive because routine tasks and inefficiencies consume some time. I define below the governance mechanisms (board characteristics) which may, by and large, determine board activity and how they were measured.

3.2.1 Board Meetings:

Neither the Companies Act nor the CMA guidelines on corporate governance prescribe the frequency of the board meetings. However, a number of public listed companies in Kenya now report on the number of board meetings they held in the year.

In this study the main variable of interest which is used as a proxy for the intensity of board activity is the number of meetings (excluding telephonic meetings of the board) held by the board of directors as recorded in the firms' minute books. I assumed that the characteristics of the meeting for example content, quality, location, length, and the level of interaction at the meeting will hold constant during the period of the study.

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3.2.2 The Determinants of Board Activity:

3.2.2.1 Board Size

The Companies Act is silent on the board size (it sets a minimum of 2 directors) of public listed companies in Kenya. The CMA guidelines on corporate governance practices (2002 p 125) however provide that:

3.1 (vii) The size of the board should not be too large to undermine an interactive discussion during board meetings or too small such that the inclusion of a wider expertise and skills to improve the effectiveness of the board is compromised.

Ultimately, the size of the board is however a product of the company's relationships with the environment. If the organization has requirements for co-opting important external elements of its environment, the greater this need for co-optation, the more members the organization will probably have to place on its board. Pfeffer (1972) also hypothesizes that the number of directors an organization has will be directly related to the size of the organization. Thus I expected to find that as board size increases board activity would also increase to compensate for increasing process losses.

In this study board size is the total number of directors sitting on the board at the annual general meeting as reported in the annual report.

3.2.2.2 Inside Ownership

Inside ownership refers to the proportion of equity held by insiders. I hypothesized that if board activity is a good proxy for active monitoring by the board of directors, then board activity should be a substitute for high levels of inside ownership in disciplining managers. More specifically, as inside ownership rises insiders have incentives to protect shareholders' interest and need less supervision by the board since board activity is from the efficient contracting view, "a costly monitoring alternative."

For the purpose of this study inside ownership is the proportion of common stock beneficially owned by all officers and directors measured in percentage points. I expected to find an inverse relationship between the intensity of board activity and the level of inside ownership.

3.2.2.3 *Outside Directors*

The CMA corporate governance guidelines (2002) propose that a balanced board constitutes an effective board. It therefore requires that the board of directors of every listed company should reflect a balance between independent, non-executive directors and executive directors. The independent and non-executive directors should form at least one-third of the membership of the board to ensure that no individual or small group of individuals can dominate board decision- making processes (CMA guidelines on corporate governance (2002 p 124, 125)).

Thus if higher board activity facilitates better board monitoring, outside directors are more likely to demand more board meetings to enhance their ability to monitor management. However, in boards with more outside directors, more time is likely to be spent in briefing board members than would be required in boards with higher inside directors.

Thus, there should be a positive relationship between the representation of outside directors on the board and the level of board activity.

For the purpose of this study I adopt the definitions of "independent" and "non-executive" directors used in the CMA corporate guidelines (2002) as follows:- (Clauses 2.1.4.1 pg 124 -5): An "independent director" means a director who:-

a) has not been employed by the company in an executive capacity within the last five years;

b) is not affiliated to an adviser or consultant to the company or a member of the company's senior management or a significant customer or supplier of the company or with a not-for-profit entity that receives significant contributions from the company, or within the last five years has not had any business relationship with the company (other than service as a director) for which the company has been required to make disclosure;

c) has no personal service (contracts) with the company, or a member of the company's senior management;

d) is not employed by a public company at which an executive officer of the company serves as a director;

e) is not a member of the immediate family of any person described above; or

f) has not had any of the relationships described above with any affiliate of the company.

A "non-executive director" means a director who is not involved in the administrative or managerial operations of the company. (CMA corporate guidelines (2002; p. 125 clause 2.1.4.2) and I measured independent directors as the percentage of board outsiders as defined above based on information from the annual report and the respondent firms.

3.2.2.4 Unaffiliated owners of large equity blocks

I define unaffiliated block holders as those shareholders owning more than five per cent of common stock, whether persons or institutions that are not related to firm executives and their relatives, or employee stock ownership plans. This information is in the company's annual reports.

3.2.2.5 Board Committees

The CMA proposes that the board should establish relevant committees and delegate specific mandate to them. (CMA guidelines on corporate governance (2002 p. 124 clause 2.1.1). It specifically recommends the establishment of audit and nominating committees. The PSICT (1991) recommends that these committees should mainly comprise independent non-executive directors due to the potential for conflict of interest.

This study proposes that an increase in the amount of delegation by the board, proxied by the total number of standing committees is likely to decrease the amount of work the board performs directly as a group. This may however increase the need for coordination

and supervision by the board. Secondary data was collected from the Respondent firms on the number of standing board committees and from the annual reports.

3.2.2.6 Leadership Structure

All the companies quoted in the Nairobi Stock Exchange have separated the roles of the Chairman and the CEO. (Jebet, (2001)).

It is expected that as in the case of outside directors, an outside board chairman needs to be informed more frequently. Thus if the intensity of the board activity measures the quality of the board's monitoring, boards with an outsider chairman should meet more frequently. The information will be obtained from the annual reports. A dummy variable set to one if an insider is chairman and zero otherwise was used.

3.2.2.7 Director incentive plans

Director incentive plans have become an increasingly popular measure for inducing outside directors to improve their monitoring performance. The CMA corporate governance guidelines (2002 p 124) (2.1.1(iii)) recommends that non executive directors' remuneration should be competitive in line with remuneration of other directors in competing sectors. If such plans motivate directors to become better monitors as suggested by Perry (1996), and board activity measures the quality of the board's monitoring, then all else being equal, board activity is expected to be higher where such plans are in use.

A dummy variable set to one if the firm employs director incentive plans and Zero if otherwise will be used. The data was obtained from the annual reports and the respondent firms.

3.2.2.8 The number of other directorships held by outside directors

The CMA corporate governance guidelines (2002, p 124, clause 2.1.6) prohibit a person from holding more than five directorships in any public listed company at one time. They also recommend that no person should hold more than two chairmanships in any public

listed company at any one time so as to ensure effective participation of the company's affairs. CMA corporate governance guidance (2002 p 126 clause 3.2 (iv)).

However, I expected to find that as the number of directorships held by outsiders rises, the quality of the board's monitoring as proxied by board meeting frequency would rise.

The data was obtained from the respondent firms and the annual reports. I measure average additional directorships as the total number of all board seats held by independent directors.

3.2.2.9 Firm Size

Larger firms operate in an environment involving potentially more complex information and making decisions pertaining to larger firms is likely to be more time-consuming. Hence firm size is also likely to influence board activity with board activity expected to increase with firm size.

The log of market value was used as a measure of firm size.

3.2.2.10 Operating performance changes around years of high board meeting frequency

Jensen (1993) argues that boards in well-functioning firms should be relatively inactive and exhibit few conflicts. In such firms, the boards operate routinely in performing board tasks. The role of corporate boards becomes increasingly more important during crises, when shareholders' interests are in visible danger.

As firms' performance declines, boards are more likely to become more active to cope with these problems. I expect to find an inverse association between past performance and current board meeting changes, signifying that corporate boards become more active in the presence of problems.

In law, directors have a legal responsibility to make proper decisions in discharge of their duty of care towards shareholders. Although directors are not held personally or collectively liable, the risks of poor decisions is likely to dominate director's concerns (Jensen, 1993).

Directors who have more time to confer are likely to make better decisions in response to crises since time constraints are considered to be a major deterrent to more active monitoring by the board of directors. Thus it is expected that more active monitoring which is proxied by increases in board activity will be reflected in improvements in performance. Specifically I expect that high board meeting frequency will be followed by significant improvements in operating performance as measured by the firm's price to book ratio.

3.3 Data Collection

Data collection was done as follows: -

Data on the composition of the board, the board size, the leadership structure, the total number of shares, the shareholders and the extent of shareholding was obtained from the annual financial reports of the companies. This information was also verified by the information collected from the company secretaries.

Data on the number of board meetings, the number of standing board committees and how often they met, and the number of other directorships held by the outside directors and whether director incentive plans and employee stock options were in use was obtained from the company secretaries.

Data on the company's financial performance was obtained from the company's financial statements for the years 1998 to 2003. The annual accounts were obtained from the NSE library since all quoted companies are required to avail a copy of the same to the NSE.

The above data was collected and summarized as per the collection instrument in Appendix 2.

3.4 Method of Data Analysis

The data obtained on the corporate governance characteristics was analyzed using descriptive statistics. Governance mechanisms may be related in complicated ways and as earlier stated this study relies on the notion that governance mechanisms are substitutes

or complements (Vafeas (1999)). Hence Pearson's correlation analysis was used to measure the degree of linear relationship between the variables of the study.

To investigate the interactions between board meeting frequency and corporate governance mechanisms (the determinants of board meetings frequency) panel data and regression analysis were used. T- statistics and analysis of variable were done to validate the model. The model tested was similar to one of Vafeas (1999) but with the necessary adjustments and configuration to domesticate it to the Kenyan conditions and environment.

To examine the interaction between board meeting frequency and firm value regression analysis was done but on realizing that such a regression (using board meeting frequency and all corporate governance variables as independent variables) was not conveying enough information in terms of predicting firm value, stepwise regression was used to select predictor variables.

CHAPTER 4

DATA ANALYSIS

In the study two objectives were set. The first objective was to explore the impact of corporate governance variables on board activity. The proxy for board activity is the frequency of board meetings. The second objective was to examine interactions between board meeting frequency and financial performance. The study covers the period between 1998 and 2003.

The importance of board meeting frequency is considered an open question. Vafeas (1999) assertion is that, " It would seem easier and less costly for a firm to adjust the frequency of its board meetings to attain better governance than to change the composition of its board or its ownership structure or approve charter amendments".

4.1 Summary Statistics

The variables used in this study include: NBM = Number of Board meetings; NSBC = Number of standing Board committees NSCM= number of standing Board committee Meetings. NBD= number of Board directors, NED= number of Executive Directors, NND= Number of Non – Executive Directors; NUBD = Number of unaffiliated block holder directors; NAO= Number of affiliated outsiders; NTLS = Number of total shares held by largest shareholder, NPUB = Number/percentage of total shares held by unaffiliated block holders; NSOD is Number/ percentage of shares held by officers and directors (insider ownership). NBOD = Number of other directors held by outside directors, ESOP = Employee stock potions; BD= Board of Director Leadership Structure; Dip= Directors incentive plans.

Table one (1) shows that the mean number of board of meetings over the period of the study was seven. The statistics show that over half of the observations had six annual meetings (medians=6) over the period of the study. The minimum number of meeting in a year over the same period is two while the maximum is eighteen (18). Over seventy five percent the companies in this study had nine (9) meetings in a year.

In a particular year, the average number of board of directors is nine. Unaffiliated block holder directorship (NUBD) and affiliated outsiders (NAO) are low with a mean of one. Insider ownership (NSOD).is rampant with a mean or average of 40 percent and a maximum of 10 percent in some firms.

Table 1 Summary Statistics of Corporate Governance Variables

Variable	N	N*	Mean	Median	StDev	Min	Max	Q1	Q3
NBM	269	1	7	6	4	2	18	4	9
NSBC	264	6	4	4	2	1	8	3	6
NSCM	258	12	15	12	13	3	72	8	18
NBD	270	0	9	8	2	1	14	8	10
NED	267	3	1	1	1	1	5	1	2
NND	270	0	7	7	2	3	13	7	8
NUBD	231	39	1	1	1	0	5	1	2
NAO	216	54	1	1	1	0	4	1	1
NTLS	270	0	36	35	15	2	75	27	46
NPUB	252	18	47	48	19	0	74	37	64
NSOD	114	156	40	48	23	0	70	30	60
NBOD	146	124	4	1	12	0	63	1	2
BD	14	245	1	1	0	1	1	1	1
DIP	14	245	0	0	0	0	1	0	1

Unaffiliated block holders (NPUB) hold substantial number of shares. Due to low response or lack of it, the variable directors incentive plans (DIP) is dropped. It is clear that most of the respondents were reluctant to disclose information on director's allowances and bonuses and details on the subject of insider shareholder ownership (NSOD) i.e. there were 156 missing answers out of 270 expected. At the same time most of the firms were less informed about other directorships held by outside directors. As all quoted companies have a separate leadership structure (Jebet 2001) the variable BD is dropped.

Over the period of the study firms in the financial sectors had the highest number of board meetings (10) on the average. This was followed by industrials that had seven (7) board meetings on average. See Table 2.

The years 2002 and 2003 experienced the highest board meetings over the period. These were difficult periods for many companies with most of them reporting a decline in earnings or even losses. Over the same period a number of companies opted for extensive restructuring.

An examination of the minimum and maximum meetings, over the period of the study 1998 to 2003, a trend emerges that demonstrate that the number of board meeting tend to increase over a period of decline in earnings providing direct evidence that board's meet more often during crisis situations. Insider ownership, i.e. managers who are shareholders, is substantial in firms that are categorized as financial or industrial. See Table 2.

Table 2 Descriptive Statistics: NBM, NSBC,...By Industry

Variable	INDU	N	N*	Mean	Median	TrMean	StDev	SE Mean	Minimum	Maximum	Q1
NBM	1	48	0	5	5	5	1	0	2	8	
	2	59	1	5	6	5	1	0	4	8	
	3	66	0	10	10	10	4	1	4	18	
	4	96	0	7	6	7	4	0	2	18	
NSBC	1	48	0	4	3	4	1	0	1	6	
	2	60	0	4	4	4	2	0	2	8	
	3	60	6	5	6	5	1	0	2	8	
	4	96	0	4	4	4	2	0	1	8	
NSCM	1	48	0	9	8	8	5	1	3	26	
	2	60	0	15	12	13	13	2	6	68	
	3	66	0	22	16	20	18	2	6	72	
	4	84	12	14	12	12	10	1	6	58	
NBD	1	48	0	8	8	8	1	0	6	11	
	2	60	0	9	9	9	2	0	6	13	
	3	66	0	9	9	9	2	0	8	14	
	4	96	0	9	8	9	2	0	1	13	
NED	1	48	0	1	1	1	0	0	1	2	
	2	60	0	1	1	1	1	0	1	3	
	3	66	0	2	1	1	1	0	1	3	
	4	93	3	2	1	1	1	0	1	5	
NND	1	48	0	7	7	7	2	0	4	10	
	2	60	0	7	7	7	1	0	5	10	

	3	66	0	8	8	8	2	0	5	13
	4	96	0	7	7	7	2	0	3	11
NUBD	1	45	3	2	2	2	1	0	1	5
	2	46	14	1	1	1	1	0	0	2
	3	60	6	1	2	1	1	0	0	2
	4	80	16	1	1	1	0	0	1	2
NAO	1	36	12	1	1	1	1	0	1	3
	2	54	6	1	1	1	0	0	1	2
	3	56	10	1	1	1	1	0	0	2
	4	70	26	1	1	1	1	0	1	4
NTLS	1	48	0	24	25	24	6	1	15	36
	2	60	0	35	37	35	5	1	27	43
	3	66	0	53	52	53	14	2	23	75
	4	96	0	32	34	32	13	1	2	53
NPUB	1	42	6	46	42	46	12	2	34	71
	2	48	12	40	43	40	25	4	0	67
	3	66	0	46	50	47	19	2	0	71
	4	96	0	52	48	52	16	2	22	74
NSOD	1	18	30	31	33	31	23	5	3	57
	2	12	48	1	1	1	1	0	0	2
	3	36	30	37	40	38	20	3	1	63
	4	48	48	55	60	56	14	2	1	70
NBOD	1	3	45	63	63	63	0	0	63	63
	2	48	12	1	1	1	1	0	0	3
	3	30	36	10	1	8	18	3	1	45
	4	65	31	1	1	1	0	0	1	2

INDU = Industry: 1 = Agriculture; 2 = Commerce; 3 = Financials; 4 = Industrials.

4.2 Analysis of the Determinants of Board Meeting Frequency

The determinants of board meeting frequency are explored using regression analysis. The dependent variable is number of board meetings (NBM) (excluding telephonic meetings of the board). The independent variables that capture (or are proxies) of the corporate governance mechanisms are: board size or number of members of the board (NBD); number of executive directors (NED), number of non executive directors (NND); number of standing board committees (NSBC); number of standing board committee meeting (NSCM); number of unaffiliated block holder directors (NUBD); number of affiliated outsiders (NAO), number or share percentage of shares held by largest shareholder (NTLS); percentage of total shares held by unaffiliated block holders (NPUB); percentage of shares held by officers and directors of the company (insider ownership) (NSOD), number of other directorship held by outside directors (NBOD); firms and employee stock options (ESOP).

The emerging expression is:

$$NBM = f(NBD+NED+NND+NSBC+NSCM+NUBD+NAO+NTLS$$
$$+NPUB+NSOD+NBOD+ESOP+BD+DIP$$

Where:

Board meeting (NBM)	The total number of annual board meetings for each firm.
Board size (NBD)	The total number of directors sitting on each company's board.
Executive director (NED)	The total number of executive directors of each company's board
Outside Directors (NND)	The total number of non-executive directors of each company's board
Board Committees (NSCB)	The total number of standing board committees

Number of standing Committee Meetings (NSCM)	The total number of meetings of the standing board committees
Unaffiliated Block holder Directors (NUBD)	The number of directors representing the unaffiliated blockholder shareholders
Affiliated outside directors (NAO)	The number of outside directors with potential business ties with the firm e.g. lawyers, auditors, management consultants
Shareholding (NTLS)	The total number of shares held by the largest shareholders
Unaffiliated Blockholders (NPUB)	The number of percentage of total shares held by the unaffiliated blockholders (those who own more than 5% of the firm's stock)
Inside Ownership (NSOD)	The number of percentage of shares held by officers and directors
Other directorships (NBOD)	The total number of other directorships held by outside directors
Employee stock options (ESOP)	The percentage/number of shares held by employees of the firm
Leadership Structure (BD)	The insider chairman dummy equals one if an insider chairs the board and zero otherwise
Director Incentive Plans (DIP)	A dummy variable set to one if the firm employs director incentive plans and zero otherwise

4.2.1 Panel Data and Regression Analysis

With only forty-eight companies it was not possible to generate a regression equation from ten (10) independent variables that are proxies for corporate governance. The proxies range from number of standing board committees to number of other directorship held by outside directors.

When ten independent variables were used, the statistical software used gave the following results "not enough data in column". This result is typical whenever few observations or cases (in our case forty eight companies) are used in the presence of large independent variables in generating regression coefficients. The option open in the face of significant firm effects, is to use panel data as suggested by Yaffe (2004), SAS Institute (1999), and (Stata, 2003)

Panel data analysis is a popular form of longitudinal data analysis amongst social and behavioural science researchers. A panel is a cross-section or group of people or firms who are surveyed periodically over a given time span. In our case, the span is six years running from 1998 to 2003.

Panel data analysis endows regression analysis with both a spatial and temporary dimension. The spatial dimension pertains to a set of cross sectional units of observation. These could be countries firms, commodities or even individuals. The temporal dimensions pertains to periodic observations of a set of variables characterizing these cross sectional units over a particular time span e.g. number of board meetings, number of board directors etc. In this study we use unbalanced partial because we have missing data. This enables us to use the pooled regression model as a baseline for comparison.

4.2.2 Correlations

We use the Pearson product moment correlation coefficient to measure the degree of linear relationship between two variables. The correlation coefficient assumes a value between -1 and +1. If one variable tends to increase as the other decreases, the correlation coefficient is negative. Conversely, if the two variables tend to increase together, the correlation coefficient is positive.

For a two-tailed test of the correlation:

H0: $r = 0$ versus H1: $r \neq 0$ where r is the correlation between a pair of variables. The results of the correlations for corporate governance variable are summarized in Table 3 below.

Table 3. Correlations: NBM, NSBC, NSCM, NBD, NED, NND, NUBD, NAO, NTLS, NPUB, NSOD, NBOD

	NBM	NSBC	NSCM	NBD	NED	NND	NUBD	NAO
NSBC	0.513							
	0.000							
NSCM	0.545	0.233						
	0.000	0.000						
NBD	0.511	0.232	0.408					
	0.000	0.000	0.000					
NED	0.105	0.137	0.257	0.198				
	0.089	0.027	0.000	0.001				
NND	0.520	0.238	0.290	0.857	-0.116			
	0.000	0.000	0.000	0.000	0.058			
NUBD	0.140	-0.109	0.112	0.081	0.010	0.043		
	0.033	0.101	0.096	0.218	0.881	0.517		
NAO	-0.002	-0.096	-0.137	0.148	-0.033	0.137	0.439	
	0.974	0.166	0.048	0.030	0.631	0.044	0.000	
NTLS	0.552	0.559	0.318	0.281	0.096	0.270	-0.099	-0.053
	0.000	0.000	0.000	0.000	0.118	0.000	0.134	0.439
NPUB	0.322	0.007	0.205	0.165	-0.037	0.178	0.241	-0.062
	0.000	0.915	0.001	0.008	0.566	0.005	0.000	0.383
NSOD	0.401	-0.019	0.020	0.067	-0.308	0.263	0.248	0.378
	0.000	0.844	0.842	0.477	0.001	0.005	0.014	0.000
NBOD	-0.198	-0.039	-0.020	-0.174	0.259	-0.276	-0.352	-0.342
	0.017	0.644	0.816	0.036	0.002	0.001	0.000	0.000

	NTLS	NPUB	NSOD
NPUB	0.043		
	0.492		
NSOD	0.036	0.794	
	0.706	0.000	
NBOD	-0.072	-0.374	-0.454
	0.391	0.000	0.000

Cell Contents: Pearson correlation
P-Value

The number of board meetings is significantly, in a statistically sense, related to the following variables: NSBC (51.3 percent (%)), NSCM (54.5 percent (%)), NBD (51.1 percent (%)), NND (52 percent (%)), NUBD (14 percent (%)), NTLS (55 percent (%)), NPUB (32 percent (%)), NSOD (40 percent (%)), NBOD (negative19.8 percent (%)).

For the variables positively correlated with number of board meetings, the interpretation is that increases in such variables precede increases in the number of board meetings. For example, as the number of standing board committees increase one would expect more board meetings to supervise, coordinate or ratify the recommendations made by various standing committees.

It appears that the number of board meetings is negatively correlated with the number of other directorship (NBOD-19.8 percent (%)). A possible explanation is that the directors will have to spread their time for board meetings across many companies and ultimately run out of time. At the same time, the number of directors is a determinant of the number of standing committees i.e. as number of members of board increases, so is the capacity to create more standing and/or board committees.

The correlation between number of board of directors (NBD) and number of non-executive/independent directors (NND) is 85.7 percent. It is possible that the inclusion of independent directors might not achieve its effect if non-independent directors outnumber them. This happens when the existing directors respond to the statutory requirement that the board include non-executive directors by appointing non-executive directors who will not challenge the

existing directors. This could have a far-reaching corporate governance implication because lack of board of directors control.

The number or percentage of shares held by officers and directors or insider ownership (NSOD) is positively correlated with the number of total shares held by an affiliated block holder. This implies that the insiders who are owners are at the same time affiliated owners. Furthermore, the number of other directorships held by outside directors (NBOD) is negatively correlated to number or percentage of shares held by officers and directors (Inside ownership) or NSOD. It is possible that the insiders could have formed companies that they use as an investment vehicle. It equally possible that migration exists between outside directors and inside directors or that after some time, inside directors become outside directors.

4.2.3 Regression Results – Board Meeting Frequency and Corporate Governance

The objective at this stage is to explore the connection between board activity (NBM) and selected corporate governance variables. The regression equation explaining the number of board meeting (NBM) as a proxy for board activity is expressed as follows:

The regression equation is

```
NBM = - 3.98 - 0.228 NSBC + 0.0327 NSCM - 0.688 NBD - 3.23 NED + 1.92 NND
      + 1.20 NUBD - 1.56 NAO + 0.124 NTLS + 0.196 NPUB - 0.107 NSOD
      + 0.222 NBOD
```

42 cases used 228 cases contain missing values

Predictor	Coef	SE Coef	T	P
Constant	-3.976	2.185	-1.82	0.079
NSBC	-0.2282	0.2563	-0.89	0.380
NSCM	0.03272	0.02284	1.43	0.162
NBD	-0.6881	0.3556	-1.94	0.062
NED	-3.2278	0.8653	-3.73	0.001
NND	1.9154	0.3899	4.91	0.000
NUBD	1.1976	0.8264	1.45	0.158
NAO	-1.559	1.473	-1.06	0.298
NTLS	0.12353	0.02998	4.12	0.000
NPUB	0.19648	0.05041	3.90	0.001
NSOD	-0.10662	0.04133	-2.58	0.015
NBOD	0.22212	0.05500	4.04	0.000

```
S = 1.211        R-Sq = 92.7%     R-Sq(adj) = 90.0%
```

Analysis of Variance

Source	DF	SS	MS	F	P
Regression	11	556.096	50.554	34.45	0.000
Residual Error	30	44.023	1.467		
Total	41	600.119			

The coefficients of predictor variables show both the sign and magnitude of the relationship between the independent variables and the dependent variable, when considered along with other variables. The t- statistics is statistically significant for the following variables at 10 percent significant level: number of board directors (NBD) whose (*t=-1.94; p-value=0.062*) number of executive directors (NED) (whose *t=-3.73; p-value=0.001*), number of non executive/independent directors (NND) (whose *t-ratio=4,91, p-value=0.000*), number of total shares held by largest shareholder (NTLS) (*whose t=4.12;p-value=0.000*); number/percentage of total shares held by unaffiliated block holders (NPUB) (*whose t ratio=3.90;p-value=0.001*) and number of percentage of shares held by officers and directors (inside ownership) (NSOD) (*whose t ratio is 2.58;p-value 0.015*): number of other directorships held by outside directors (NBOD) (whose t ratio = 4.04; p-value = 0.000). For all these variables, their *p- value* for the t ratio is below the critical (α) of 0.10. We conclude that for these variables, over the period of study, variations in them were accompanied by variations in the number of board meetings. We can use our knowledge of the variable whose value is different from zero to predict changes in board meetings and associated costs. These are confirmed by t-values that are above the critical of 1.76 to show that the coefficients are significantly different from zero.

In the regression equation above, the impact of the number of board committee (NSBC) of negative 0.2282 is insignificant given its p-value of t-ratio values indicate that there is sufficient evidence that the coefficient is zero for likely Type I error rates (α levels of .10). We therefore reject the hypothesis that NSBC when considered along with other variables have impact on board activity (NBM). The same conclusion applies to number of standing board committee meetings (NSCM). One possible explanation is that the role of board committees, that is, whether they focus on decision management or monitoring may not be clear.

The coefficient for number of board of directors (NBD) is negative and statistically significant i.e. the number of board meetings (NBM) decreases as the number of board directors (NBD) increases. Therefore the number of board of directors is useful in estimating average change in board activity (NBM). For example, for every one-unit change in the number of board of directors (board size), the board activity will on average decrease by 0.688. Again this is seen when NBD is considered along with other corporate governance variables. This finding concurs with Steiner (1972) assertion that process losses increase rapidly with group size. It is possible that a carefully selected membership of a large board is fully diversified and requires fewer board meetings (Changnati et al (1985) and Pearce and Zahra (1992)). This might be attributed to decentralization of decision making from the main board, to standing board committee meetings.

The increase in the number of executive directors (NED) is associated with the reduced board activity. The negative co-efficient sign for number of executive directors (NED) of negative 3.2278 confirms this. This is in line with the proposition that insiders tend to be more informed about the company's affairs and hence require fewer board meetings. It appears that a large presence of non-executive/independent directors (NND) is accompanied by reduction of number of board meetings. The presence of non-executive/independent is important in controlling the number of times board members meet and board related expenses for two reasons. Either they are efficient thus managing a firm's business in a few meetings or they do not have time for meetings. Outside directors (NND), are considered independent and better placed to monitor management Bearle and Means (1932).

The number of total shares held by the largest shareholders (NTLS) and the number of percentage of total shares held by unaffiliated blockholders are both positive and statistically significant. This is to be expected as the share ownership of companies quoted on the NSE is not widely dispersed (Jebet, 2001) and hence they require more board meetings to stay well informed.

As the number of shares held by insiders (NSOD) increases, the fewer the number of board meetings. The explanation is: in companies dominated by inside shareholders, a number of decisions are made at management level and later ratified by a board dominated or controlled by insiders. The earlier arrangements dilute the importance that is attached to regular board

meetings. This confirms the hypothesis that monitoring role of external board members through board meetings is less critical for firms with higher proportions of inside ownership as high insider ownership helps align the interests between managers and shareholders. This finding concurs with Vafeas (1999) – that the percentage of inside ownership is inversely related to board activity.

Finally the number of other directorships held by outside directors (NBOD) emerge as influencing variable that impact positively on board meeting frequency. Successful directors are expected to hold similar positions in a number of companies. The greater the number of additional board seats held by a director the greater the reputation of that director, (Weir *et al* 2002). The finding supports that of Vafeas (1999) but contradict Shivdasani and Yermack (1999) who suggest that the relationship is not linear as directors holding more than three directorships may be over extending themselves at the expense of their monitoring ability.

4.2.4 Validation of the Model

The t-statistics above test the null hypothesis that each coefficient is zero given that all other variables are present in the model. The purpose of t – test is to assist us in making statistical inferences about a population parameter based on the estimate generated from a specific sample. Thus we can say that t-test is a test of statistical significance and should not be used to test the theoretical validity of any estimated relationship.

In addition we need analysis of variance (see the regression results above). The analysis of variance table contains sums of squares (abbreviated SS). SS Regression is sometimes written SS (Regression | b0), and sometimes called SS Model. SS Error is sometimes written as SS Residual, SSE, or RSS. MS Error is often written as MSE. SS Total is the total sum of squares corrected for the mean. In statistics we use the analysis of variance table to assess the overall fit of the model.

The F-test is a test of the hypothesis Ho: All regression coefficients, excepting b0, constant, are zero. The main issue under consideration is whether or not the ratio of the explained variance to unexplained variance is sufficiently high enough to reject the hypothesis that board meeting frequency is unrelated to corporate governance mechanisms. Specifically, the test statistics and hypothesis are:

H_o: $\beta = 0$

$$F_e = \frac{\text{Variance Explained by Regression X}}{\text{Unexplained Variance}}$$

A 0.05 significance test involves finding the critical F- value that leaves 5 percent (%) of the distribution in the right-hand tail. Thus the decision rule becomes: If the calculated value of F_e exceeds the critical value of F_{cr} , reject H_o . In this study the critical value (F_{cr}) is 2.12 (derived from the table). Since F_e of 34.45 is greater than 2.12 i.e. critical value from F- distribution tables, we infer that knowledge of selected corporate governance variables provide knowledge useful in predicting board activity(NBM).

The r-square for the above regression is 92.7 percent. This measures the variation in board meeting frequency explained by the combined influence of all independent variables. We infer that 97.2 percent of the observed changes in the dependent variable, NBM, have been explained or accounted for by combined changes in the predictor variables.

Regression Results – With Corporate Governance, Industry and Company as Predictor Variables

The results of the regression equation are as follows:

```
The regression equation is
NBM = - 4.57 - 0.249 NSBC + 0.0352 NSCM - 0.695 NBD - 3.22 NED + 1.96 NND
          + 1.18 NUBD - 1.62 NAO + 0.123 NTLS + 0.197 NPUB - 0.114 NSOD
          + 0.217 NBOD + 0.233 INDU

42 cases used 228 cases contain missing values
```

Predictor	Coef	SE Coef	T	P
Constant	-4.565	3.159	-1.45	0.159
NSBC	-0.2492	0.2724	-0.91	0.368
NSCM	0.03519	0.02503	1.41	0.170
NBD	-0.6947	0.3621	-1.92	0.065
NED	-3.2165	0.8801	-3.65	0.001
NND	1.9571	0.4270	4.58	0.000
NUBD	1.1813	0.8418	1.40	0.171
NAO	-1.623	1.517	-1.07	0.293

NTLS	0.12334	0.03046	4.05	0.000
NPUB	0.19715	0.05128	3.84	0.001
NSOD	-0.11428	0.05115	-2.23	0.033
NBOD	0.21712	0.05904	3.68	0.001
INDU	0.2331	0.8893	0.26	0.795

S = 1.231 R-Sq = 92.7% R-Sq(adj) = 89.7%

Analysis of Variance

Source	DF	SS	MS	F	P
Regression	12	556.200	46.350	30.60	0.000
Residual Error	29	43.919	1.514		
Total	41	600.119			

From the regression above, the inclusion of industry as a factor as a predictor variable along with other variables results in decline in r-square from 97.2 percent to 92.7 percent. This is because the explanatory power of the industry is low or that it has interaction effect with the earlier variables.

However different companies follow different corporate governance approaches. Therefore the impact of corporate governance on board activity varies from one company to another. But the coefficient of negative 0.0694 shows that the effect is almost insignificant. See the regressions below:

When company is included, the regression equation is:

NBM = - 7.40 + 0.096 NSBC + 0.0230 NSCM - 0.613 NBD - 2.02 NED + 1.87 NND
+ 1.10 NUBD - 1.23 NAO + 0.143 NTLS + 0.189 NPUB - 0.0925 NSOD
+ 0.201 NBOD - 0.0694 Serial(Company)

42 cases used 228 cases contain missing values

Predictor	Coef	SE Coef	T	P
Constant	-7.399	2.918	-2.54	0.017
NSBC	0.0965	0.3130	0.31	0.760
NSCM	0.02296	0.02287	1.00	0.324
NBD	-0.6126	0.3476	-1.76	0.089
NED	-2.016	1.099	-1.83	0.077

NND	1.8652	0.3792	4.92	0.000
NUBD	1.1001	0.8033	1.37	0.181
NAO	-1.234	1.441	-0.86	0.399
NTLS	0.14264	0.03115	4.58	0.000
NPUB	0.18854	0.04910	3.84	0.001
NSOD	-0.09247	0.04093	-2.26	0.032
NBOD	0.20102	0.05474	3.67	0.001
Serial(comp)	-0.06935	0.04065	-1.71	0.099

S = 1.175   R-Sq = 93.3%   R-Sq(adj) = 90.6%

Analysis of Variance

Source	DF	SS	MS	F	P
Regression	12	560.112	46.676	33.83	0.000
Residual Error	29	40.007	1.380		
Total	41	600.119			

When both industry and company (serial) is included, the regression equation is:

NBM = - 11.7 + 0.116 NSBC + 0.0317 NSCM - 0.617 NBD - 1.49 NED + 2.06 NND
+ 0.980 NUBD - 1.43 NAO + 0.149 NTLS + 0.189 NPUB - 0.126 NSOD
+ 0.167 NBOD + 1.18 INDU - 0.0962 Serial

42 cases used 228 cases contain missing values

Predictor	Coef	SE Coef	T	P
Constant	-11.720	4.526	-2.59	0.015
NSBC	0.1156	0.3105	0.37	0.713
NSCM	0.03170	0.02373	1.34	0.192
NBD	-0.6171	0.3444	-1.79	0.084
NED	-1.489	1.169	-1.27	0.213
NND	2.0582	0.4066	5.06	0.000
NUBD	0.9796	0.8018	1.22	0.232
NAO	-1.433	1.437	-1.00	0.327
NTLS	0.14908	0.03130	4.76	0.000
NPUB	0.18885	0.04865	3.88	0.001
NSOD	-0.12591	0.04869	-2.59	0.015
NBOD	0.16744	0.06062	2.76	0.010
INDU	1.1849	0.9549	1.24	0.225
Serial	-0.09623	0.04573	-2.10	0.044

S = 1.164   R-Sq = 93.7%   R-Sq(adj) = 90.7%

Analysis of Variance

Source	DF	SS	MS	F	P
Regression	13	562.198	43.246	31.93	0.000
Residual Error	28	37.922	1.354		
Total	41	600.119			

4.3 The Interactions between Board Meeting Frequency, Corporate Governance Mechanisms and the Firm Value

4.3.1 The Interactions between Board Meeting Frequency and the Value of the Firm

From our literature review (Chapter 2), we see that the association between board meeting frequency and firm value is not beyond question.. The theoretical position is that we expect benefits from board meetings to translate into profitability that ultimately translate into a better firm value.

The price to book ratio is considered as useful in measuring firm value. It is useful because it standardizes measures that capture increase in value and thus facilitates comparison across firms.

The emerging expression is:

PBR = NBM+ NSBC+ NSCM+ NBD+ NED+ NND+ NUBD+ NAO+ NTLS+ NPUB+ NSOD+ NBOD+ INMVF+ RTA+ ROE

Where:

PBR : price to book ratio

INMVF: log of market value

RTA : return on total assets

ROE : return on equity

Our findings show that the value of the firms initially declines as the number of meetings increases from two meetings to eight and then increases (graph 1). However a careful examination of the increase reveals that the increase in market value applies to only four cases out of almost two hundred and forty five cases that constitute this study. These four cases had eighteen meetings in a year. When these four cases are eliminated from the sample, the conclusion is that low price to book ratio is associated with high board meeting frequencies i.e. thin differences between price and book value per share is considered a valid signal to trigger board of directors intervention. Even before eliminating these cases, a filled trend line is u-shaped. See Table 4.

Graph 1 Book to Market Ratio(MtBR) and Board Meeting Frequency (1998 - 2003)

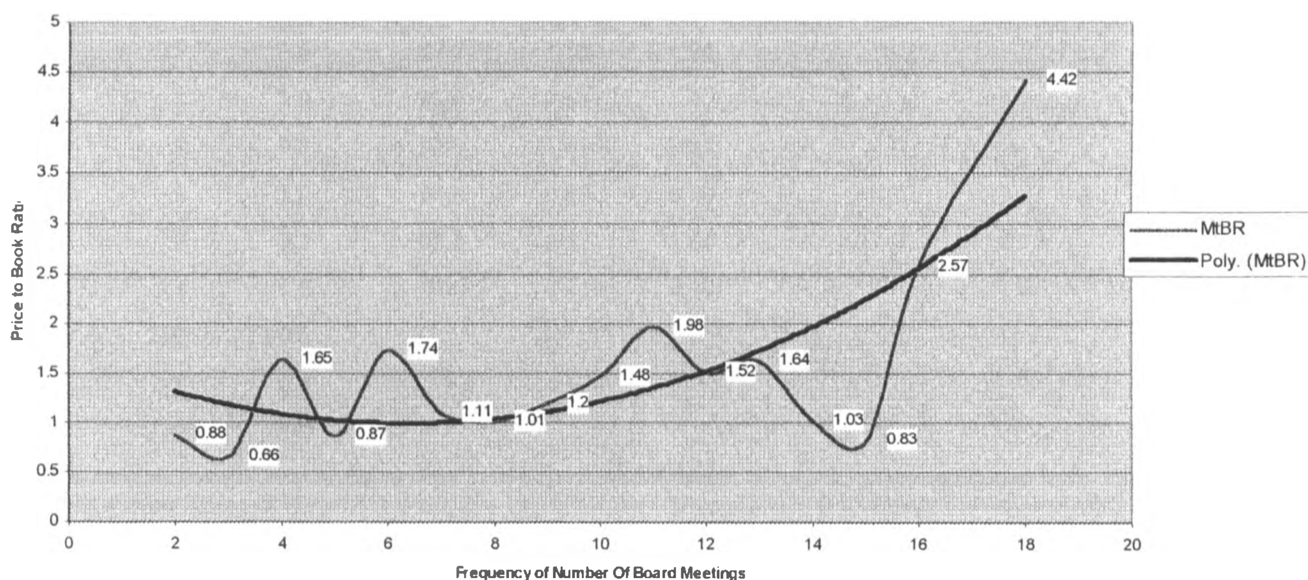

Table 4 Frequency, mean and Median of NBM

Annual NBM	Obsv No Of	Percent	Cumm Perc	Mean	Median
2	10	3.7	3.7	0.88	0.74
3	6	2.2	5.9	0.66	0.62
4	73	27	32.9	1.65	0.69
5	14	5.2	38.1	0.87	0.85
6	73	27	65.1	1.74	1.07
7	4	1.5	66.6	1.11	1.1
8	19	7	73.6	1.01	0.68
9	4	1.5	75.1	1.2	1.23
10	12	4.4	79.5	1.48	1.12
11	7	2.6	82.1	1.98	2.2
12	15	5.6	87.7	1.52	1.24
13	5	1.9	89.6	1.64	1.27
14	9	3.3	92.9	1.03	0.82
15	5	1.9	94.8	0.83	0.69
16	9	3.3	98.1	2.57	1.69
18	4	1.5	100	4.42	4.79
Total	269	99.6			
Missing	1	0.4			
System	270	100			

Regression Results- Interaction between Board Meeting Frequency and the Value of the Firm

The first regression in this section uses the price book ratio as a proxy for firm value as a dependent variable and board meeting frequency and all corporate governance variables as independent variables. The results of the regression are as below:

The regression equation is

PBR (Firm Value) = - 0.87 + 0.247 NBM - 0.209 NSBC - 0.0011 NSCM - 0.085 NBD + 0.37 NED

- 0.199 NND + 0.488 NUBD + 0.87 NAO + 0.0148 NTLS - 0.0760 NPUB

+ 0.0523 NSOD + 0.689 NBOD + 0.075 lnMVF + 0.0439 RTA + 0.0145 ROE

36 cases used 234 cases contain missing values

Predictor	Coef	SE Coef	T	P
Constant	-0.865	5.767	-0.15	0.882
NBM	0.2468	0.1583	1.56	0.135
NSBC	-0.2091	0.2792	-0.75	0.463
NSCM	-0.00106	0.02014	-0.05	0.959
NBD	-0.0847	0.3098	-0.27	0.787
NED	0.366	1.107	0.33	0.745
NND	-0.1989	0.4550	-0.44	0.667
NUBD	0.4880	0.6944	0.70	0.490
NAO	0.872	1.203	0.72	0.477
NTLS	0.01482	0.05778	0.26	0.800
NPUB	-0.07603	0.06614	-1.15	0.264
NSOD	0.05233	0.05235	1.00	0.329
NBOD	0.6886	0.4792	1.44	0.166
lnMVF	0.0746	0.3668	0.20	0.841
RTA	0.04393	0.06562	0.67	0.511
ROE	0.01454	0.02177	0.67	0.512

S = 0.9146   R-Sq = 72.9%   R-Sq(adj) = 52.5%

Analysis of Variance

Source	DF	SS	MS	F	P
Regression	15	44.9418	2.9961	3.58	0.004
Residual Error	20	16.7302	0.8365		
Total	35	61.6720			

However most of the coefficients are not significantly different from zero, at least in a statistical sense. However r-square is high.

On realizing that a regression using board meeting frequency and all corporate governance variables, as independent variables is not conveying enough information in terms of predicting firm value, stepwise regression is employed in selecting predictor variables.

Stepwise regression removes and adds variables to a regression model for the purposes of identifying useful subset predictors. At this stage we introduced return on equity (ROE) as a control variable. RoE is related to firm value. The stepwise regression results were as follows:

Stepwise Regression: PBR versus NBM, NSBC,

```
 Alpha-to-Enter: 0.15  Alpha-to-Remove: 0.15

Response is    PBR    on 17 predictors, with N =   36
N(cases with missing observations) = 234 N(all cases) =  270
```

Step	1	2	3
Constant	0.8316	-0.5697	0.9565
ROE	0.0362	0.0339	0.0341
T-Value	4.21	4.84	5.15
P-Value	0.000	0.000	0.000
NBM		0.171	0.217
T-Value		4.30	5.08
P-Value		0.000	0.000
NBD			-0.191
T-Value			-2.25
P-Value			0.031
S	1.09	0.887	0.837
R-Sq	34.28	57.88	63.64
R-Sq(adj)	32.35	55.33	60.23
C-p	29.7	9.5	6.1

The results show the constant term, the coefficient and its t-value for each variable in the model, S (square root of MSE and R- Square). The results show market improvement in p-values. In step one of the stepwise regression, the variable return on equity (ROE) entered the model with a significant coefficient; in step two the variable number of board meetings (NBM) entered the model. These variables explain changes in market value of firms.

The regression below better capture corporate governance variables that impact on the value of the firm. The variable market value of the firm was dropped. The variables that impact on the firm value (Price to Book Ratio) are NBM, NPUB, NSOD,NBOD (marginal) and ROE.

The regression equation is:

```
PBR = - 0.83 + 0.153 NBM - 0.186 NSBC + 0.323 NUBD + 0.727 NAO - 0.0487 NPUB
           + 0.0399 NSOD + 0.688 NBOD + 0.0356 RTA + 0.0290 ROE + 0.00208 RPS
```

39 cases used 231 cases contain missing values

Predictor	Coef	SE Coef	T	P
Constant	-0.828	1.228	-0.67	0.506
NBM	0.15287	0.07417	2.06	0.049
NSBC	-0.1855	0.1427	-1.30	0.204
NUBD	0.3234	0.4887	0.66	0.513
NAO	0.7265	0.9199	0.79	0.436
NPUB	-0.04871	0.01848	-2.64	0.014
NSOD	0.03990	0.01319	3.03	0.005
NBOD	0.6878	0.3490	1.97	0.059
RTA	0.03562	0.03938	0.90	0.373
ROE	0.02900	0.01159	2.50	0.018
RPS	0.002076	0.001289	1.61	0.119

S = 0.8001   R-Sq = 71.2%   R-Sq(adj) = 61.0%

Analysis of Variance

Source	DF	SS	MS	F	P
Regression	10	44.3689	4.4369	6.93	0.000
Residual Error	28	17.9223	0.6401		
Total	38	62.2912			

4.3.2 Number of Board Meetings (NBM) and Firm Value

The number of board meetings (NBM) is a measure of board activity. The only justification for frequent board meetings is if they add value to the firm. The coefficient for NBM is positive (+0.15237) and is interpreted as follows: the value of a firm positively responds to changes in board meeting frequency. A potential inference is that an active board can transform a loss-making firm into a profitable one and that directors who meet more frequently are more likely to perform their duties than the ones that avoid meetings. Lorsch (1992) suggestion that directors who do not have enough time for board meeting are likely to be ineffective in monitoring management are supported by these findings. However this is only attainable in firms that the board and not chief executive officers set the agenda (Jensen, 1993). The conclusion is that board-meeting frequency is related to firm value.

4.3.3 Total Shares Held By Unaffiliated Block Holders (NPUB) and Firm Value

Total shares held by unaffiliated block holders (NPUB) are inversely related to firm value i.e. it coefficient is negative (-0.04871). This is in concurrence with Vafeas (1999) assertion that unaffiliated owners of large equity blocks facilitate corporate governance since they have the power to discipline management. They can sack managers whose performance is below par Denis et al (1997). Good corporate governance mitigates agency problem thus enhancing the value of the firm (Grossman and Hart, 1980).

4.3.4 Percentage of Shares Held By Officers and Directors of the Company or Insider Ownership (NSOD) and the Value of the Firm

An important control mechanism is inside ownership McConnel and Servaes (1990). If that assertion holds, then a positive relation between firm value and insider ownership is expected. Our findings, a positive coefficient of 0.03990 confirms the hypothesized relationship for companies listed at the NSE. This finding is in agreement with Jensen's (1993) suggestion that inside directors are a source of effective corporate governance. Inside directors, because they have a stake in their firm take keen interest in what is going on in the company. In summary insider ownership helps in mitigating agency problems.

4.3.5 Number of Directorships Held by Outside Directors (NBOD) and the Value of the Firm

Weir et al (2002) argue that additional directorship is a proxy for director quality. Firms with directors of exceptional quality are expected to be more profitable than identical firms with low quality directors. This is because that class of directors will reflect exceptional quality in superior decisions in order to preserve their reputation i.e. reputation capital hypothesis. In the regression above NBOD has a positive coefficient of 0.6878 that is statistically significant. This finding does not support Dowen (1995) who found that NBOD have no influence on firm performance; but are in line with Gilson (1990) and Kaplan and Reishus (1990) who present evidence that trace firm performance to director's reputation.

CHAPTER 5

Conclusions and Recommendations

5.1 Conclusions

We find that board activity as measured by the frequency of board meetings is related to a number of corporate governance variables such as the board size, the number of executive directors, number of total shares held by largest shareholder, the number of shares held by unaffiliated block holders; the number or percentage of shares held by officers and directors (inside ownership) and the number of other directorship held by outside directors.

Specifically we have evidence that the number of board meetings decrease with the board size. This result is not surprising given that most quoted companies in Kenya have between 5 and 10 directors (Jebet 2001) and the inference is therefore that board meeting time is well utilized due to the smaller sizes of the boards.

We also find that the number of board meetings decrease with the number/percentage of shares held by officers and directors of the firm (inside ownership). This is consistent with the notion that the monitoring role of external board members is less critical for firms with higher proportions of inside ownership and that higher inside ownership helps to align the interests of managers to those of shareholders. Inside ownership thus appears to be a substitute for board monitoring activity. We find that the frequency of board meetings increases with the number of outside directors thus supporting the notion that outside directors require more opportunities (meetings) for keeping up with the firm's affairs.

Unlike Vafeas (1999) we find that the number of meetings increase with presence of unaffiliated owners of large equity blocks advancing further the argument that where an individual shareholder owns a large equity stake in the firm, they have an increased incentive to monitor management hence requiring more meetings.

The number of board meetings is also significantly related to the number of other directorships held by outside directors giving support to Vafeas (1999) argument that the intensity of board activity is determined by the reputation capital and not by the population of outsiders who serve on the board.

Like the findings of Vafeas (1999) the use of board standing committees considered to provide directors effective contacts because they are small, have no impact on frequency of board meetings. It is possible that firms do not make proper use of such committees by not giving them sufficient independence to make decisions without reference to the board or that their role is not well understood.

The size of the firm as measured by the log of the market value has no discernible influence on the frequency of board meetings. Contrary to the notion that keep abreast of the affairs of larger firms is likely to be more time consuming.

On the association between board meeting frequency and the value of the firm (price to book ratio) the results show that boards increase the frequency of their meetings following poor performance and as a consequence of such increase the performance of the firms improves as captured by the increase in firm value giving support to Jensen (1993) and Vafeas (1999) that the role of corporate boards becomes increasingly more important during crises, when shareholders' interests are in visible danger.

The results further show that the relationship between governance mechanisms and performance is a complex one. They raise questions about the efficacy of a policy that imposes prescribed internal governance structures on firms because such an approach creates difficulties when trying to assess the effectiveness of those mechanisms given the differences among firms. (In this study we were unable to assess the effectiveness of leadership structure as all public listed companies have a separate leadership structure as required by CMA).

Cadbury (1992) recognizes that flexibility should be a part of the governance system. However the prescriptive nature of the CMA regulations and guidelines does little to encourage such an approach. Greater flexibility and a recognition that the mix of governance mechanisms may vary according to a firm's specific circumstances offer a possible solution. Our results lend weight to

the need for greater flexibility in understanding how governance control mechanisms impact in particular circumstances and more specifically how to strengthen the link between corporate governance structures and shareholder's interests.

Finally, although only companies quoted on the NSE were studied, the results are likely to be relevant for a wider set of firms as they show that boards respond to poor performance by raising their level of board activity and as a consequence firm performance improves. This finding also has important governance implications. Frequent board meetings can be a remedy to limited director interaction time thus improving the effectiveness of the board. It would seem cheaper and less costly to adjust a firm's frequency of its board meetings to attain better governance than to change the composition of its board, or its ownership structure.

Further, planning the timing and frequency of board meetings would enable the transformation of the board from a reactive means to end crises to a proactive tool to prempt them resulting in benefit to shareholders.

5.2 Limitations of this Study

The study focused on the companies quoted on the NSE only. Only 48 companies are listed. There are many other private and public companies operating in Kenya. The findings of this study cannot be generalized.

Time and data were a major limitation.

We also had to drop some variables such as director incentive plans because firms were reluctant to disclose information relating to this variable.

Another limitation of this study was that we held constant important characteristics of board meetings such as the content, length, location, level of interaction at the meeting, who sets the agenda for board meetings, how much and when information is provided to directors to enable them prepare for the meetings and the quality of the directors. They would have shed more light as to the quality of the board meetings.

5.3 Suggestions for further research and recommendations

This study concentrated on the importance of board activity as measured by board meeting frequency as a corporate governance mechanism.

Further investigation is suggested on the issues of the quality of the board meetings such as the powers of the board of directors to set the agenda, the amount of time set aside for substantive issues and routine tasks and the length and contents of the board meetings.

With respect to the other corporate governance mechanisms further research could be done into the value relevance of other board attributes such as board size, board composition, ownership structure and board committees in companies in Kenya.

It is recommended that for boards to improve their effectiveness in their role of monitoring management they should be involved in setting the agenda for board meetings and they should make the time to fully prepare and understand the problems and implications of the topics in the agenda before the meetings and set aside sufficient time for such meetings.

Management should recognize board meeting time as an important resource and they should plan board meetings better, giving board members adequate, timely and correct information and sufficient time to prepare for meetings. They should use board meeting time as an opportunity for meaningful exchange of ideas and high level counsel between themselves and the board on the "bigger picture policy issues" and not for discussing mundane routine tasks in a manner resembling traditional or religious rituals.

Board committees provide an opportunity for board members to interact closely with management in smaller group settings. Their role (that is whether they are decision management, advisory or monitoring) should be clarified and strengthened.

Given the differences among firms, the Regulators need to constantly review the efficacy of corporate governance guidelines and regulations and allow for more flexibility in the governance system as opposed to the "one size fits all" approach presently adopted which makes it difficult to assess and improve the effectiveness of corporate governance mechanisms.

Shareholders and investors should insist on more detailed information on the frequency of board and standing committee meetings and how much time is spent at such meetings so as to be better informed as to how effectively the board monitors management.

APPENDIX I

LIST OF PUBLIC QUOTED COMPANIES IN KENYA
MAIN INVESTMENT MARKET SEGMENT

Agricultural

1. Brooke Bond Ltd
2. Kakuzi
3. Rea Vipingo Plantations Ltd
4. Sasini Tea and Coffee Ltd

Commercial and Services

5. Car & General (K) Ltd
6. CMC Holdings Ltd
7. Hutchings Biemier Ltd
8. Kenya Airways Ltd
9. Marshalls (E.A.) Ltd
10. Nation Media Group
11. Tourism Promotion Services Ltd
12. Uchumi Supermarkets Ltd

Finance and Investment

13. Barclays Bank of Kenya Ltd
14. CFC Bank Ltd
15. Diamond Trust Bank Ltd
16. Housing Finance Co. Ltd
17. ICDC Investments Co. Ltd
18. Jubilee Insurance Co. Ltd
19. Kenya Commercial Bank Ltd
20. National Bank of Kenya Ltd
21. NIC Bank Ltd
22. Pan Africa Insurance Holdings Ltd
23. Standard Chartered Bank Ltd

Industrial and Allied

24. Athi River Mining Limited
25. B.O.C. Kenya Ltd
26. Bamburi Cement Ltd
27. British America Tobacco Ltd
28. Carbacid Investments Ltd
29. Crown Berger Ltd
30. Dunlop Kenya
31. E.A.Cables Ltd
32. E. A. Portland Cement Ltd

33. East African Breweries Ltd
34. Firestone East Africa Ltd
35. Kenya Oil Ltd
36. Mumias Sugar Co. Ltd
37. Kenya Power & Lighting Ltd
38. Total Kenya Ltd
39. Unga Group Ltd

Alternative Investment Market Segment

40. A. Bauman & Co. Ltd
41. City Trust Ltd
42. Eaagads Ltd
43. Express Kenya Ltd
44. Williamson Tea Kenya Ltd
45. Kapchorua Tea Co. Ltd
46. Kenya Orchards Ltd
47. Limuru Tea Co. Ltd
48. Standard Newspapers Group

APPENDIX 2

DATA COLLECTION FORM

The Data Collection Form has been set in relation to the objectives of the study. All the questions relate to board meeting frequency, corporate governance mechanisms and firm performance.

DATA REQUIRED

1. **Name of the Company:**

2. **Please supply information on the following:**

		1998	1999	2000	2001	2002	2003
1	Number of Board Meetings*						
2.	Number of Standing Board Committees						
3.	Number of Standing Board Committee Meetings						
4.	Number of Board Directors						
5.	Number of Executive Directors						
6.	Number of non-executive/independent Directors						
7.	Number of unaffiliated blockholder Directors **						
8.	Number of affiliated outsiders***						
9.	Number of total shares held by largest shareholder						
10.	Number/percentage of total shares held by unaffiliated blockholders **						
11	Number/percentage of shares held by officers and directors (inside ownership)						
12.	Number of other directorships held by outside Directors						
13.	Employee stock option plans (percentage number of shares)						
14.	Number of shares outstanding						

Note:
- * Please exclude telephonic meetings of the board.
- ** Unaffiliated blockholders: single ownership of more than 5% of the firm's stock
- *** Affiliated directors: those with potential business ties with the firm e.g. lawyers, auditors, management consultants.

CORPORATE GOVERNANCE MECHANISMS

3) BOARD OF DIRECTORS:

Leadership Structure of the Board; Joint or Separate: ……………………………

when separated: ……………………………………………………………………

4) DIRECTOR INCENTIVE PLANS:

Director incentive plans are used: …………………………………………………

when introduced: ……………………………………………………………………

Stock option plans are used: ………………………………………………………

when introduced: ……………………………………………………………………

5) FINANCIAL PERFORMANCE

A) PROFIT AND LOSS STATEMENT FOR THE PERIOD ENDED ______________						
	1998	1999	2000	2001	2002	2003
Turnover						
Profit Before Tax						
Taxation						
Profit After Tax						
Preference Dividends						
Profit attributed to Ordinary Shareholders						
Ordinary Dividends						
Retained Earnings						
No. of Ordinary Shares						

B) BALANCE SHEET AS AT ______________________________

	1998	1999	2000	2001	2002	2003
Fixed Assets						
Other Non Current Assets						
Current Assets						
Current Liabilities						
Net Current Assets						
Long Term Liabilities						
Total Net Assets						
Financed by:						
Share Capital						
Reserves						
Total Shareholders Funds						

C) FIRM VALUE (MARKET) FOR THE PERIOD ENDED

	1998	1999	2000	2001	2002	2003
Common stock opening price						
Common stock closing price						

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