BOARD COMPOSITION AND
PERFORMANCE IN QUOTED COMPANIES IN
KENYA

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A Management Research Project submitted in partial
fulfillment of the requirements for the degree of Master
of Business Administration, Faculty of Commerce,
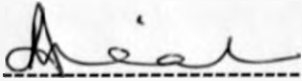University of Nairobi.

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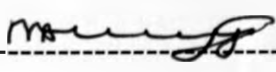# DECLARATION

This research project is my original work and has not been submitted for a degree in any other university.

Signed; --

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This project has been submitted for examination with my approval as university supervisor.

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DEDICATION

This study is dedicated to my mother who has always stood with me during my study period and was a great source of inspiration, during this time.

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I give the Glory to God for His grace that was sufficient throughout the entire period.

Special thanks to my supervisor, Mr Anyangu for his invaluable guidance, contribution, support, advice and patience throughout the research period. I am grateful to my colleagues for their input in the whole study period.

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I also appreciate with all my heart the tireless effort of Mrs. Jedidah Kalama who typed the project so willingly, taking the work as her own. May God perfect all that concerns her and Beth Mugo who has stood with me the entire study period being more than a sister, may the good Lord remember her work of love to all especially me. My gratitude also goes to Mureithi, Sheila and Boom for their love and material support.

I do recognize all those in one way or another assisted me in all manner of contribution during this period.

GOD BLESS YOU ALL.

ABSTRACT

This study examines the effect of board composition on firm's performance. The focus is on all the quoted companies in Kenya for a period of ten years starting from 1994 to December 2003.

The basic methodology involved sampling the companies that were continuously listed in the Nairobi Stock Exchange for the entire period. The primary data was collected using a questionnaire method. Secondary data was also utilized. A multiple regression model was used to analyze the data gathered. The dependent variable was the company's performance measured by Return on equity (model 1) and Tobin's q (model 2). The independent variables included elements of board composition practices (board independence, audit committee independence, CEO duality and directors from financial institutions) and other important control variables including firm's size, financial leverage and board size.

We find no significant relationship between firms' performance as measured by Return on equity and board composition variables. We also find some evidence that firm's performance measured by Tobin's q has a significant relationship with firms leverage and size. These empirical findings suggest that, adding outside directors to the board, audit committee independence, directors from financial institutions, CEO duality are not performance enhancing. We also document that the most popular or preferred board mix consists of an average of 8 members in size, 70%non-executives and no CEO duality. The findings reflect that boards in Kenya are embracing the recommendations on good corporate governance outlined by Capital Market Authority 2002.

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CHAPTER 1   INTRODUCTION

1.1   BACKGROUND OF STUDY

1.1.1 GOALS OF THE FIRM AND THE ROLE OF THE BOARD

Firms pursue different goals among them profit maximization, shareholders wealth maximization, social responsibility (NGO's) and business ethics. Most finance authors agree that the primary goal of the firm is to maximize owners' wealth, which equals the market value of the owners' investment in the company. (Gary, 1998, Levy and Samat 1999, Copeland and Weston, 1992, and Ross Westerfield and Jaffe, 1990). This goal has several desirable features, which makes it perhaps the ultimate goal of all firms:

- Maximizing owners' wealth is pragmatic because most owners prefer to have more money rather than less. This therefore is the goal pursued by the owners of firms, who appoint managers and expect them to pursue this objective for them.

- Maximizing the owners' wealth is socially responsible because it helps society use scarce resources efficiently. Investors provide financing to companies they believe will increase their wealth and withhold it from the rest. Managers compete for this capital by increasing the net cash flow the company earns for the owners or by reducing the owner's opportunity cost.

- Managers can pursue the goal of maximixising the owners wealth without explicitly balancing the interest of the other stakeholders namely customers, employees, suppliers and creditors because the owners are paid last. According to Gary (1998)'Customers requirement for a product worth of price, employees requirements for

competitive wages and suppliers and creditors requirements for timely payments of amounts owed them must be met before a single dollar of profit is available to the owners.' This means an increase in owners' wealth can be interpreted as evidence that a company has met the needs of its other stakeholders and is producing a product or providing a service that adds value to the society.

- Finally the market price of a company's common stock provides a public record of the manager's success at maximizing the owner's wealth

Research on corporate governance has identified a number of mechanisms intended to ensure that management teams act in the best interest of shareholders and as a result the entire shareholders. These include external mechanisms such as institutional ownerships, debt financing, and the market for managerial labour and internal mechanisms, which include managerial ownership, executives' compensation and the board of directors. (Shleifer and Vishny 1997)

The board of directors of the modern corporation plays a critical role in the enactment of these mechanisms being fiduary responsible to the shareholders and having the right to monitor, ratify and sanction the decisions of the managers of the corporation. The role of the boards is therefore critically tied to the imperfect agency relationship between shareholders and managers that is itself direct consequence of the modern corporate form (Mihmea .2001)

Board of directors therefore being the major organ working toward maximizing the shareholders wealth and resolving the agency conflict, its composition is of great concern. According to Jensen (1976), it's generally accepted that board of directors play a fundamental role in corporate

governance and the structure of the board matters. Agency theorists suggest that the board of directors is in place to monitor and interest the decisions of top managers and possibly intervene on behalf of shareholders. The ability of a board to effectively monitor management had been directly linked by the empirical literature to board independence, where the degree of independence is in turn related to its composition. In this respect, board composition becomes significant as the primary responsibility in keeping the board independence dependent on outside disinterested members of the board that are not directly beholden to management (e.g. Fama, 1980; Fama and Jensen, 1983; Welsbach 1988; and Zahra and Pearce, 1989).

1.1.2 BOARD COMPOSITION

Four main approaches to measuring board composition have been identified: inside, outside, affiliated and independent/interdependent directors (Daily, Johnson, and Dalton 1998). The essence of these measurements is to capture the extent a board operates independent of the firm and its management, specifically the CEO. The insider/outsider distinction refers to whether a board member is an employee of the firm. The affiliated operation goes beyond employment, and considers other factors that might affect a director's independence, such as family relationship, supplier, customer, consultant, etc. While such affiliation is believed to affect independence, it may be highly effective in resource dependence and counseling functions. The independent/interdependent distinction (Daily 1998) differentiates directors who are already on the board when the current CEO is appointed. Board members who are on the board before the CEO arrives are considered independent, and those appointed by the CEO, interdependent, even that director may be a total outsider.

According to Pearce and Zahra (1992), Board composition refers to the number of director's hereafter "board size" and type of members as determined by the usual insider or outsider classification. Insiders are current members of top management team and employees of the company or its subsidiaries. Outside directors have no such association, but are further grouped as affiliated or non-affiliated (independent). Affiliated outsiders are not members of the current management or employees of the company but have close links with the firm as in the case of former executives of consultants. Non-affiliated outsiders are usually referred to as independent directors. They are recruited primarily because of their expertise, name recognition and skills. In theory these independent directors are not under the control of the company's executives.

Fama and Jensen (1983) established that the composition of the board of directors is a critical factor in establishing the effectiveness of the board as an objective monitor of management. according to them. board composition refers to the relative numbers of inside (management) and outside non-management) directors serving on the board. They argue that outside members of the board. those that are not employed by the organization nor have any other business ties to firm aside from their directorships. serves as the real monitors on the board since they have no affiliation with management.

1.1.3 BOARD COMPOSITION AND AGENCY COSTS

In most listed companies there is a division between the shareholders, the board and management due to the size and scale of operations of such companies. Although there is usually some overlap between the constituents of each group, it is important to appreciate the division and why it exists. The corporate form of firm organization has obvious advantages for shareholders (suppliers of capital) and managers. Shareholders can participate in the gains from entrepreneurial ventures even though they lack management's skills: managers can pursue profitable business opportunities even though they lack large personal wealth. Both parties benefit from this division of labor. Fischel, (1982)

However, as well as benefits from specialization of function, there are also certain costs inherent in the corporate form of firm organization. The most significant of these being 'agency' costs, Jensen and Meckling (1976) (So called because the body of shareholders and the directors/managers are, in a loose non-legal sense, in a principal agent relationship). Agency costs arise because of a divergence between the interest of shareholders and that of managers:

> "As residual claimants on the firm's income stream, shareholders want their agents – the firm's managers – to maximize wealth. Because managers cannot capture all of the gains if they are successful, and will not suffer all of the losses should the venture flop, they have less incentive to maximize wealth than if they themselves were the principals. Rather, managers have an incentive to consume excess leisure, perquisites and in general be less dedicated to the goal of wealth maximization than they would be if they were not simply agents". Fischel (1982)

Agency costs comprise, (i) the cost incurred by the shareholders in monitoring managers in order to minimize the divergence between their interests; (ii) 'bonding' costs incurred by the managers; (iii) the 'residual loss' resulting from the remaining divergence in shareholders' and managers' interests.

Regarding (i) and (ii), there are in fact numerous legal rules, devices and market forces (e.g. the market for corporate control (takeovers), the capital and product markets, and the market for managerial talent) which serve to reduce the divergence between the interests of shareholders and managers, Henry Butler (1989). Where a change in the use of such devices and rules brings about a net reduction in agency costs, corporate financial performance will, in theory, improve. It is significant in the present context that the use of independent non-executive directors to monitor the performance of the executive management is generally treated as an element of this tapestry of monitoring devices and rules. It appears that those who advocate an increase in the proportion of independent non-executive directors on company boards are implicitly, if not explicitly, suggesting that such a development would bring about a net reduction in agency costs.

1.2   STATEMENT OF THE PROBLEM

The increased need for accountability and transparency call for a good corporate governance practice by public listed companies. Stile (1993) explained "the spectacular company collapse today, results from lack of positive measures with corporate control." He observes that issues of corporate governance are currently being emphasized due to the hard economic times, which has exposed corporate weaknesses. He concluded 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.

Some US studies have looked for direct evidence of a link between board composition and corporate performance. A study by Baysinger and Butler (1985) indicated that the proportion of independent non-executive directors in 1970 was positively correlated with return on equity (an accounting measure of performance) in 1980. On the other hand, studies by Klein (1998), Bhagat and Black (1988) and Hermalin and Westbach (1991) have found that a high proportion of independent directors do not result in better future performance of the firm. They also found that the proportion of independent non-executive directors had no consistent effect on market-adjusted share price performance. Then there is the study of Agrawal and Knoeber (1996) which showed that the greater the proportion of independent directors, the slower the company's growth. Agrawal and Knoeber interpreted their results as evidence that board independence is negatively related to company performance. However, the results of Agrawal and Knoeber study are also explicable on the basis that a high proportion of independent directors were a response to slower growth rather than cause of the slower growth. Indeed, the study by Hermalin and Weisbach showed that the proportion of independent directors tended to increase when a company performed poorly.

Still other studies find no relationship between board composition and firm performance (Mac Avoy et al. 1983). Weisbach (1988) reports that while management ownership is significantly related to overall performance, board composition is not. In a recent meta-analytic review of board structure/leadership structure and firm financial performance, Dalton et al

(1998) concludes that there is 'little evidence of systematic governance structured financial performance relationship' p.269.

The above studies depict conflicting and inconclusive empirical findings, which has necessitated the research in question.

In Kenya context, the governance debate is an issue in companies, with the advocators arguing that companies' board should incorporate all stakeholders' interest in the decision-making. The board should be concerned about the firm's performance to maximize stakeholders' interests. Board composition is one mechanism available to reconcile the interest of shareholders and managers in public companies.

Several studies have been carried out in the field of corporate governance Wambua (1999), Mwangi (2001), Jebet (2001), Mucuvi (2002). In all these studies there is a great emphasis in corporate governance practices in various industries. However, none of them has linked corporate governance issues with firm's performance. This research paper isolates one principle of good corporate governance, board composition, and seeks to find its relationship with firms' performance

1.3   OBJECTIVES OF THE STUDY

The study will seek to satisfy the following objectives

i)   To find out whether there is a relationship between board composition and firm's performance.

ii)   To identify the most preferred board mix as regards size, board independence and C.E.O duality in reference to firm's performance.

1.4   SIGNIFICANCE OF THE STUDY

1. The study will be of importance to various quoted companies in making decisions about their board composition taking into account the Capital Market Act of 2002 provision in a bid to improve their performance.

2. To the government agencies for example C.M.A. in formulating future policies and regulations affecting quoted companies.

3. The study will provide an insight to scholars towards further research in related field.

CHAPTER 2   LITERATURE REVIEW

2.1   CORPORATE GOVERNANCE AND BOARD COMPOSITION

Corporate governance was defined by Britain's Cadbury Committee (1992) as the systems by which companies are directed and controlled. One aspect of corporate governance so defined is the composition and structure of the board of directors. Board composition is taken to mean the make-up of the board in terms of executive and non-executive directors, independent and affiliated non-executive directors. Board structure refers to the structural features of the board, such as the presence or absence of committee (e.g. audit and remuneration committees) and whether the roles of chairperson and chief executive officer, (CEO) are performed by one or two person (CEO duality)

In recent years a number of bodies including the American law institute (1994) the Bosch Committee (1995) and the Australian Investment Managers Association (AIMA) (1995) have made recommendations regarding best practice in the area of board composition and structure. Regarding board composition all these bodies have felt that best practice involves a certain proportion of independent non-executive directors. As regards boards structure all of these bodies have recommended that boards should appoint an audit committee. Some have also recommended the appointment of remuneration and nomination committee and all have recommended a separation of the roles of chairperson and chief executives. In Kenya the C.M.A decided to take a prescriptive and non-prescriptive approach regarding the board composition and structure. It requires every listed company to disclose in its annual reports a statement of directors

indicating whether the company is complying with corporate governance guidelines.

The C.M.A states that the board should compose of a balance of executive directors (including at least 1/3 independent non-executive directors) of diverse skills or expertise to ensure that no individual or small group of individuals can dominate board decision-making process. Further the act advocates for no CEO duality to balance power of authority and provide for checks and balances, however where the role of CEO is combined with board chair there are certain conditions to be fulfilled (CMA cap 485A 3.2) 2002 publication.

2.2 BOARD COMPOSITION
2.2.1 BOARD SIZE

Traditionally boards have been perceived as, self perpetuating, exclusive and performing a somewhat passive role, rather than providing a guiding role in their functional governance requirements within the organization.

In today's corporate environment there is still evidence of boards comprised of large number of directors leading companies in a traditionally conservative style. The reality is that many boards generally are in a state of transformation in regard to corporate governance dynamics and are in fact reflective of their environment and the pressures and characteristics of those various industry sectors and the markets in which they exist. This is to say nothing of the impact of industry regulators and respective corporate, legal, financial and prudential legislative requirements.

Because of disparity in the size of organizations, difference in the competitiveness of the markets, variance in both size and importance of the respective industry sectors and the nature of the organization (public,

private, listed, not for profit etc.), there is not a convenient 'one size fits all' prescription for the size of the board.

The appropriate sizing of the board is a function of the individual organization's need to respond to external environmental dynamics as well as its need to address the dynamics of the internal issues it is experiencing. Obviously this will vary greatly between organization and industry sectors. Usually the most appropriate size is a function of the complexity and size of the company, its operations, geographical spread, and diversity of its business.

Amongst internal factors likely to have some impact on board size are issues impacting on the organizations well being status and stage of development. Is it well structured? Is it well managed? Is it in a sound financial position? Does it have a clear strategic vision and committed strategy? Does it have an ethical commitment? And what are the skill and competency needs at the board level?

Too large a board can be dysfunctional (becoming prey to factional elements and agendas) to the point of destroying the board's cohesiveness, and as a consequence, its effectiveness. The board should have sufficient numbers and diversity to cover the required range of skills, experience and expertise required by the company. The differences and needs between companies, industry sectors, and markets could vary greatly.

Larger boards tend to result in better corporate financial performance. The first explanation takes a resource dependence view, whereby directors are seen to link the company with resources from its environment. This role is seen to be particularly important in times of corporate decline, when the necessity for corporations to co-opt resources from their environments is inevitably heightened. Companies with smaller boards are seen as being

more likely to perform poorly or fail; a small number of board members is believed to indicate an inability or lessened ability by a firm to co-opt resources from its environment that are necessary for survival. Second, larger boards are believed to bring more diverse perspectives to bear when formulating strategy. The third explanation for a board size-corporate performance relationship concerns centralization of control. Of concern here is the extent to which the CEO can influence the board. In this regard, it has been proposed that 'larger boards are not as susceptible to managerial domination as their smaller counterparts'. Zahra and Pearce (1989) and, in particular, that CEO's are most likely to dominate smaller boards. Chaganti Mahajan and Sharma, (1985). Hence, it is often proposed that a company with a smaller board is more likely than one with a larger board to have poor financial performance. This is because the CEO and /or other executives may have more scope to pursue strategic decisions, which go unchecked by directors having some degree of impartiality. The legal concern with larger boards tends to be that they tend to have more directors who are on the boards of other companies (i.e. interlocks) as we mentioned earlier, this can lead to concerns about conflicts of interest and anti-competitive behavior.

2.2.2 BOARD INDEPENDENCE

It is often proposed that inside (executive) directors cannot be relied on to impartiality monitor their own performance. In contrast, outsiders are viewed as more independent and therefore, impartial. Also, Sheppard proposes that outside directors 'provide an indicator of board's orientation towards its external environment ... and thus its ability to respond to change'. Sheppard, (1994). The inability to respond to change is one of the major causes of corporate decline. Miller, (1990)

Those arguing in favor of having a board dominated by outside directors propose that the independence of inside directors is open to question. One role of the board is to monitor and evaluate top management. In this respect, inside directors are seen to be in a position to serve their own best interests. From the preceding arguments there are compelling arguments in favor of outside directors. Howerever, some arguments have been made against representation by outsiders on boards. It has been suggested that outsiders do not have the time and expertise to perform effectively. Zahra and Pearce (1989). In addition, outsiders may find it difficult to 'understand the complexities of the company and to monitor its operations and, hence, to be fully responsible or effective'. Changati Mahajan and Sharma, (1985). These two arguments would lead us to expect that having more insiders on boards is conducive to higher corporate performance as these directors can be expected to have more time, expertise and knowledge to bring which might help avoid corporate collapse.

Outsider representation on boards has not been shown to be consistently associated with positive outcomes. For example, Boyd found that insider dominated boards had lower levels of CEO pay Boyd, (1994) and Hill and Snell, found outsider dominated boards to be associated with less research and development and more unrelated and overall diversification. Hill and Snell, (1988).

2.2.3 CEO DUALITY

CEO duality is typically defined to occur when the board chair of a company is also its chief executive officer (CEO). Those arguing in favor of CEO duality adopt the argument that duality leads to increased effectiveness, which will be reflected in improved company performance. CEO duality is

seen to result in a situation where there is a clear leader of the organization so that there is no room for doubt as to who has authority or responsibility over a particular matter. Donaldson and Davis , (1991). Given this, it has been proposed that separation of board chair and CEO roles 'is guaranteed to produce chaos both within the organization and in relationships with the boards'. In the event that such 'chaos' does ensue, this may have a detrimental effect upon the formulation of corporate strategy and the responsiveness of the company to changes in the external environment. Both of these factors could potentially contribute to poor corporate financial performance.

Compelling arguments have also been made against CEO duality. In particular, it has been proposed CEO duality leads to a situation where the governance role of the board of directors is compromised. The argument is aptly put in the following quote:

'In a company where the chairman is also the CEO ... power concentrated in one individual and possibilities for checking and balancing powers of the CEO.... are virtually eliminated. In such a corporation, the board may not be able to function as an independent body – independent from the influences of top management". Changati, Mahajan and Sharma, (1985)

Taking an agency theory perspective, Daily and Dalton propose separating the roles of CEO and chairperson 'reduces the opportunity for the CEO and inside directors to exercise behaviors which are self-serving and costly to the firm's owners'. Daily and Dalton (1998)

It has also been proposed that the separation of CEO and board chair roles is necessary because one person cannot perform both roles effectively as both the chairman and CEO have a distinctive domain. A further argument for separating the roles of chairperson and CEO concerns the relative role

expectations on each. In contrast to the CEO, who is involved in the day-to-day management of the company, the board chair 'is often involved in special planning assignments, in policy review and formulation and in public and stakeholder relations' Changati Mahajan and Sharma , (1985) It is likely that, given his or her day to day executive commitments, the CEO will not be able to effectively perform the additional roles of chairperson, and a fortiori during times of crisis. Furthermore, some of the benefits, which the CEO can obtain from having a chairperson, will inevitably be absent when the roles are combined. For example, Stewart has highlighted several roles of chairpersons, including mentoring (acting as a coach and counselor positively seeking to influence the [CEOs] behaviors), and consultant (giving advice to the CEO and other directors). Stewart (1991).

Yet another proposal for the separation of CEO and chairperson roles is that – in the case of a poorly performing company – 'it is not immediately clear what process would be relied on to remove CEO/board chair.' Daily and Dalton (1998). This is because the CEO who is also board chair is assumed to have a board, which largely defers to him or her. Interestingly, research by Harrison Torres and Kukalis (1988) indicates that it is more difficult to replace either the CEO or board chair when these roles are separated than when the two roles are held by one individual. Harrison, Torres and Kukalis (1988).

Finally, CEO duality may lessen and organization's ability to adapt to change. In this regard, Argent gives autocratic leadership and CEO duality among the management defects, which can contribute to eventual failure: "An autocratically run company that also has not responded to change is plainly in jeopardy, for it means that the autocrat himself has almost

certainly failed to notice how the world has changed. He is the company: if he has not understood some new trend in the business environment then the company is doomed. It might not happen for years, or it might be tomorrow. It only needs some stroke of bad luck to expose that fatal flaw that his company has been allowed to develop". Argenti, (1986).

2.3 BOARD COMPOSITION AND FIRM'S PERFORMANCE

Bhagat and Black (1999) recently surveyed the literature on how board composition affects firm's performance or vice versa. Prior studies of the effect of board composition on firm's performance generally adopt one of two approaches. The first approach involves studying how board composition affects the board's behavior on discrete tasks, such as replacing the CEO, awarding golden parachutes, or making or defending against a takeover bid. This approach can involve tractable data, which makes it easier for researchers to find statistically significant results. But it does not tell us how board composition affect overall firm's performance. For example, there is evidence that firms with majority-independent boards perform better on particular tasks, such as replacing the CEO (Weisbach, 1988) and making takeover bids, (Byrd & Hickma, 1992). But these firms could perform worse on other tasks that cannot readily be studied using this approach (such as appointing a new CEO or choosing a new strategic direction for the firm), leading to no net advantage in overall performance. This paper adopts the second approach of examining directly the correlation between board composition and firm's performance. This approach allows us to examine the "bottom line" of firm's performance (unlike the first approach), but involves much less tractable data. Firm's performance must be measured over long period, which means that performance measures are

noisy and perhaps misspecified; Kothari and Warner (1997) and Barber and Lyon (1996).

Prior research does not establish a clear correlation between board independence and firm performance. Early work by Vance (1964) reports a positive correlation between proportion of inside directors and a number of performance measures. Baysinger and Butler (1985), Hermalin and Weisbach (1991), and Mac Avoy, Cantor, Dana and Peck (1983) all report no significant same-year correlation between board composition and various measures of corporate performance. Baysinger and Butler report that the proportion of independent directors in 1970 correlates with 1980 industry-adjusted return on equity. However, their 10-year lag period is very long for any effects on board composition on performance to persist.

Three recent studies offer hints that firms with a high percentage of independent directors may perform worse. Yermeck (1996) reports a significant negative correlation between proportion of independent directors and contemporaneous Tobin's q. but no significant correlation for several other performance variables (sales/assets; operating income/sales); Agrawal and Knober (1996) report a negative correlation between proportion of outside directors and Tobin's q. Klein (1998) reports a significant negative correlation between a measure of change in market value of equity and proportion of independent directors, but insignificant results for return on assets and raw stock market returns.

Event Studies. Rosentein and Wyatt (1990) find that stock prices increase by about 0.2%, on average when companies appoint additional outside directors. This increase, while statistically significant, is economically small and could reflect signaling effects. Appointing additional independent directors could signal that a company plans to address its business problems

even if board composition doesn't affect the company's ability to address these problems. Rosentein and Wyatt (1997) find that stock prices neither increase nor decrease on average when an insider is added to the board. Composition of board committees; Klein (1998) finds that inside director representation on a board's investment committee correlates with improved firm's performance. She finds little evidence that "monitoring" committees that are usually dominated by independent directors – the audit, compensation, and nominating committees – affect performance, regardless of how they are staffed.

2.4   MEASURES OF FIRM'S PERFORMANCE

Performance measures are designed to indicate the effectiveness of the control systems in achieving the organization's goals (Govindarajan, 1988). This variable is designed to measure the association with firm performance the board composition adopted by the firms. Firm's performance can be measured using either accounting, market based measures, or both. Accounting measures includes:

a)   Return on equity (ROE), which is calculated as income before tax and abnormal items divided by total equity. Although managerial discretion may affect accounting returns through smoothing and accounting manipulations in the short run, in the long run accounting and market measures of return should reflect the same economic factors for the firm (Carr, 1997). ROE is highly correlated with other accounting performance measures such as return on assets, (Antle and Smith, 1986)

b)   Earning per share. which is the basic reported earnings per share in the companies financial reports. This ratio measures the worth to the shareholders of the earnings attributable to each ordinary share over time. The latest net profit after minorities, preference dividends and tax but before abnormal is divided by the weighted average number of shares on issue during the year.

Market based measure includes:

a)   Total shareholders return calculated as return on common stock consisting of the year-end closing price of a firm's stock and dividend per share dividend by the share price of the previous year. This measure reflects the one-year total gain (loss) a shareholder receives for holding the firm's common stock (Bloom and Milkovich, 1998; Kren and Kerr, 1997).

b)   Tobin's q which is computed as market value of common stock and book value of preferred stock and book value of long-term debt dividend by book value of total assets, with all values measured at year-end. Other measures of Tobin's q are possible but Chung and Pruitt (1994) report very high correlation between relatively careful and relatively crude measures.

One accounting measure and one market based measure were used in the study.

CHAPTER 3   RESEARCH METHODOLOGY

3.1   POPULATION OF THE STUDY

The population of the study consists of the companies listed on the Nairobi Stock Exchange as at 31 December 2003

3.2   SAMPLING

The sample comprised of all the companies, which were listed on the Nairobi Stock Exchange continuously for the 10 years ending 31 December 2003

3.3   DATA COLLECTION

Both primary and secondary data were utilized. The primary data was collected using a self –administered questionnaire whose respondents were the companies' secretaries. This provided information about audit committee independence and the number of directors from financial institutions.

Secondary data was collected from the companies' financial statements. The companies' total equity, market capitalization, and book value of long and short-term debts, total assets and earning before tax were extracted for each year. The firm's performance was calculated using this information.

3.4   DATA ANALYSIS

Multiple regression analysis was carried out to examine the effect of board composition on firm's performance. Descriptive statistics namely mean, mode, minimum and maximum were calculated to establish the most preferred board mix among the companies. The model was as follows:

1   ROE= f (BI, ACI, BS, CEO, SIZE, LEV, FID)

2   Tobin's q (Q) = f (BI, ACI, BS, CEO, SIZE, LEV, FID)

The dependent variable is the Company's performance as measured by return on equity and Tobin's q

Return on   = Income before tax
Equity (ROE)   Total Equity

Tobin's q   = Market value of common stock + Book value of
                         preferred stock + Book value of long
                         term debt

Book value of total asset

Independent variables are: -

    a) Board independence (BI)- measured by the fraction of outside directors on the board , while outside directors have been defined in a number of ways in literature (Daily, Johnson and Dalton), we define outside directors as those who are not employees, suppliers, customers, consultants or family member of the company.

    b) Audit committee independence (ACI). This is measured by the proportion of outside directors on audit committee

c) CEO duality: a dummy variable that takes the value one, if the CEO is also the chairman of the board.

d) Directors from financial institutions on board (FID) are the proportion of directors from financial institutions.

Control variables include: -
a) Firm's size (SIZE) measured by the natural log of total asset.
b) Financial leverage (LEV) which is the ratio of the sum of short terms and long term debt and total asset.
c) Board SIZE (BS), which is measured by the number of directors in the board.
   These variables act as controls for firm's specific effects on the performance. The model is similar to the one used by Erickson et al (1998) and Bhagat and Black (1998).

CHAPTER 4   DATA ANALYSIS AND FINDINGS

4.1   INTRODUCTION

The purpose of the study was to find out whether there exist a relationship between the companies board composition and their financial performance and also to collect evidence of the most preferred board mix in terms of board size and independence and CEO duality. The study concentrates on those companies listed on the Nairobi Stock Exchange as at 31st Dec 2003. There were 46 companies that were continuously quoted in the NSE throughout the study period. However only 34 of them responded to the questionnaire and these were the companies used for this study.

The details on the entire variables for 34 companies were obtained and listed on appendix 1. Computer software SPSS was used in determining the correlation matrix of the entire variables and descriptive statistic as indicated in appendix 2 and Appendix 3, which also shows the regression output from the same software.

4.2   BOARD COMPOSITION PRACTICES

Table 1:   Descriptive Statistics

	BSI	DIR	BI	ACI	FID	SIZE
N valid	34	34	34	34	34	34
Missing	0	0	0	0	0	0
Mean	8.32	5.91	.70509	.49100	.25415	14.87991
Mode	8	5a*	0.667	.400	.200	14.650
Min	3	2	.375	.000	.000	10.839
Max	14	10	.909	1.000	.812	19.193

a*- multiple modes exist, the smallest value shown.

Table 1 provides the descriptive statistic for the sample studied. The mean proportion of outside directors present in the board is 70.5% indicating that an average board in a public company has a majority of outside directors. A study carried out by Yun et al (1998) for Canadian firms found the proportion of outside directors as 67%. In New Zealand the proportion of outside directors varied from 42% to 50.5% over a five year period with an increasing trend over time as reported by Prevost et al (2002) in their study. In contrast a study carried out by Li (1994) reports a mean of 58% from a sample of 390 firms in ten industrialized countries with a wide variation between 83% in France to 9%in Japan. Kenyan boards therefore have a higher proportion of outside directors compared to other countries. This however compares well with the mean proportion for companies in US and New Zealand during 1980-1990 as reported by Fox et al (1998) whereby US company's board had board independence of 60-70% and New Zealand between 73-76%.

A typical Kenyan board consists of an average of 8.32 members that is quite small compared to that observed in other countries, for example Dalton and Kesner (1987) reports a mean board of 21.04 in Japan, 11.44 in the UK and 12.96 in US. This however is consistent with board's size in other relatively small countries like Finland that is 3.7 according to Eisenberg, Sundgren and Wells (1998) report. Prevost et al (2002) reports a board size of 6 in New Zealand.

All the 34 companies in the sample have both a chairperson and CEO in their board that is no CEO duality. This is unlike companies in other countries, Prevost et al (2002) reported CEO duality in approximately 33.3% of the firms in the sample studied. Dalton and Kesner study (1987) reported in 11% in Japan and 82% in US of the firms studies.

The fraction of outside directors on the audit committee (ACI) is on average about 49.1% which indicates that directors in audit committees are balanced between the executive and non executives. This contrast with audit committee in Canadian firms whose average is 85% which indicates that they primarily consist of outside directors as documented by Yun et al (1998) in their study.

The percentage of directors from the financial institutions is 25.4%, which is higher than that in Canadian boards as exhibited by Yun et al (2000). Average Canadian board has an average of 4.4%, precisely the average number of directors from the largest Canadian pension fund and from banks are 3% and 4.9% respectively. This means for both countries the audit committee is mainly dominated by directors not necessarily from financial institutions.

The sampled firms range in size from Ksh 10.8m to Ksh 19.2m, which is in contrast with firms studied by Yun et al (1998), which differed widely in size from $1m to $25.5. The average size of firms in our sample is approximately Ksh 14.9m.

The average sample firm in our study has a debt ratio (LEV) of 57.9%, which is higher than that of Canadian firms studies by Yun et al (1998) who documented a 25% debt ratio.

4.3   BOARD COMPOSITION AND FIRM'S PERFORMANCE

4.3.1   BOARD COMPOSITION AND FIRM'S PERFORMANCE AS MEASURED BY RETURN ON EQUITY (ROE); MODEL 1

Table 2:   *Correlation matrix for Kenyan Board composition variables.*

	ROE	BI	ACI	FID	LEV	SIZE
ROE	1.000	.013	-.048	.117	-.071	-.044
BI	.013	1.000	-.056	.288	.079	.078
ACI	-.048	-.056	1.000	-.017	-.120	-.153
FID	.177	.288	-.017	1.000	.241	.179
LEV	-.017	.079	-.120	.241	1.000	.270
SIZE	-.044	.078	-.153	.179	.270	1.000

We examine whether collinearity among variables affect our results to assure that our findings are not driven by model specification errors. We conducted a Pearson correlation test among independent variables to examine their relationship.

The result shows little correlation between the independent variables with the highest correlation being between BI and FID (r=0.288 or 28.8%) and between SIZE and LEV (0.27or 27%). The rest shows little cross-correlation between them. This means that they do not influence each other in their implication to the board composition.

The analysis shows no significant relationship between return on Equity with board independence, audit committee independence, proportion of directors from the financial institutions, leverage and firms size. In all these, measure of correlation is very low below 0.05 and close to 0.00. Thus empirical result for the company's performance as measured by ROE all

indicates little or no correlation (model 1).

The p-value for correlation between the company's performance on one hand and the various predictors shows clearly that performance and the respective variables are uncorrelated.

Taking the following hypothesis:

Ho: company performance is not correlated with individual predictor variables that is:

$$ROE \neq \lambda p \ (BI, \ ACI, \ FID, \ FID, \ SIZE)$$

Ha: Company performance correlated with individual predictor that is

$$ROE = \lambda p \ (BI, \ AC, \ FID, \ LIV, \ SIZE)$$

$$(\alpha = 0.05)$$

We find the following results:

Table 3:   *P-value for the correlation between company's performance and Individual predictors.*

Performance/ Predictor	BI	ACI	FID	LEV	SIZE
ROE	.0471	.394	.255	.345	.402
STASTICAL DECISION	NS*	NS*	NS*	NS*	NS*
MANAGERIAL DECISION	BI not correlated to performance	ACI not correlated to performance	FID not correlated to performance	LEV not correlated to performance	LEV not correlated to performance

NS*- not significant

Taking the P-value as 0.05, we conclude that the correlation between company's performance and BI, ACI, FID, LEV and SIZE is not statistically significant. The empirical results in this study show no significant relationship between company's performance and the independence of the board as measured by proportion of outside directors, the audit committee independence, the proportion of outside directors drawn from financial institutions, company's leverage and size. Note the P-value is the observed level of significant, the smallest value at which Ho can be rejected. The decision rule is:

- If the P-value is greater than or equal to α, which is 0.05 the null hypothesis is not reject (fail to reject)
- If the P-value is smaller than α the null hypothesis is rejected.

The calculated R of 0.175 for the model shows that all the predictors taken together have little or no significant correlation with the dependant variable. Thus BI, ACI, FID, LEV, and SIZE together have little, if any correlation with the company's performance. The co-efficient of determination (R=0.031) confirms that all these variables acting together have no significant explanatory power on the company's performance.

Making references about the population in regression, we look at whether a significant relationship exists between the company's performance on one hand and each of the independent variables on the other. The hypotheses can be stated as below:

H0 = βi=O (there is no explanatory relationship)

Ha =$\beta i \neq$O (there is a explanatory relationship)

(A two - tail test)

Where βi = Coefficients for BI, ACI, FID, LEV, and SIZE respectively.

The test statistics is given by; bi

$$sb$$

Where   bi = unstandardised coefficient

Sb =Standard error of each predictor.

The test statistic, t, follows a t distribution with n-k- 1 degree of freedom.

The critical value for t_{n-k-1}, α =k28 = 2.0484 (from tables).

If t calculated>t critical, reject the null hypothesis otherwise, do no reject.

We have the following results:

Table 4:   *Correlation coefficient model 1*

Predictor	t-calculated	t-critical	Decision
BI	-.122	-2.0484	DNR*
ACI	-.354	-2.0484	DNR*
FID	.780	2.0484	DNR*
LEV	-.506	-2.0484	DNR*
SIZE	-.274	-2.0484	DNR*

DNR* = Do not reject.

Thus we fail to reject the null hypothesis and conclude that available results provide no indication that BI, ACI, FID, LEV, and SIZE have any significant explanatory power (or cause variation) in the company's performance.

The p-value approach also produces the same results as shown below:

Table 5:   P-value for Correlation in reference to population.

Predictor	P-value (calculated)	P-critical	Decision
BI	.903	.050	DNR*
ACI	.726	.050	DNR*
FID	.442	.050	DNR*
LEV	.617	.050	DNR*
SIZE	.786	.050	DNR*

DNR* - Do not reject

In all the above P>0.05, so we fail to reject the null hypothesis. Thus these independent variables have no significant power to explain changes
in the company's performance.
We can also test whether there is any significant relationship between the company's performance and all the predictor's variables taken together. We set up the null hypothesis as follows:

Ho: $\beta_i = \beta_2 = \beta_3 = \beta_4 = \beta_5 = 0$ (There is no linear relationship

between company performance and any of the explanatory variables)

H1=$\beta_i = 0$ (At least one regression coefficient is not

Equal to zero)

The F test statistics is used:

F = $\underline{MSR}$ calculated from ANOVA

   MSE   table

F = 0.178

The F test statistics is distributed as F with k

and n-k-1 degree of freedom.

F 5,28,0.05 = 2.56 (This is the table or critical value)

Since the calculated value of 0.178 < 2.56 (Critical), we fail to reject the

null hypothesis. A consideration of the P-value of 0.969>0.05 leads to the

same conclusion. Thus empirical results show no linear relationship

between the company's performance and any one of the predictor variables.

A multicollinearity test in this study found little collinearity between the

variables as shown by the low values (>1.00) of the collinearity diagnostic

table. High collinearity occurs when co linearity diagnostic values are

greater than 10 .A plot of residual statistic value shows whether the data has

a time series effect on it. This has also been exhibited in the Durbin-Watson

statistic of 2.477 (high auto correction exists) this can be attributed to the

time series nature of the data where results of a previous year are likely to

have an effect on subsequent years.

4.3.2. BOARD COMPOSITION AND COMPANY'S PERFORMANCE AS MEASURED BY TOBIN'S Q (MODEL 2)

When Tobin's Q is used, the independent variables of SIZE, BI, ACI, LEV,

and FID can be tested for their regressive power on the dependent variable

(Tobin's Q).

H0 = βi = 0 (there is no explanatory relationship between performance

and individual predictors).

Ha =βi ≠ 0 (There is an explanatory relationship).

(α = 0.05 a two tail test)

Where β_i are co-efficient SIZE, BI, ACI, LEV, and FID.

T critical is distributed as:

$t_{n-k-1}, \alpha = t\ 28,\ 0.05 = 2.0484$ or -2.0484

The results are shown in table 6 below:

Table 6:   Correlation coefficient model 2

Predictor	t-calculated	t-critical	Decision
SIZE	-2.2888	-2.048	REJECT
BI	.164	2.048	DNR*
ACI	.615	2.048	DNR*
LEV	5.448	2.048	REJECT
FID	.623	2.048	DNR*

DNR*- Do not reject

This table show that except for company's leverage and size other variables have no significant explanatory power on the company's performance as measured by Tobin's Q. Thus only leverage and size of the firm have significant effect on company's performance as measured by a market-based method. (Tobin's Q).

These results can also be understood by considering respective p-value as summarized in table 7 below:

Table 7:   *P- value for the correlation*

Predictor	P-value	Decision
SIZE	.030	REJECT
BI	.871	DNR
ACI	.544	DNR
LEV	.000	REJECT
FID	.539	DNR

* DNR - do not reject

The table clearly shows the same results as stated above, that is only the company's size and leverage have a significant effect on the its performance as measured by Tobin's Q.

When the model is tested for effect of all the predictors on performance the hypotheses are as follows;

Ho: $\beta i = \beta 2 = \beta 3 = \beta 4 = \beta 5 = 0$

(There is no linear relationship between company performance and any of the explanatory variables).

Ha: At least $\beta j = 0$ (At least one regressive co-efficient is not equal to zero).

At F 5, 28, 0.05 = 2.56 (critical value)

F calculated (from ANOVA table) = 6.761

Since 6.76, < 2.56, we reject the null hypothesis and conclude that at least one of the independent variables has a significant effect on the company's performance (these have already been identified as size and the leverage). There is low collinearity between the individual predictors. There is also low auto-correlation as shown in the Durbin - Watson statistics of 1.510)

CHAPTER 5   CONCLUSION AND RECOMMENDATIONS

5.1   SUMMARY OF FINDINGS AND CONCLUSION

This study found no significant correlation between company's performance as measured by Return on equity and board composition explained by board independence, audit committee independence, company's leverage and size. This is consistent with Mac Avoy et. al. (1983), Hermalin and Weisbach (1991), Mehran (1995), Klein (1998), Yemeck (1996) and Bhagat and Black (2000), who reported an insignificant relation between board independence and accounting performance. Also Yun et.al (1998) document that most U.S studies suggest no relationship between board independence and firm's performance and on Canadian firms he found a significant negative relation between board independence and firm's performance.

However two variables namely SIZE and LEVERAGE were found to be significant when the measure of performance was market based. Company's performance, can be enhanced by the level of leverage, while size of the firm affects it negatively. Low-level leverage means the company is lowly geared, while high level suggests a highly geared firm. Both situations may enhance performance, since low gearing means less chances of liquidation and hence investment of available resources in profits generating ventures, and easy access to finance for expansion. A highly geared firm will have large amount of borrowed fund available for investment and if this is done wisely it will result to an increased profitability. Size affect performance negatively, the larger the firm the more it becomes prone to mismanagement,

corruption leading to misallocation of resources hence poor performance. However it may also affect performance positively since large firms have public confidence and therefore ease access to funds, which can be channeled to profitable ventures. Hermalin and Weisbach (1991) and Bhagat and Black (2000) find no relationship between board independence and firm's performance using Tobin Q as a measure. This compares well with what is documented in this study.

Our findings contrast with Yun et. al (1998) who evidenced that the existence of outside directors from financial institution and outside directors who also sit on the audit committee have a important role in improving firm's performance in Canada. This is not the case in Kenyan firms, where these variables have no significance on firm's performance.

Regarding Board characteristic, most of Kenya boards have an average of 8 members. The Cadbury Report (1992) in UK prescribed a code of Best practice. Among the features of boards seen as desirable in this code was that" ...... the representation of non-executive (i.e. outsiders) directors on time board should be sufficient in number to carry weight in the boards deliberations..." In this respect Kenyan boards appear well equipped to perform their governance role effectively with over 70% of our boards having a majority of outside directors.

The Cadbury Report (1992) also recommends that there should be a clear division of responsibilities at the top of any large company between the chairman and the chief executive officer. This was also recommended by the Capital Market Authority (2002). None of the Kenyan board has CEO duality that is chief executives who are also board chairperson, indicating that such companies, prima facie, have an effective board leadership structure.

5.2   RECOMMENDATIONS

The research findings add to the literature documenting the importance of firm's leverage and size in performance. More significantly, the empirical evidence give some insights to the Kenyan listed companies about the insignificant relationship between most of board composition variables and firm's performance especially board independence. It also shed light on the most preferred mix of Kenyan boards. However, board size, its independence mechanisms to provide independence by use of audit committee, retaining directors from financial institutions all are not statistically significant in explaining company's performance.

5.3 LIMITATIONS OF THE STUDY

The study encountered the following limitations:

- Out of the 46 companies continuously quoted in the Nairobi Stock Exchange in the study period only 34 were sampled for the study, the rest did not respond to the questionnaire. A bigger sample would have resulted to better generalization.

- The resources available to the researcher like time and funds led to a narrower scope of the study. It focused only the quoted companies, without these constraints a wider scope would have been considered.

- The study period was affected by the researchers relocation to the coast province, which created a time lag for the data analysis

- Most of the company's personnel were unwilling to fill in the questionnaire, which could have resulted to bias information

5.4 SUGGESTIONS FOR FURTHER RESEARCH

Further research will be extremely beneficial in this area covering other dimensions of corporate governance other than board composition and firm's performance. A study also on the same can be extended to privately owned firms in Kenya or conducted on quoted companies category wise for example in the financial, industrial sector and so on.

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COMPANIES INCLUDED IN THE STUDY

S.NO.	NAME OF COMPANY	BOARD SIZE (BS)	OUTSIDE DIRECTORS	BOARD INDEP. BI	CEO DUALITY	ACI	FID	LEV	SIZE	ROE	Q
1	Brooke Bond	9	7	0.778	None	0.423	0.111	0.138	16.398	1.727	0.467
2	Kakuzi Limited	8	3	0.375		0.667	0.125	0.362	13.104	-0.122	0.75
3	Rea Vipingo	5	4	0.80	"	0.75	0.40	0.400	13.83	6.4	0.697
4	Sasini	8	6	0.75	"	0.167	0	0.19	14.65	0.257	0.80
5	CMC	9	7	0.778	"	0.571	0.444	0.312	14.66	1.84	0.644
6	Car & General	7	5	0.714	"	0.40	0.286	0.515	13.28	0.090	0.956
7	Kenya Airways	11	9	0.818	"	0.273	0.41	4.1	14.75	0.798	5.56
8	Marshalls	8	6	0.750	"	0.667	0.25	0.74	14.06	-1.35	4.389
9	Nation Media	11	10	0.909	"	0.30	0.273	0.337	14.92	2.43	2.595
10	TPS Serena	8	6	0.750	"	0.667	0.125	0.497	14.38	2.43	0.89
11	Uchumi	10	9	0.90	"	0.556	0.30	0.623	14.65	0.569	1.504
12	Barclays	12	7	0.583	"	0.571	0.167	1.08	17.95	0.73	1.45
13	ICDC	11	10	0.909	"	0.40	0.182	0.0778	14.605	2.089	1.00
14	Housing Finance	8	5	0.625	"	0.40	0.625	0.89	19.193	1.202	1.06
15	Jubilee Insurance	11	9	0.818	"	0.444	0.812	0.656	15.464	0.162	2.44
16	KCB	12	9	0.75	"	0.667	0.25	0.887	18.047	1.066	0.95
17	Pan Africa Ins.	9	7	0.778	"	0.571	0.333	0.366	14.855	0.859	0.557
18	NBK	10	7	0.70	"	0.571	0.20	1.082	16.878	-1.225	1.139
19	Stanchart	10	4	0.40	"	0.25	0.20	0.889	17076	2.799	1.076
20	Athi River	8	5	0.625	"	0.60	0.25	0.405	140.95	0.136	0.907
21	BAT	9	6	0.667	"	0.833	0.222	0.49	15.63	0.148	1.132
22	BOC Kenya	6	5	0.833	"	0.80	0.20	0.220	14.056	1.749	1.196
23	Crown Berger	7	5	0.714	"	0.40	0.143	0.446	13.66	0.29	0.723
24	Bamburi	14	9	0.643	"	0.33	0.143	0.273	16.467	0.653	1.479
25	EAB	12	7	0.583	"	0.286	0.417	0.346	14.193	0.917	0.797
26	Firestone	6	4	0.667	"	0.25	0.167	0.293	14.742	0.346	1.600
27	KPL Co.	9	8	0.889	"	0.50	0.333	0.856	17.095	1.263	1.050
28	Total (K)	8	4	0.50	"	0.25	0.00	0.657	15.733	1.134	1.166
29	Unga Ltd	6	5	0.833	"	0.80	0.23	0.473	15.289	-1.461	0.719
30	A Baumann	5	3	0.60	"	0.33	0.11	0.215	13.023	-0.268	0.345
31	City Trust	3	2	0.667	"	0.50	0.333	0.067	12.129	0.701	0.566
32	Eaagads	3	2	0.667	"	0.5	0.00	0.190	12.227	1.359	1.090
33	Kapchona	5	4	0.80	"	0	0.4	0.312	13.305	1.604	1.114
34	Limuru Tea	5	2	0.40	"	1.00	0.20	0.302	10.839	1.060	3.44

Appendix 2   Regression Output : Model 1

Descriptive Statistics

	Mean	Std. Deviation	N
ROE	.81209	1.42474	34
BI	.70509	.14098	34
ACI	.49100	.21589	34
FID	.25415	.16762	34
LEV	.57902	.68063	34
SIZE	14.87991	1.82573	34

Correlations

		ROE	BI	ACI	FID	LEV	SIZE
Pearson Correlation	ROE	1.000	.013	-.048	.117	-.071	-.044
	BI	.013	1.000	-.056	.288	.079	.078
	ACI	-.048	-.056	1.000	-.017	-.120	-.153
	FID	.117	.288	-.017	1.000	.241	.179
	LEV	-.071	.079	-.120	.241	1.000	.270
	SIZE	-.044	.078	-.153	.179	.270	1.000
Sig. (1-tailed)	ROE		.471	.394	.255	.345	.402
	BI	.471		.376	.049	.329	.330
	ACI	.394	.376		.462	.249	.194
	FID	.255	.049	.462		.085	.156
	LEV	.345	.329	.249	.085		.061
	SIZE	.402	.330	.194	.156	.061	
N	ROE	34	34	34	34	34	34
	BI	34	34	34	34	34	34
	ACI	34	34	34	34	34	34
	FID	34	34	34	34	34	34
	LEV	34	34	34	34	34	34
	SIZE	34	34	34	34	34	34

Variables Entered/Removed[b]

Model	Variables Entered	Variables Removed	Method
1	SIZE, BI, ACI, LEV, FID[a]		Enter

a. All requested variables entered.

b. Dependent Variable: ROE

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.175[a]	.031	-.142	1.52276

Model Summary[b]

	Change Statistics					Durbin-Watson
Model	R Square Change	F Change	df1	df2	Sig. F Change	
1	.031	.178	5	28	.969	2.477

a. Predictors: (Constant), SIZE, BI, ACI, LEV, FID

b. Dependent Variable: ROE

ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig
1	Regression	2.060	5	.412	.178	.969[a]
	Residual	64.927	28	2.319		
	Total	66.987	33			

a. Predictors: (Constant), SIZE, BI, ACI, LEV, FID

b. Dependent Variable: ROE

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig
		B	Std. Error	Beta		
1	(Constant)	1.606	2.699		.595	.557
	BI	-.241	1.966	-.024	-.122	.903
	ACI	-.441	1.249	-.067	-.354	.726
	FID	1.331	1.708	.157	.780	.442
	LEV	-.210	.415	-.100	-.506	.617
	SIZE	-4.191E-02	.153	-.054	-.274	.786

Coefficients

Model		95% Confidence Interval for B	
		Lower Bound	Upper Bound
1	(Constant)	-3.923	7.134
	BI	-4.269	3.787
	ACI	-2.999	2.117
	FID	-2.167	4.830
	LEV	-1.059	.639
	SIZE	-.356	.272

Coefficients[a]

Model		Correlations			Collinearity Statistics	
		Zero-order	Partial	Part	Tolerance	VIF
1	(Constant)					
	BI	.013	-.023	-.023	.914	1.094
	ACI	-.048	-.067	-.066	.967	1.034
	FID	.117	.146	.145	.857	1.166
	LEV	-.071	-.095	-.094	.882	1.134
	SIZE	-.044	-.052	-.051	.898	1.114

a. Dependent Variable: ROE

Coefficient Correlations[a]

Model			SIZE	BI	ACI	LEV	FID
1	Correlations	SIZE	1.000	-.020	.127	-.223	-.114
		BI	-.020	1.000	.050	.001	-.275
		ACI	.127	.050	1.000	.087	-.041
		LEV	-.223	.001	.087	1.000	-.197
		FID	-.114	-.275	-.041	-.197	1.000
	Covariances	SIZE	2.347E-02	-6.115E-03	2.432E-02	-1.419E-02	-2.984E-02
		BI	-6.115E-03	3.867	.122	8.855E-04	-.922
		ACI	2.432E-02	.122	1.559	4.502E-02	-8.680E-02
		LEV	-1.419E-02	8.855E-04	4.502E-02	.172	-.140
		FID	-2.984E-02	-.922	-8.680E-02	-.140	2.917

a. Dependent Variable: ROE

Collinearity Diagnostics[a]

Model	Dimension	Eigenvalue	Condition Index
1	1	5.092	1.000
	2	.522	3.123
	3	.237	4.637
	4	.118	6.565
	5	2.546E-02	14.141
	6	5.821E-03	29.576

Collinearity Diagnostics[a]

Model	Dimension	Variance Proportions					
		(Constant)	BI	ACI	FID	LEV	SIZE
1	1	.00	.00	.01	.01	.01	.00
	2	.00	.00	.03	.00	.81	.00
	3	.00	.00	.08	.85	.10	.00
	4	.01	.04	.79	.09	.04	.01
	5	.03	.85	.02	.03	.02	.14
	6	.96	.11	.08	.02	.03	.84

a. Dependent Variable: ROE

Casewise Diagnostics[a]

Case Number	Std. Residual	ROE	Predicted Value	Residual
3	3.579	6.400	.95068	5.44932

a. Dependent Variable: ROE

Residuals Statistics[a]

	Minimum	Maximum	Mean	Std. Deviation	N
Predicted Value	.35475	1.50774	.81209	.24984	34
Residual	-2.07883	5.44932	-1.63E-17	1.40267	34
Std. Predicted Value	-1.830	2.784	.000	1.000	34
Std. Residual	-1.365	3.579	.000	.921	34

a. Dependent Variable: ROE

Appendix 3   Regression Output : Model 2

Descriptive Statistics

	Mean	Std. Deviation	N
Q	1 36024	1 11818	34
BI	70509	14098	34
ACI	19100	21589	34
FID	25415	16762	34
LEV	57902	68063	34
SIZE	14 87991	1 82573	34

Correlations

		Q	BI	ACI	FID	LEV	SIZE
Pearson Correlation	Q	1 000	076	035	.213	668	- 103
	BI	076	1 000	- 056	288	079	078
	ACI	.035	- 056	1 000	- 017	- 120	- 153
	FID	.213	288	- 017	1 000	241	179
	LEV	668	079	- 120	.241	1 000	270
	SIZE	- 103	078	- 153	.179	270	1 000
Sig. (1-tailed)	Q		335	422	113	000	281
	BI	.335		376	049	329	330
	ACI	.422	376		462	249	194
	FID	.113	049	462		085	156
	LEV	.000	329	249	085		061
	SIZE	.281	330	194	.156	061	
N	Q	34	34	34	34	34	34
	BI	34	34	34	34	34	34
	ACI	34	34	34	34	34	34
	FID	34	34	34	34	34	34
	LEV	34	34	34	34	34	34
	SIZE	34	34	34	34	34	34

Variables Entered/Removed[b]

Model	Variables Entered	Variables Removed	Method
1	SIZE, BI, ACI, LEV, FID[a]		Enter

a. All requested variables entered

b. Dependent Variable: Q

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	740[a]	547	.466	.81705

Model Summary[b]

		Change Statistics				Durbin-Watson
Model	R Square Change	F Change	df1	df2	Sig. F Change	
1	.547	6.761	5	28	.000	1.510

a. Predictors: (Constant), SIZE, BI, ACI, LEV, FID

b. Dependent Variable: Q

ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	22.568	5	4.514	6.761	.000[a]
	Residual	18.692	28	.668		
	Total	41.260	33			

a. Predictors: (Constant), SIZE, BI, ACI, LEV, FID

b. Dependent Variable: Q

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	2.988	1.448		2.063	.048
	BI	.173	1.055	.022	.164	.871
	ACI	.412	.670	.080	.615	.544
	FID	.571	.916	.086	.623	.539
	LEV	1.212	.222	.738	5.448	.000
	SIZE	-.188	.082	-.307	-2.288	.030

Coefficients[b]

Model		95% Confidence Interval for B	
		Lower Bound	Upper Bound
1	(Constant)	.022	5.955
	BI	-1.989	2.334
	ACI	-.961	1.784
	FID	-1.307	2.448
	LEV	.756	1.668
	SIZE	-.356	-.020

Model			Zero-order	Partial	Part	Tolerance	VIF
			Correlations			Collinearity Statistics	
1	(Constant)						
	BI		.076	.031	.021	.914	1.094
	ACI		.035	.115	.078	.967	1.034
	FID		.213	.117	.079	.857	1.166
	LEV		.668	.717	.693	.882	1.134
	SIZE		-.103	-.397	-.291	.898	1.114

a. Dependent Variable: Q

Coefficient Correlations[a]

Model			SIZE	BI	ACI	LEV	FID
1	Correlations	SIZE	1.000	-.020	.127	-.223	-.114
		BI	-.020	1.000	.050	.001	-.275
		ACI	.127	.050	1.000	.087	-.041
		LEV	-.223	.001	.087	1.000	-.197
		FID	-.114	-.275	-.041	-.197	1.000
	Covariances	SIZE	6.758E-03	-1.761E-03	7.002E-03	-4.085E-03	-8.592E-03
		BI	-1.761E-03	1.113	3.518E-02	2.549E-04	-.266
		ACI	7.002E-03	3.518E-02	.449	1.296E-02	-2.499E-02
		LEV	-4.085E-03	2.549E-04	1.296E-02	4.950E-02	-4.021E-02
		FID	-8.592E-03	-.266	-2.499E-02	-4.021E-02	.840

a. Dependent Variable: Q

Collinearity Diagnostics[a]

Model	Dimension	Eigenvalue	Condition Index
1	1	5.092	1.000
	2	.522	3.123
	3	.237	4.637
	4	.118	6.565
	5	2.546E-02	14.141
	6	5.821E-03	29.576

Collinearity Diagnostics[a]

Model	Dimension	Variance Proportions					
		(Constant)	BI	ACI	FID	LEV	SIZE
1	1	.00	.00	.01	.01	.01	.00
	2	.00	.00	.03	.00	.81	.00
	3	.00	.00	.08	.85	.10	.00
	4	.01	.04	.79	.09	.04	.01
	5	.03	.85	.02	.03	.02	.14
	6	.96	.11	.08	.02	.03	.84

a. Dependent Variable: Q

Casewise Diagnostics[a]

Case Number	Std. Residual	Q	Predicted Value	Residual
8	3.184	4.389	1.78745	2.60155

a. Dependent Variable: Q

Residuals Statistics[a]

	Minimum	Maximum	Mean	Std. Deviation	N
Predicted Value	.44307	5.67092	1.36024	.82697	34
Residual	-.85003	2.60155	6.531E-16	.75262	34
Std. Predicted Value	-1.109	5.213	.000	1.000	34
Std. Residual	-1.040	3.184	.000	.921	34

a. Dependent Variable: Q

Appendix 4

QUESTIONNAIRES

Dear Respondent,

This questionnaire is intended to collect information about board
composition in all the companies quoted on the Nairobi Stock Exchange. It
is intended to collect data purely for academic purposes for the University of
Nairobi.

Your response will be treated in strict confidence and will be highly
appreciated.

Please do not indicate your name.

Thanking you in advance for your time and assistance.

INSTRUCTIONS

Tick the appropriate response.

1. From which sector do the directors who are non-employee belong to?

   a) Finance and Investment

   b) Industrial and allied

   c) Agricultural

   d) Commercial and service

   e) Others specify

2. Apart from the managerial role do the board members play other roles in the company? If yes which ones:

   a) Suppliers

   b) Major customers

   c) Consultants

   d) Others Specify

3. Is there an audit committee in the board?

   Yes ☐   No ☐

4. How many outside directors are members of the audit committee?