RELATIONSHIP BETWEEN BOARD COMMITTEES AND FINANCIAL PERFORMANCE OF COMPANIES LISTED AT THE NAIROBI STOCK EXCHANGE

BY

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Declaration

This research project report is my original work and has never been presented for a degree in any other university.

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

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Dedication

I dedicate this research report to my parents Joseph. K. Ndambuki and Monica M. Kituku, brother and sisters for their understanding support and encouragement throughout the study. They gave me the drive to accomplish what I have today and without them this would not have been possible. This also goes to my Son Gabriel Mwendwa and most of all the almighty God for bringing me this far.

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Abstract

This study sought to analyze board committees in terms of their size, composition, structure and diversity (gender and ethnic) and the effect this has on firm financial performance. The study hypothesized that there is a positive relationship between board committees' characteristics and financial performance of firms listed at the NSE. In achieving the above objective, the study applied secondary data obtained from the audited financial statements of the listed firms for the period 2002-2006. Data were obtained from the Research Department at the Capital Markets Authority. A multiple regression model was applied in determining the nature of relationship between firm performance and characteristics of board committees.

The study has established that non executive directors and presence of several board committees has an effect on firm-level financial performance. This implies that properly constituted board committees with the right mix of non executive directors tend to contribute more to performance than boards with a predominance of inside directors. Ethnic diversity of board committees also enhances firm profitability and market fundamentals. Membership on board committees provides a more accurate picture of each director's role on the board which should lead to a more accurate test of the relationship between board composition and board effectiveness. The study recommends that further research should be conducted with the view of performing inter-sectoral comparison across various market segments. Further research may also incorporate other fundamental characteristics of board committee's members such as age diversity and skills diversity within the research model.

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List of Abbreviations and Acronyms

AGM	:	Annual General Meeting
AMIS	:	Alternative Market Investment Segment
CalPERS	:	California Public Employees Retirement System
CCG	:	Centre for Corporate Governance
CEO	:	Chief Executive Officer
CMA	:	Capital Markets Authority
EPS	:	Earnings per Share
MMIS	:	Main Market Investment Segment
NASDAQ	:	National Association of Security Dealers Automated Quotation
NSE	:	Nairobi Stock Exchange
NYSE	:	New York Stock Exchange
SEC	:	United States - Securities and Exchange Commission
SET	:	Stock Exchange of Thailand

CHAPTER ONE

1.0 INTRODUCTION

1.1. Background to the Study

Corporate governance is concerned with the way in which corporations are governed and in particular recently the relationship between the management and its shareholders. It refers to the manner in which the power of a corporation is exercised in the stewardship of the corporation's total portfolio of assets and resources with the objective of maintaining and increasing share holder value and satisfaction of other stake holders in the context of its corporate mission. It is concerned with creating a balance between economic and social goals and between individual and communal goals while encouraging efficient use of resources, accountability in the use of power and stewardship and as far as possible align the interests of individuals, corporations and society. (Definition adopted from the Centre of Corporate Governance Kenya - CCG).

The area of corporate governance has attracted a rapidly growing interest in most economies. This follows the development of an active market for corporate control in the recent years. Contested take over bids illustrate in a dramatic way the consequences of an underlying difference of the interest between management and shareholders. In a successful corporate such differences are less acute since the market valuation of the firm is not depressed so as to invite a bid to change the incumbent management team.

According to Ayogu (2004) from a practical point of view, the problem of "corporate governance" is concerned with the design of institutions that induce management in their actions. to take into account the welfare of stakeholders-investors, employees, communities' suppliers and customers. On the other hand, management runs the firm through managing its day to day operations and setting its business strategy. At least in the "structure-conduct performance" paradigm, management's perceptions of the market structure and the firm's strengths and weaknesses jointly determine their choice of corporate strategy (long run plan for profit maximization) and organization structure (the internal allocation of tasks, decision rules and procedures for appraisal and reward, selected for the best pursuit of that strategy).

Both corporate strategy and organizational structure may have an influence on the economic performance of the firm and the market in which it sells, market structure referring to attributes of the market that influence the firm's conduct. Attributes such as the number and size distribution of sellers and buyers, extent of barriers to entry and exit, extent and character of product differentiation, extent and character of international competition and certain parameters of demand (elasticity and growth rate). On the other hand, boards of directors are supposed to govern the corporations. They have the power to set dividends, to hire, fire and set the compensation of senior executives; to decide to enter new lines of business and to reject merger offers or to approve and submit them to stock holders.

According to Capell and David (2004) corporate governance involves the manner in which a company is managed to create and distribute increasing value to its shareholders. This involves the structure of the boards (board committees), management board relationships, carrying out value creating activities, shareholders rights, record keeping, information disclosure and management compensation and its disclosure. The holy trinity of good corporate governance is the notion of share holders rights to question board and management decisions, transparency and management or boards full accountability for their actions (Capell et al, 2004).

There may be difficulties of enforcing accountability of management to shareholders because of the predominance of directors with executive responsibilities on company boards. Shareholders whether institutional or private are frequently not in a good position to enforce accountability of management through representation on boards or by exercise of voting rights at Annual General Meetings. Due to these a remedy to mitigate has been the development of an active market for corporate control with a lot of unease on the part of the take over mechanism. This leads back to the need to improve the internal operation of the system of corporate governance. Corporate governance has become the catch call description for institutional investor efforts to influence the fundamental business policies of corporate management.

1.1.1. Why corporate governance – Boards and board committees

In Kenya, the Centre for Corporate governance was established in March 1999 as the Private Sector Corporate Governance Trust (PSCGT) by stakeholders made up of representatives from the private sector, the government and regulatory authorities with a

mandate among others to stimulate and facilitate the adoption, promotion and implementation of the highest standards of corporate governance in Africa through coordinated programmes, collaborative networks and enhanced regional corporation and assist national action plans relevant to the promotion, implementation and application of highest standards of corporate governance by providing technical and other support relevant to institutional and capacity building.

In his presidential address Jensen (1993) argued that the board of directors fails to monitor management as boards are in effect captured by the CEO. Jensen argued that management controlled the nomination process and the flow of information to the board, and board culture was to be non-confrontational. The spectacular failures of Parmalat, WorldCom MCI, and Enron seem to bear out Jensen's pessimistic view of the board. As a result of these failures, governance by the board of directors and its committees has been a focus of much recent regulatory and congressional attention. The 2002 Sarbanes-Oxley Act requires that all Audit Committee members be independent, financially literate and that at least one member have accounting or financial management expertise.

Following the passage of the act, the NYSE and Nasdaq adopted listing requirements with respect to the independence, required that the Auditing committee has at least three independent directors and set the criteria that a director must meet to be regarded as an independent director. More over, stockholder activist groups such as the Institutional Shareholder Services and California Public Employees Retirement System (CalPERS) have also focused their attention on the membership of these board committees.

Inherently these regulatory requirements and shareholder activity suggests that monitoring by the board and board committees are seen as an important aspect of corporate boards.

Good corporate governance helps in wealth creation for companies and its shareholders and for the capital markets. This is necessary in order to attract investors, create competitive and efficient companies and business enterprises, enhance the accountability and performance of those entrusted to manage corporations and promote efficient and effective use of limited resources among others. (Centre for Corporate Governance Kenya).

The issue of corporate governance has raised a lot of concern in the recent past since though in principle its clear, shareholder supremacy has hardly been a conspicuous feature. Managers have enjoyed a measure of discretion to pursue their own objectives without the need to consider seriously the interests of shareholders. The situation has led to criticism that managers of large corporations exercise power without responsibilities and that company boards are self perpetuating oligarchies (Dimsdale, 1994)

In Kenya, in the last 10 to 15 years, a number of banks and non banking financial institutions have experienced failures and the board has been subjected to part of the responsibility, these include Euro bank, Exchange bank, and Pan African bank among others. Whether the board determines the performance of firms and how it does it,

whether through specific board committees or management needs to be looked into by continuous studies which revolve around corporate governance (Molonko, 2004).

1.1.2. Conceptual issues in corporate governance

The hallmark of the modern corporation is the separation of ownership and control rights. The problem inherent in such separation of rights have been extensively studied and are generally well appreciated even though satisfactory solutions are yet to be devised. This is "the agency problem" whereby the basic concern is understanding the decision making and control in organizations where there is a potential conflict of interest between those making decisions and those whose wealth position is affected by those decisions (Fama, 1980). As early as 1932, Berle and Means addressed the importance of managerial holdings of equity in a modern corporation. Jensen and Meckling (1976) theorized that stock ownership by management can alleviate agency problem.

In many economies of the industrialized world, notable strides have been made in aligning the interests of managers and owners. But by and large, the problems persist. In fact the renewed interest in corporate governance (concomitant with the current interest in civil governance) is indicative of the growing realization that while many academic papers preach socially efficient outcomes based on invisible hands, experiences many of which are reported in the media warn us otherwise. The so called invisible hands of the market are in fact visible. They are humans who run corporations and sundry enterprises that populate the domain of the free markets and "like the rest of us corporate managers have many personal goals and ambitions, only one of which is to get rich" (Shleifer and

Vishny, 1998). A good example of the above is the case of Enron which collapsed in the late 2001 due to issues mainly attributed to corporate governance.

The Capital Markets Authority provides that the board of directors should assume a primary responsibility of fostering the long term business of the corporation consistent with their fiduciary responsibility to share holders. In addition the board of directors should accord sufficient time to their functions and act on a fully informed basis while treating all shareholders fairly in the discharge of duties and responsibilities. According to Goyder (2004), "Directors owe their duty to the corporation; are accountable to their shareholders for the discharge of their duty; and are responsible for the impact of their actions upon stakeholders". Corporate governance is and should be every ones priority (Adopted from the corporate governance bulletin, 2004).

1.1.3. Composition and structure of company boards.

The Cadbury committee (1992) in their report described board committees' composition as the make up of boards based on the executive and non executive directors, independent and affiliated non executive directors. On the other hand board structure looked at the presence of committees and the issue of duality (whether the CEO - Chief Executive Officer is still the chairperson of the board)

Most companies in Kenya have moved in the direction of concentrating authority in larger companies on the board of directors with whom the share holders have little contact. The composition of the company boards greatly affects the inclination of interests. Where there is a high proportion of executive directors in the board who

combine the role of director with responsibility for management within the company, then the distinction between directors who are representatives of shareholders interests and management has tended to become obscured. In this case the difference between the board and the higher management of the company largely disappears (Dimsdale, 1994). The lack of effective shareholder representation is of some importance since there are many areas where the interest of the managers and the shareholders do not coincide. These includes a wide range of issues such as the level and structure of executive pay, the allocation of funds between dividends and retentions, the priority to be accorded to growth in relation to profitability among others.

A preponderance of executive directors could be corrected if the number of non executive directors was increased as the latter could be expected to attach a greater weight to the interests of shareholders. Whidbee (1997) in his study on the relationship between determinants of the board composition finds that it reflects the ownership structure of the firm. In particular he finds that managers with high equity stakes use their voting rights to exclude outside directors from board membership.

The Capital markets authority requires that for public offering of shares and listing to the main investment market segment (MIMS) an organisation should have at least a third of the board as non executive directors. The same applies for those institutions seeking to be listed in the Alternative Market Investment Segment (AMIS).

1.1.4. Board committees concept

The Capital Markets Authority in Kenya recommends that all boards of directors of listed companies should operate with the help of relevant board committees. A committee structure permits the board to address key areas in more depth than may be possible in a full board meeting. A wide diversity of approaches in committee structures and function responds to the specific needs of companies having different business challenges and corporate culture. Such committees could include Audit, Credit, Compensation, Human resources committee, Strategy committee etc.

Firms establish committees for a number of reasons. For example, some committees are formed to evaluate and reward top management (e.g compensation committee). Others exist in order to advise the CEO in his/her decisions (e.g. finance and investment committees) Another group of committees exist to ensure that the firm is in compliance with regulations and external factors (e.g. audit and environmental committees). Firms typically choose individuals with expertise to serve on one or more committees to support their top management (Agrawal and Knoeber, 1999). This observation is further supported by Trans Grid (2005), who notes that board committees have an important role to play in the governance of corporations. They can be especially important where specific skills are required to undertake detailed review of specialized areas. The use of board committees however does not impinge on the responsibilities of the board as a whole in that specific area.

In his speech on the role of the board, the chairman of Barclays PLC points out as follows "The board is responsible to shareholders for creating and sustaining shareholder value, through the management of our business. To do this, we meet regularly and have a formal schedule of matters that only the board can deal with. Some specific responsibilities have been delegated to board committees… Each committee is made up solely of independent non executive directors, except for the board corporate governance and nominations committee which I chair". Matthew W Barrett, Chairman Barclays PLC (Board meeting on the 9th March, 2006)

Some institutions have adopted to have the committees of the board consisting of non executive directors who report regularly to the board on their activities. In such cases executive management and any outsourced service providers and experts may attend committee meetings by invitation as circumstances dictate. The centre for corporate governance, Kenya (CCG), the capital markets authority (CMA) for publicly listed companies and the Central bank of Kenya for the banking industry have developed guidelines on corporate governance practices that most institutions endeavour to adhere to, with the focus being on ensuring compliance with all aspects of corporate governance and their implementation in line with the needs of the business. While there has been research on some aspects of the board of directors, little research exists on board committee structure. Specifically, why do firms have certain committees and what functions are performed in each committee?

1.1.5. Evolution of Committee Structure

As noted earlier, there is no guideline on which committees should be formed though in some economies certain committees are a requirement, a good example being the Stock Exchange of Thailand (SET) requirement for listed firms to establish audit committees by the end of 1999. The 2002 Sarbarnes Oxley Act advocates for the formation of Audit committees comprised of only independent directors.

Perhaps not surprisingly, committee structures are shaped in part by factors external to the board such as regulatory bodies, labour unions and shareholders. An example of how explicit regulation affects committee structure is the United States Securities and Exchange Commission (SEC) requirement that firms have board committees performing the audit function. Such committees are required of all firms whose shares are listed on the New York Stock Exchange (NYSE). Other forms of governmental oversight encourage, but do not mandate, the formation of certain types of committees.

Pressure from shareholders, unions and interest groups can also induce formation of certain committees, For example, pressure from trustees of public pension funds in California and New York led some major oil companies to institute environment or public policy committees in the wake of 1989 Exxon Valdez Oil spill. Unions and Shareholder groups unsuccessfully pressured Eastman Kodak and Echlin to form health and environmental committees after the firms were fined for rules violations in the late 1980's. Therefore the existence of these committees is to ensure the firm is in compliance with regulations and external factors. Committees also exist to help advise the CEO on

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his or her decisions (e.g. Finance, investment and strategy committees) and others to evaluate and reward top management (compensation committee).

Firms also adopt committees subsequent to crisis (e.g Labour dispute, environmental problems and natural disasters among others). As firms grow overtime, it is more likely that some crisis will emerge and a natural response by firms is to manage the crisis by establishing new committees or assign new tasks to existing committees. To sum up what is clear is that board committees are evolving over time.

1.1.6. Measures of Firm Financial Performance

Financial performance is a subjective measure of how a firm can use assets from its primary mode of business and generate revenues. It is a general measure of a firm's overall financial health over a given period of time and can be used to compare similar firms across the same industry or to compare industries or sectors in aggregation.

Prior work on the measurement of corporate financial performance is extensive. Perhaps the primary distinction to be made among the many alternative measures is between measurements of accounting and economic profits (Becker and Olson, 1987; Hirsch, 1991). Economic profits represent the net cash flows that accrue to shareholders; these are represented by capital market returns. Accounting profits can differ from economic profits as a result of timing issues, adjustments for depreciation, choice of accounting method, and measurement error. Additionally, economic profits are forward looking and reflect an historical perspective. Although there is a widespread agreement in the literature that capital market measures are superior to accounting data, accounting data

provide additional relevant information (Hirschey and Wichern, 1984). Each is the best available measure of its type (Hall, Cummins, Laderman, and Mundy, 1988; Hirsch, 1991; Hirschey and Wichern, 1984).

Ratio analysis is a powerful tool of financial analysis. A ratio is defined as "the indicated quotient of two mathematical expressions and as the relationship between two or more things". A ratio is used in financial analysis as a benchmark for evaluating the financial position and performance of a firm. The absolute accounting figures reported in the financial statements do not provide a meaningful understanding of the performance and financial position of a firm. Ratios help to summarize large quantities of financial data and to make qualitative judgement about the firm's financial performance (Pandey, 2005). Weston (1992) indicates that the limitations of ratio analysis arise from the fact that the methodology is basically univariate, i.e. each ratio is examined in isolation. To overcome these short comings of ratio analysis, different ratios should be combined to give a broader perspective with better predictive information.

1.2. Statement of the problem.

Corporate governance has drawn a lot of interest of late following the increasing number of corporate failures and financial scandals that have been caused by incompetence, fraud, and abuse of power and responsibilities by the agents running the firms. The way a company is run in terms of decision making at the board level is critical in the survival or collapse of corporate bodies.

In Kenya many studies have been conducted and previous research done on corporate governance in Kenya includes a study by Jebet (2001) which covered determination of the existing corporate governance structures in publicly quoted companies in Kenya. Furthermore a study in relation to corporate governance practices and the relationship if any between the extent of corporate governance and company performance for companies listed in the NSE was conducted by (Linviru, 2005). The above two studies looked at corporate governance in general and not the different aspects of the board such as the composition, structure or even activity.

More closely related are studies by Mutisya (2005) who looks at the relationship between corporate governance and firm performance whereby she specifically looks at board size, number of board meetings in a year and proportion of shares held by top directors and management. This study did not address the board size in terms of board committees and the number of board meetings was specific for the full board The other one was by Molonko (2004) in which he looked at board size, proportion of non executive directors and board compensation and the effect this has on firm performance, with no reference to board committees which are key to the operation of many corporate boards.

None of the above studies as noted addressed different aspects of board committees and the effect they have on firm performance. However this study sought to address the issue of board committees in terms of their numbers (types), size, composition (executive in relation to non executive members), diversity (gender in terms of number of female members and ethnic in terms of members not of African origin) and whether there is any

relationship to the overall performance in terms of turnover, earnings per share and profitability amongst other performance indicators for companies listed at the Nairobi stock exchange.

1.3. Research objective.

This study sought to analyze board committees in terms of their size, composition, structure and diversity (gender and ethnic) and the effect this has on firm financial performance.

1.4 Importance of the study.

For policy makers and advisors such as the Capital Markets Authority, Centre for Corporate Governance and the Nairobi Stock Exchange, this study stands to give an insight in formulating policies on board committees which play a critical role in corporate governance. For purposes of research this study forms a good basis to interested scholars to further increase on the body of knowledge on governance through board committees.

CHAPTER TWO

2.0 LITERATURE REVIEW

2.1. Introduction

The broad objective of this study was to analyze board committees in terms of their size, composition, structure and diversity (gender and ethnic) and the effect this has on firm financial performance. In light of this, this chapter reviews empirical studies on corporate governance and financial performance with special emphasis on structure of board committees. According to Mugenda and Mugenda (2003), literature review involves the systematic identification, location and analysis of documents containing information related to the research problem being investigated. The rest of the chapter is organized into sections and/or sub-sections.

2.2. Corporate governance system

According to Campbell (2004), corporate governance involves the manner in which a company is managed to create and distribute increasing value to its share holders. This includes the structure of the board (audit, nomination and compensation committees) , management board relationships, carrying out value creating activities, share holders rights, record keeping, information disclosures, management compensation and its disclosure. "The holy trinity of good corporate governance is the notion of shareholders right to question board / management decisions, transparency and management or board's full accountability for their actions (Campbell et al, 2004)". He further notes that effective corporate governance is where the shareholders have a right to regularly

question the decisions of the board and management. the decisions of the board and management are transparent and both are fully accountable for their actions.

The Basel Committee on Banking Supervision (BCBS) states that from the banking industry perspective, governance involves the manner in which the business and affairs of individual institutions are governed by their board of directors and senior managers.

The Cadbury committee in describing the systems by which companies are directed and controlled which it termed corporate governance looked into the board of directors in terms of their composition and structure. Composition meaning the make up of the boards based on the executive and non executive directors. On the other hand, board structure looked at the presence of committees and the issue of duality. Duality refers to whether the chief executive officer (CEO) serves as the chairperson of the board as well.

According to a study conducted by Charkham (1989) and Sykes (1990) on the system of corporate governance in Britain, the British system of unitary boards depended for its successful operation on a measure of self discipline by members of the board In cases where the roles of the CEO and the chairman of the board are combined, the individual who holds both offices is subject to a measure of conflict between his commitment to management and the need for a balanced view of interest of shareholders. There is a danger that the interest of shareholders will be subordinated to the priorities of management. Shareholders are deprived of a safeguard in that one of the functions of the chairman is to dismiss the CEO should that be necessary. The removal of the CEO

becomes considerably more difficult if the office is combined with the chairmanship of the company. Where there is a combined CEO/Chairman then the need for strongly independent non executive directors is even more pressing.

2.2.1. Corporate Governance practices

With different people and institutions coming up with how best to define corporate governance, then emphasis will be placed on different aspects based on the definition (Linyiru, 2005). According to Hendriske et al (2004) Corporate governance is the system that maintains the balance of rights, relationships, roles and responsibilities of shareholders, directors and management in the direction, conduct, conformance and control of the sustainable performance of the company business with honesty and integrity in the best long term interest of the company, shareholders and business community stakeholders. The above definition captures aspects that are in accordance with the recommendations of the Capital Markets Authority (CMA) on corporate governance practices for companies quoted at the NSE.

According to Dimsdale and Prevezer (1994) on their publication on Capital markets and Corporate governance regarding the role of the shareholders; they are entitled to attend the Annual General Meeting (AGM) of a company at which they approve the accounts and annual reports, they elect the new board members proposed by the current directors and re elect board members offering themselves for re election by rotation. However, small shareholders who are dissatisfied with the results of a company cannot generally expect to make such impact on the board at a formally constituted AGM. A well

informed small investor could however cause some discomfort to a board by posing searching questions.

Corporate governance has become a highly topical issue as indicated by the extensive recent discussion in the financial press and the appointment of the Cadbury committee. The way in which managers are made responsible to boards of directors and them in turn to shareholders is an important aspect of the functioning of a free enterprise economy. Decision takers must ultimately be accountable to someone for their decisions. In many economics, it is very clear that accountability is to the shareholder as the owners of the company. Boards of directors are appointed to represent the interests of shareholders while managers report to the board (Dimsdale and Prevezer, 1994).

Developing 'good practices' for directors has become an important issue in research, teaching, and practice of enhancing corporate governance. Researchers and managers acknowledge the importance of well functioning board of directors as good governance practice seem to result in creation of firm value, improved (financial) results in creation of firm value, improved (financial) results, firm continuity and improved company structure (Johannison and Huse, 2000). Kitonga (2005) in his study, confirms the need for a corporate governance audit in Kenya, however so far there may be no laid down procedure for such an audit and it would be interesting to see how such can be derived.

2.2.2 Corporate governance structures and firm performance

The board in terms of governance structures vis-a-vis board performance has been looked as: board compensation and firm performance (Jensen and Murphy, 1988); and outside

directors and firm performance (Byrd and Hickman, 1992) whereby they classified the directors into three categories namely inside directors, affiliated outside directors, and independent outside directors.

The Cadbury committee contains specific recommendations concerning board structure and responsibilities. These include two key guidelines to ensure board independence. First, boards should include at least three non-executive directors. Secondly, the chief executive officer and the chairman of the board should have separate responsibilities. The latter leads the issue of CEO duality and firm performance whereby a firm is said to have a dual CEO when the CEO functions simultaneously as the chairman of the board. The issue of CEO duality has attracted a lot of attention in the area of corporate governance and firm strategy as noted by Alibrandi (1985), Anderson and Anthony (1986), and Vance (1983).

Board committees and firm performance has been also looked into in terms of, structure, ownership, diversity and performance (Hayes et al, 2004; Carter et al, 2003; and Klein, 2002). However despite widespread public attention and a surge in research interest in corporate governance, the relationships among board composition, board size, ownership structure and firm performance are still little understood (Hayes, Mehran, and Schaefer, 2004).

2.3. Board Committees

2.3.1. Board Committees' Formation

Board committees are established to enhance the decision making of an organization since they discuss and analyze issues before presenting them to the main board of directors. The types of board committees vary and there is no specific number or types of board committees. In their study Hayes, Mehran and Schaefer (2004) documented that there is a significant amount of variation in their samples on the number of committees and presence of each committee. However some board committees have been perceived as important especially the audit committee for organizations in the financial sector.

As noted earlier, firms establish committees for a number of reasons. For example, some committees are formed to evaluate and reward top management (e.g. compensation committee). Others exist in order to advise the CEO in his/her decisions (e.g. finance and investment committees). Another group of committees exist to ensure that the firm is in compliance with regulations and external factors (e.g. audit and environmental committees). Firms typically choose individuals with expertise to serve on one or more committees to support their top management (Agrawal and Knoeber, 1999).

Since the Asian financial crisis in 1997, multi-national institutional investors such as the California Public Employees Retirement System (CalPERS) have entailed good corporate as one of the preconditions for their investment decisions in Asian financial markets. Major financiers for instance the International Monetary Fund (IMF), the World Bank and the Asian Development Bank have also pressured Asian companies to improve their

governance practices. In response to the strong demand for good corporate governance. the stock exchange of Thailand (SET) have set up regulations and developed proposals for corporate governance reform to improve the standard of financial reporting and accountability. One important reform is the SET's requirement for listed firms to establish audit committees by the end of 1999.

Academically there has been relatively limited number of research in the area of audit committee formation and audit committee independence, especially in the emerging market. One line of research has focused on the demand for the voluntary formation of audit committees (Pincus et al., 1989; Bradbury, 1990; Memon and Williams, 1994). Another line concentrates on the economic demand for audit committee independence in well established audit committees (Deli and Gillan, 2000; Klein, 2002).

In Thailand, the audit committee has been a new corporate governance entity required by law. However, results provide further evidence that many audit committees of publicly traded companies are not comprised exclusively of independent outside directors as prescribed by the exchange. This is consistent with evidences from the US such as Verschoor (1993) and Klein (1998, 2002), supporting the claim that "one size can't fit all" audit committees.

The 2002 Sarbanes Oxley Act requires that most firms have an Audit Committee comprised of only independent directors and that the Audit Committee meets at least four times as year. Following the passage of the act, NYSE and NASDAQ imposed an

additional requirement that the Audit Committee has at least three independent directors. This supports the recommendations of the Blue Ribbon Committee on improving the effectiveness of corporate Audit Committees (1999).

2.3.2. Board Committees Composition, Structure and Firm-level Performance

Klein in his study on firm performance and board committee structure (1998) established significant ties between firm performance and how boards are structured. Primarily a positive relationship was found between the percentage of inside directors (executive) directors on the finance and investment committees and accounting and stock market performance measures. Secondly the study also noted that firms significantly increase executive director representation on these two committees experience significantly higher contemporaneous stock returns and return on investments than firms decreasing the percentage of inside directors on these committees.

The above findings are consistent with Fama and Jensen's assertion that inside directors provide valuable information to boards about the firms long term investment decisions. However the empirical evidence on the monitoring effectiveness that the outside directors provide is somewhat mixed. While several authors find that independent outside directors protect shareholders in specific interests where there is no agency problem, Weishbach (1988), and Byrd and Hickman (1992) found that there is no relationship between outside directors and shareholders welfare. (Agrawal and Knoeber 1996; Klein, 1998)

Rosenstein, Stuart and Wyatt (1990) documented a positive stock price reaction to the appointment of outside directors even when outside directors already constitute a

majority suggesting that outside directors provide expertise beyond the monitoring service. consistent with the hypothesis that outside directors provide expertise. Booth and Deli (1999) found that the use of bank debt has a positive relation to the likelihood that commercial bankers will sit on the board and especially in investment and audit committees, suggestion that commercial bankers supply expertise and bank debt markets.

Studies have been conducted to try and establish the relationship between board composition and corporate performance. Among them is a study conducted by Baysinger and Butler (1985) which indicated that the proportion of independent non executive directors in 1970 was positively correlated with return on equity as a measure of performance in 1980. Further studies by Klein (1998) Bhagat and Black (1988) and Hermalin and Weisbach (1991) have found that a high proportion of independent directors do not result in better future performance of the firm. They also found out that the proportion of independence of non executive directors had no consistent effect on market adjusted share price performance.

Another study by Agrawal and Knoeber (1996) indicated that the greater the proportion of independent directors the slower the company's growth. They then interpreted the results as evidence that the board independence is negatively related to company performance. The study by Hermalin and Weisbach showed that the proportion of independent directors tended to increase when a company performed poorly. However some earlier studies find no relationship between board composition and firm performance (Mac Avoy et al, 1983).

Empirical evidence has shown that properly constituted boards with the right mix of non executive directors tend to contribute more to performance than boards with a predominance of inside directors (Weisbach, 1988; Bhagat and Black, 2001; Mehran 1995). A closely related issue is the participation of non executive directors on the main committees of the board. John and Sebet (1998) argue in favour of a committee structure that gives the non executive directors a key role especially in the audit, remuneration and appointment committees. This recommendation seems to go down well with policy makers. In Nigeria for example the new code of corporate governance provides that the non executive directors should chair the remuneration committee, the membership of which should comprise wholly or mainly of outside directors (Sanda, Garba and Mikailu 2005).

In a recent empirical work, Hayes et al. (2004) reported no relationship between the fraction of outside directors serving on a committee and the performance of the firm, a finding that runs counter to that of Klein (1988) and that John and Senbet (1998) noted to have been in support of greater participation of outside directors on the major committees of the board. Chidambaran (2007) in his study finds little evidence that the composition of the committees impact upon firm value. To some extend poor performance and regulatory pressure change committee structure. Firms that are doing well hesitate to make changes.

2.3.3. Ownership, Numbers of Board Committees and Firm Performance

According to Weisbach (1988) management ownership is significantly related to overall performance but board composition is not. This is further supported by other studies conducted in the area of ownership and performance which suggest a positive correlation between shareholding of large investors and firms' performance with the institutional investors being more effective in monitoring firms' performance than individual shareholders according to Holderness and Sheehan (1988) for 114 public listed companies listed at the NYSE.

Hayes et al (2004) established that the number of committees is positively related to the number of directors, the number of committees is also positively related to firm size. Firms that pay dividends have more committees while firms with a higher CEO ownership have fewer committee functions performed by the board and also fewer board committees. On the other hand firms with larger boards more assets and more board meetings have more committee functions. In addition dividend paying firms have more committee functions and firms with higher CEO ownership assign fewer tasks to each committee hence the agency problem.

Hayes et al (2004) further established that firms with a human resource committee have lower performance measured by market to book ratio than those without. Firm performance is negatively related to the percentage of shares held by outside directors on the acquisition committee, ethics committee, succession committee and technology committee, but it positively related to the percentage of shares held by outside directors

serving on the finance, investment and strategy committee. Though consistent with a number of other studies (Mehran and Hamid. 1995; Mutisya, 2005; and Adenikinju, 2001), firm performance is positively related to the percentage of shares held by the CEO. However they did not find a link between performance and the fraction of outside directors serving on each committee.

The centre for corporate governance (CCG) in Kenya conducted a Survey of the banking Industry in which case they established that in their sample, 80% of the banks have various committees; Audit, Credit, Human Resources, Investment, External Relations. Asset and Liabilities, Nominations, Tender and Management. In terms of Membership composition, each committee has at least one board member and senior management of the bank (Corporate Governance Bulletin, 2004).

2.3.4. Board Committee Diversity and Firm Performance

In a recent study conducted on the issue of board diversity and firm performance, in the U.S (Carter et al 2007), they note that the case of board diversity based on equity and fairness is normative and generally accepted by the U.S legal system and culture. Corporations, organisations and individuals seldom publicly or directly dispute the proposition that women and ethnic minorities deserve equitable opportunities to serve on boards and in upper management positions. While the issue of fairness says nothing with respect to whether a diverse board of directors adds value to the firm, the business case implies that board members are not perfect substitutes, with identical abilities and talents, but instead have unique characteristics that create additional value for the shareholders.

One of the central propositions of the business case for board diversity is that women and minority directors provide significant unique information to the board and managers which improves strategic decision making. In addition board diversity ostensibly encourages different and creative new perspectives on the strategic decisions of the corporation (Brancato and Patterson, 1999). Diverse directors generate increased communication on topics often not addressed by the board which mitigates stagnant thinking, renews the organization and broadens the focus of the corporation (Stephenson, 2004).

Empirical studies (Stephenson. 2004. Robinson and Dechant, 1997) have also noted that information flow and decision making are improved because board diversity encourages higher level problem solving and constructive dissent. Stephenson, a strong proponent of the business case for board diversity, further argues that women and minority directors have unique knowledge of some consumer markets and certain customers because of their extensive participation in these markets. According to Klein (1998) directors have a stronger and more direct impact on executive compensation, new director selection, strategic managerial decisions and other actions that significantly affect corporate performance if they serve on board committees with primary responsibility for these functions. Any unique advantages or disadvantages that might exist for women and minorities relative to board process should have a more direct effect through committee assignments.

In their research paper, Carter, D'souza, Simpkins and Simpson (2007) on the diversity of corporate board committees and firm financial performance, they concluded that gender and ethnic diversity affect financial performance of the firm through rather different channels. Gender diversity has a positive impact on financial performance through the audit function but there is no clear indication that the same affects financial performance through the executive compensation function or director nomination function of the board. Ethnic minority diversity appears to have a positive impact on financial performance through all three board functions they investigated: audit, executive compensation and director nomination. In their study they examined a subset of functions performed by the board and board committees and their standard approach to the measurement of board diversity was to calculate the percentage of female and minority directors which they defined as any members from the Asian, Latinos and African – Americans ethnic groups, on each of the audit, compensation, and nomination committees of the board. Locally, no such studies have been conducted to address the effect of gender and ethnic minority on corporate boards to the performance of the firm.

Other studies which do not directly address the issue of board committees, but have a significant impact on the same include the board size and board activity. It has been hypothesized that the larger the board, the more the number of board committees. Board activity in terms of meetings even by the board committees provides a monitoring role Chidambaran (2006), which has led to increase in firm value The theoretical foundation for the function of monitoring and controlling managers derives from agency theory (Jensen and Meckling, 1976) and transaction cost economics (Williamson, 1988).

2.3.5. Board size and firm performance

Theodore et al., (1998) found out that for small firms, large board size is associated with decreasing firm value. Several studies hypothesize a relation between board size and financial performance. Empirical tests of the relation exist in only a few studies of large US firms. They find significant negative correlation between board size and profitability in a sample of small and medium sized firms.

A study conducted on the relationship of value and board size in Singapore and Malaysia companies by Mak and Kusnadi (2001) supported the negative relationship between board size and firm value. Using a sample of companies quoted at the NSE, Yermack (1996) reported an inverse association between board size and firm value as measured by Tobin's Q. Also hypothesized by Yermack (1996) is that the number of board outsiders is likely to be positively related with board size. However as noted in the journal of financial economics (April 1998) the board size effect vis-a-vis performance has to be looked at taking into consideration other factors such as the past firm performance and current board size, the evolving nature of the firm and also the composition of the board.

2.3.6. Board Activity and Firm Performance

Jensen (2001) argues that boards of well run companies should be relatively inactive and exhibit few conflicts. Though frequent board meetings have their own costs in terms of time allowances, strategy setting and monitoring of management can be more effective.

Vafeas (1999) found that meeting frequency was influential in improving operating performance in a manner consistent with contracting and agency. He further observed

that the role of boards becomes increasingly important during crisis when shareholders interests are in visible danger. Operating performance improves following years of abnormal board activity. These improvements are most pronounced for firms with poor prior performance and firms not engaged in corporate control transactions. Overall results indicate that board activity, measured by board meeting frequency is an important dimension of board operations.

Mululu (2003) in her study on the relationship between board activity and firm performance of listed companies at the NSE shows that boards increase the frequency of their meetings following a poor performance period and as a consequence performance of firms improves hence concurring with the study by Vafeas. Langat (2006) established that there are positive relationships between listed firms and the frequency of board meetings, the ratio of outside to total directors, percentage of insider share ownership and executive compensation. According to Mutisya (2005) the board size, number of meetings in a year and the proportion of shares held by top directors and management were the most significant contributors to performance of companies listed on the NSE. The study indicates that the board size in Kenya averages 8 with most companies holding four full board meetings in a year with other board committee meetings being held with the same frequency.

2.4. Indicators of Financial Performance

The measures of performance include the firm's annual turn over; the net profits, total assets turnover and earnings per share Included in these measures of financial performance are ratios as indicated below.

$$Total\ Assets\ Turnover = \frac{Sales}{Total\ Assets} \qquad \text{.......... (1)}$$

$$Earnings\ Per\ Share = \frac{Profit\ After\ Tax}{Number\ of\ Shares\ Issued} \qquad \text{.......... (2)}$$

CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1. Introduction

This chapter presents the research methodology used in this study. Section 3.2 describes the study population; Section 3.3 describes the sample; Section 3.4 outlines the data collection procedures and sources; and Section 3.5 describes the data analysis tools and the research model to be applied

3.2. Population

The population of this study comprised of 31 firms currently listed at the Nairobi Stock Exchange (NSE) This covered firms that had been actively trading between years 2002 and 2006 (both inclusive). The firms were classified into five major sectors of the economy namely the agricultural sector; the commercial and services sector; finance and investment sector; industrial and allied sector; and the alternative investment market sector.

3.3. Sample and Sampling technique

The sample consisted of firms that had listed during the entire period 2002 -2006. These firms must have traded continuously during the entire period of study and 31 firms were found to have satisfied this criterion (Appendix II). The other reason for sampling the whole population for study was to have an adequate and fully representative sample.

3.4. Data Collection

The study applied data from secondary sources. The data for the companies was extracted from the annual reports and financial statements for the five-year period 2002-2006. These were obtained from the NSE and CMA library or the respective company secretaries. The study sought to establish if there is a relationship between characteristics of board committees and financial performance. The data sourced therefore included the following: the number of board committees; the structure of board committees (proportion of the executive in relation to the entire committee size); the diversity factor (ethnic minority and gender diversity); and size of existing board committees. On the other hand the measures of performance used included: Annual Turnover; Net Profit; Total Asset Turnover; and Earnings per Share. The data was collected using the data observation sheet shown in Appendix I which was replicated for different sectors.

3.5. Data Analysis

3.5.1. The Conceptual Model

The study conceptualized that the firm-level financial performance is influenced by various characteristics of the board committees. These include the number of board committees; the structure of board committees (proportion of the executive in relation to the entire committee size); the diversity factor (ethnic minority and gender diversity); and types of existing board committees. The conceptual model of the relationship is algebraically indicated by equation (3) below.

$$Performance = f(Number, Structure, Diversity, Types) \ldots\ldots\ldots\ldots (3)$$

3.5.2. The Analytical Model

The study applied the multiple regression model of equation (4) to establish the relationship between characteristics of board committees and firm-level financial performance.

$$(FIRMPERF_{it}) = \alpha_0 + \alpha_1(NUMBER)_{it} + \alpha_2(STRUCTURE)_{it} + \alpha_3(ETHNIC)_{it} + \alpha_4(GENDER)_{it} + \alpha_5(TYPES) + \varepsilon_{it} \ldots\ldots \quad (4)$$

Where α_0, α_1, α_2, α_3, α_4 and α_5 are regression constants; and ε_{it} is the error term.

Equation (4) specifies five independent variables: the number of board committees within a particular year (NUMBER); Structure of board committees signified by the proportion of the non executive to the entire committee size (STRUCTURE); Ethnic minority factor signified by the number of committee members belonging to minority ethnic groups or race (ETHNIC); Gender factor signified by the number of women committee members (GENDER); and the number of various types of committees (TYPES). Equation (4) was estimated four times: once each for the financial performance measures namely: Annual Turnover; Net Profit; Total Assets Turnover, and Earnings per Share (EPS). The results for all these equations were divided into two types, descriptive results and those to be obtained from the regression analysis. The Statistical Package for Social Sciences, SPSS, was used for both types of analysis. The findings were presented using tables.

3.5.3. Research Hypotheses

The study shall seek to test the following hypotheses based on the regression model of equation (4):

a) **Hypothesis 1**

H_0: There is no significant relationship between firm-level financial performance and the number of existing board committees

H_1. Firms with high number of board committee types exhibit improved financial performance

b) **Hypothesis 2**

H_0. There is no significant relationship between firm-level financial performance and the proportion of the non executive directors in existing board committees

H_1: Firms with high number of the non executive directors in their board committees exhibit improved financial performance

c) **Hypothesis 3**

H_0: There is no significant relationship between firm-level financial performance and the proportions of ethnic minority members in existing board committees

H_1: Firms with ethnic diversity in membership of their board committees' exhibit improved financial performance

d) **Hypothesis 4**

H_0 There is no significant relationship between firm-level financial performance and gender composition of existing board committees

H_1: Firms with gender diversity in their board committees exhibit improved financial performance

e) **Hypothesis 5**

H_0: There is no significant relationship between firm-level financial performance and the types of existing board committees

H_1: Firms with several types of board committees exhibit improved financial performance

3.5.4 Diagnostic Tests

3.5.4.1. T-test

The t-test was used to test the hypothesis that a particular coefficient was significantly different from zero or whether the estimated coefficient value occurred by chance in equation (4). The tests were performed at both 95% and 99% levels of confidence.

3.5.4.2. F-test

The F-statistic is important to test the hypothesis that the whole relationship provided by the equation (4) is significantly different from zero. i.e. whether the board committees' characteristics scores explain the variation in financial performance for each of the individual firms. The test was performed at both 95% and 99% levels of confidence

3.5.4.3. R^2 - Change

The R-squared (R^2) value ranging from '0' to '1' or the 'corrected R-squared' (R2) which is adjusted for degrees of freedom indicates the explanatory power (goodness of fit) of the model.

CHAPTER FOUR

4.0 DATA ANALYSIS AND PRESENTATION OF FINDINGS

4.1. Introduction

The study's research objectives were twofold. First, the study sought to analyze board committees in terms of their size, composition, and structure; and the effect this has on firm-level performance. Secondly, the study sought to establish how the diversity of board committees affects firm-level performance. The findings presented in this chapter seek to answer this key research objective. The findings were collected from 31 companies that had continuously listed at the NSE between years 2002 and 2006 (both inclusive). The chapter is organized as follows: Section 4.2 presents the characteristics of board committees; Section 4.3 presents F-test results on significance of regression models; and Section 4.4 presents the tests of hypotheses outlined earlier in chapter three.

4.2. Board Committees' Characteristics

The findings presented in Table 4.1 indicate the number of firms that had various types of committees over the sample period. The findings indicate that between 80.6% and 100% of the sample firms had audit committees throughout the sample period. The presence of nomination committees ranged between 58.1% and 83.9% of the listed firms within the sample period. Remuneration committees were notable in between 35.5% and 48.4% of the listed firms between 2002 and 2006. Finally, the finance committees were present in almost half (48.4% - 51.6%) of the listed firms within the sample period of 2002 – 2006.

The findings of Table 4.1 therefore indicate that the audit, nomination, and finance committees are most popular to firms listed at the Nairobi Stock Exchange.

Table 4.1: Number of firms with various committee types (N=31)

Committee type	Year				
	2002	2003	2004	2005	2006
Audit Committee	30 *(96.8%)*	30 *(96.8%)*	31 *(100.0%)*	25 *(80.6%)*	26 *(83.9%)*
Nomination Committee	18 *(58.1%)*	23 *(74.2%)*	19 *(61.3%)*	26 *(83.9%)*	20 *(64.5%)*
Remuneration Committee	11 *(35.5%)*	11 *(35.5%)*	13 *(41.9%)*	13 *(41.9%)*	15 *(48.4%)*
Finance Committee	16 *(51.6%)*	15 *(48.4%)*	15 *(48.4%)*	16 *(51.6%)*	15 *(48.4%)*

Source: NSE Data (2008)

4.3. Diagnostic Tests on the Analytical Model

The multiple regression model of Equation (4) was first subjected to F-tests to establish the existence of a significance linear relationship(s) between the dependent variables (financial performance) and the independent variables (committee characteristics). The null hypothesis for the test was that there existed no significant linear relationship between the dependent and the independent variables. The test was performed for each of the four dependent variables on financial performance. The tests were performed at both 95% and 99% levels of confidence. The findings are presented in Table 4.2 below.

The findings indicate that the null hypotheses were rejected at both 95% and 99% levels of confidence. This indicates that the regression model of equation (4) was significant for all the four dependent variables. It further implies that there is a significance linear relationship between the dependent and the independent variables. This formed the basis

on which the tests of relationship between financial performance and structure of board committees were performed.

Table 4.2: F-test Analysis of Significance of the Analytical Model

$(FIRMPERF_{it}) = \alpha_0 + \alpha_1(NUMBER)_{it} + \alpha_2(STRUCTURE)_{it} + \alpha_3(ETHNIC)_{it} + \alpha_4(GENDER)_{it} + \alpha_5(TYPES) + \varepsilon_{it}$		
Dependent variable	**F-statistics**	**Decision**
Annual Turnover	$F_{(5,382)} = 3.7699^{**}$	Reject H_0
Net Profit	$F_{(5,382)} = 6.9375^{**}$	Reject H_0
Total Assets Turnover	$F_{(5,382)} = 7.4865^{**}$	Reject H_0
EPS	$F_{(5,382)} = 12.0211^{**}$	Reject H_0

*** Denotes Significance at 5% level (P-values < 0.05)**
**** Denotes Significance at both 5% and 1% level (P-values < 0.01)**
H_0: There is no significant linear relationship between the dependent and the independent variables
H_1: There is a significance linear relationship between the dependent and the independent variables

4.4. Board Committees Characteristics and Firm Performance

Equation (4) was estimated four times: once each for the financial performance measures namely: Annual Turnover; Net Profit; Total Assets Turnover, and Earnings per Share (EPS). The findings are presented in the sub-sections below.

4.4.1. Firm Performance and Number of Board Committees

The first research hypothesis had the null stating that there is no significant relationship between firm-level financial performance and the number of existing board committees within a particular year. Parametric F-tests were performed on the coefficients derived from the regression analysis of equation (4) to ascertain significance of the relationship between financial performance and number of board committees. The decision rule for

the tests was based on rejecting the null hypotheses if the absolute values of the computed t-statistics are greater than critical values of a standard student-t distribution at 95% and 99% levels of confidence. The findings are presented in Table 4.3 below. The findings indicate that the null hypotheses were rejected in all the four instances. This indicates that there exists a relationship between firm-level financial performance and the number of board committees within a particular financial year. Hence, firms with high number of board committee types exhibit improved financial performance.

Table 4.3: Relating Number of Committees to Financial Performance

$$(FIRMPERF_{ij}) = \alpha_0 + \alpha_1(NUMBER)_{ij} + \alpha_2(STRUCTURE)_{ij} + \alpha_3(ETHNIC)_{ij} + \alpha_4(GENDER)_{ij} + \alpha_5(TYPES) + \varepsilon_{ij}$$

Performance measure	Regression Coefficients (α_1)	T-statistic	Decision
Annual Turnover	2,029,244,357.14	2.5974**	Reject H_0
Net Profit	387,649,889.4059	3.0899**	Reject H_0
Total Assets Turnover	3.2274	2.3345*	Reject H_0
EPS	4.8228	8.3552**	Reject H_0

* Denotes Significance at 5% level (P-values < 0.05)
** Denotes Significance at both 5% and 1% level (P-values < 0.01)
Critical values = 2.57 (at 1% significance level) and 1.96 (at 5% significance level)
H_0: There is no significant relationship between firm-level financial performance and the number of existing board committees
H_1: Firms with high number of board committee types exhibit improved financial performance

4.3.2. Firm Performance and Non Executive Composition of Board Committees

The second research hypothesis had the null stating that there is no significant relationship between firm-level financial performance and the proportion of the non executives in existing board committees. Parametric T-tests were performed on the coefficients derived from the regression analysis of equation (4) to ascertain significance of the relationship between financial performance and this structural phenomenon of

board committees. The decision rule for the tests was based on rejecting the null hypotheses if the absolute values of the computed t-statistics are greater than critical values of a standard student-t distribution at 95% and 99% levels of confidence. The findings are presented in Table 4.4 below. The findings indicate that the null hypotheses were rejected in all the four instances. This indicates that there exists a relationship between firm-level financial performance and non executive composition of board committees within a particular financial year. Hence, firms with high concentration of the non executive influence in their board committees' exhibit improved financial performance.

Table 4.4: Relating Non Executive composition of Committees to Financial Performance

$$(FIRMPERF_{ij}) = \alpha_0 + \alpha_1(NUMBER)_{ij} + \alpha_2(STRUCTURE)_{ij} + \alpha_3(ETHNIC)_{ij} + \alpha_4(GENDER)_{ij} + \alpha_4(TYPES) + \varepsilon$$

Performance measure	Regression Coefficients (α_1)	T-statistic	Decision
Annual Turnover	2,321,002,905.041	2.1492*	Reject H_0
Net Profit	730,701,650.775	2.2530*	Reject H_0
Total Assets Turnover	0.6341	3.2190**	Reject H_0
EPS	5.2433	2.6726**	Reject H_0

* Denotes Significance at 5% level (P-values < 0.05)
** Denotes Significance at both 5% and 1% level (P-values < 0.01)
Critical values = 2.57 (at 1% significance level) and 1.96 (at 5% significance level)
H_0: There is no significant relationship between firm-level financial performance and the proportion of the non executive in existing board committees
H_1: Firms with high concentration of the non executive influence in their board committees' exhibit improved financial performance

4.3.3. Firm Performance and Ethnic Diversity of Board Committees

The third research hypothesis had the null stating that there is no significant relationship between firm-level financial performance and the proportions of ethnic minority members in existing board committees. Ethnicity of board committee members was proxied by presence of members who are not of Kenyan origin or board members of foreign nationalities. Parametric T-tests were performed on the coefficients derived from the regression analysis of equation (4) to ascertain significance of the relationship between financial performance and presence of ethnic minority members of the board in various board committees. The decision rule for the tests was based on rejecting the null hypotheses if the absolute values of the computed t-statistics are greater than critical values of a standard student-t distribution at 95% and 99% levels of confidence. The findings are presented in Table 4.5 below.

Table 4.5: Relating Ethnic Diversity of Board Committees to Financial Performance

$$(FIRMPERF_{it}) = \alpha_0 + \alpha_1(NUMBER)_{it} + \alpha_2(STRUCTURE)_{it} + \alpha_3(ETHNIC)_{it} + \alpha_4(GENDER)_{it} + \alpha_5(TYPES) + \varepsilon_{it}$$

Performance measure	Regression Coefficients (α_1)	T-statistic	Decision
Annual Turnover	-3,537,981,569 634	-2.172*	Reject H_0
Net Profit	-707,832 901 0752	-2 707**	Reject H_0
Total Assets Turnover	0 6664	4 1961**	Reject H_0
EPS	5 2133	3 2956**	Reject H_0

* Denotes Significance at 5% level (P-values < 0.05)

** Denotes Significance at both 5% and 1% level (P-values < 0.01)

Critical values = 2.57 (at 1% significance level) and 1.96 (at 5% significance level)

H_0: There is no significant relationship between firm-level financial performance and the proportion of ethnic minority members in existing board committees

H_1: Firms with ethnic diversity in membership of their board committees' exhibit improved financial performance

The findings presented in Table 4.5 above indicate that the null hypotheses were rejected in regard to the four measures of financial performance used. This indicates that there exists a significant relationship between firm-level financial performance and ethnic diversity of board committees within a particular financial year. However, the negative signs of the t-statistics and the regression coefficients (Table 4.5) indicate that the firms with ethnic diversity in their board committees had reported a decline in financial performance in regard to annual turnover and profitability. Nevertheless, the assets portfolio and market fundamentals remained sound. Hence, firms with ethnic diversity in their board committees' are likely to exhibit decline in profitability, but improve on market-based fundamentals.

4.3.4. Firm Performance and Gender Diversity of Board Committees

The fourth research hypothesis had the null stating that there is no significant relationship between firm-level financial performance and gender composition of existing board committees. Gender diversity of board committee members was proxied by presence of female board members in various board committees. Parametric t-tests were performed on the coefficients derived from the regression analysis of equation (4) to ascertain significance of the relationship between financial performance and gender diversity of various board committees. The decision rule for the tests was based on rejecting the null hypotheses if the absolute values of the computed t-statistics are greater than critical values of a standard student-t distribution at 95% and 99% levels of confidence. The findings are presented in Table 4.6 below.

The findings presented in Table 4.6 below indicate that the null hypotheses were accepted in regard to the four measures of financial performance used. This indicates that there exists no significant relationship between firm-level financial performance and gender diversity of board committees within a particular financial year. Hence, gender diversity of board committees has no influence on financial performance of respective firms.

Table 4.6: Relating Gender Diversity of Committees to Financial Performance

$(FIRMPERF_{ij}) = \alpha_0 + \alpha_1(NUMBER)_{ij} + \alpha_2(STRUCTURE)_{ij} + \alpha_3(ETHNIC)_{ij} + \alpha_4(GENDER)_{ij} + \alpha_5(TYPES) + \varepsilon_{ij}$			
Performance measure	**Regression Coefficients (α_4)**	**T-statistic**	**Decision**
Annual Turnover	4,091,197,971.013	1.2782	Accept H_0
Net Profit	1,119,757,405.718	1.179	Accept H_0
Total Assets Turnover	-0.118	-0.378	Accept H_0
EPS	8.481	1.728	Accept H_0

*** Denotes Significance at 5% level (P-values < 0.05)**
**** Denotes Significance at both 5% and 1% level (P-values < 0.01)**
Critical values = 2.57 (at 1% significance level) and 1.96 (at 5% significance level)
H_0: There is no significant relationship between firm-level financial performance and gender composition of existing board committees
H_1: Firms with gender diversity in their board committees exhibit improved financial performance

4.3.5. Firm Performance and Types of Board Committees

The fifth research hypothesis had the null stating that there is no significant relationship between firm-level financial performance and the types of existing board committees. The findings of Table 4.1 indicated that only four types of board committees existed within the sample firms. These included the audit committee, remuneration committee, finance committee, and the nomination committee. Each of the firms had the audit committee at a minimum, in addition to a combination of any or all of the remaining

three types of committees. Parametric T-tests were performed on the coefficients derived from the regression analysis of equation (4) to ascertain significance of the relationship between financial performance and types of board committees. The decision rule for the tests was based on rejecting the null hypotheses if the absolute values of the computed t-statistics are greater than critical values of a standard student-t distribution at 95% and 99% levels of confidence. The findings are presented in Table 4.7 below.

The findings presented in Table 4.7 below indicate that the null hypotheses were accepted in regard to the four measures of financial performance used. This indicates that there exists no significant relationship between firm-level financial performance and the types of board committees within a particular financial year. Hence, diversity in types of board committees has no influence on financial performance of listed firms.

Table 4.7: Relating Types of Committees to Financial Performance

$$(FIRMPERF_{it}) = \alpha_0 + \alpha_1(NUMBER)_{it} + \alpha_2(STRUCTURE)_{it} + \alpha_3(ETHNIC)_{it} + \alpha_4(GENDER)_{it} + \alpha_5(TYPES) + \varepsilon_{it}$$

Performance measure	Regression Coefficients (α_i)	T-statistic	Decision
Annual Turnover	-373,585,412 7198	-0 798	Accept H_0
Net Profit	-62,135,284 5703	-0 826	Accept H_0
Total Assets Turnover	0 0273	0.599	Accept H_0
EPS	-0 965	-2 123	Accept H_0

* Denotes Significance at 5% level (P-values < 0.05)
** Denotes Significance at both 5% and 1% level (P-values < 0.01)
Critical values = 2.57 (at 1% significance level) and 1.96 (at 5% significance level)
H_0: There is no significant relationship between firm-level financial performance and the types of existing board committees
H_1: Firms with gender diversity in their board committees exhibit improved financial performance

CHAPTER FIVE

5.0 DISCUSSION, CONCLUSIONS AND RECOMMENDATIONS

5.1. Introduction

This chapter presents the summary, conclusions, recommendations derived from the findings of the study, limitations and suggestions for further research. Section 5.2 is a brief discussion of the research findings. Section 5.3 provides the conclusions. Section 5.4 provides the recommendations. Section 5.5 the limitations of the study. Section 5.6 the suggestions for further research.

5.2. Discussion of Findings

This study sought to analyze board committees in terms of their size, composition, structure and diversity (gender and ethnic) and the effect this has on firm financial performance. The study hypothesized that there is a positive relationship between board committees' characteristics and financial performance of firms listed at the NSE. In achieving the above objective, the study applied secondary data obtained from the audited financial statements of the listed firms for the period 2002-2006. Data were obtained from the Research Department at the Capital Markets Authority. A multiple regression model was applied in determining the nature of relationship between firm performance and characteristics of board committees.

The key findings of the study established that the audit, nomination, and finance committees are most popular to firms listed at the Nairobi Stock Exchange.

Remuneration committees exist in some of the firms, mainly drawn from the finance and investment listing segment of the NSE. Secondly, the findings established that there exists a relationship between firm-level financial performance two aspects of the board committees' namely non executive composition of board committees and the number of board committees within a particular financial year. Hence, firms with high number of board committees as well as non executive diversity are likely to exhibit improved financial performance within a particular financial year. However, the findings established that firms with ethnic diversity in their board committees' are likely to exhibit decline in profitability, but improve on market-based fundamentals. Diversity in gender composition, ethnic composition, and types of board committees were found to have no significant effect on financial performance of listed firms.

The findings of the study are in agreement to empirical study by Klein (1998) and Baysinger & Butler (1985) who established significant ties between firm performance and how board committees are structured The proportion of independent outside directors (non executive) was positively correlated with the return on equity as a measure of performance. The findings of the study are also consistent to John and Senbet (1998) for the support of greater participation of outside (non executive) directors on major committees of the board. It is therefore evident that properly constituted board committees with the right mix of non executive directors tend to contribute more to performance than boards with a predominance of inside directors, a finding which is consistent to previous findings by Weisbach (1988), Bhagat and Black (2001) and Mehran (1995).

5.3. Conclusions

The study has established that non executive composition and presence of several board committees has an effect on firm-level financial performance. This implies that properly constituted board committees with the right mix of non executive directors tend to contribute more to performance than boards with a predominance of inside directors. Ethnic diversity of board committees also enhances firm profitability and market fundamentals. Membership on board committees provides a more accurate picture of each director's role on the board which should lead to a more accurate test of the relationship between board composition and board effectiveness. Committee membership provides a proxy for the duties, i.e. functions, of a director on the board. Directors have a stronger and more direct impact on executive compensation, new director selection, strategic managerial decisions, and other actions that significantly affect corporate performance if they serve on board committees with primary responsibility for these functions. Any unique advantages or disadvantages that might exist for women and ethnic minorities relative to board process should have a more direct effect through committee assignments. Therefore, the number, composition of board committees and diversity has a positive and statistically significant effect on firm performance. Furthermore, the type of diversity appears to matter.

5.4. Recommendations

From the conclusions drawn from this study the policy recommendations are as follows;

The formulation of board committees should consider a right mix of non executive directors in board committees which should also be properly constituted with specified roles.

Secondly, the number of board committees could have an effect on firm financial performance however a deeper study should be undertaken to establish the optimal number of committees in different sectors and also on the basis of firm size and the link to firms' performance.

5.5. Limitations of the Study

The study addressed different characteristics of board committees and the effect they have on financial performance, however other than the audit committee some firms have combined the roles of other committees such as nomination, remuneration and staff into one committee while others have them as separate committees. Lack of proper standardization of board committees was also a limitation since some committees were customized to the operations of a firm and only for certain periods and not throughout the five year study period.

The study addressed financial performance but did not use all the available measures of the same. This limited the observations to the specific measures of financial performance that were employed in the analysis.

5.6. Suggestions for Further Research

The study had applied data from firms that had continuously traded at the bourse between years 2002 and 2006. Given that the firms are listed under various segments, the study

did not take into consideration issues such as firm size, industry sector, and regulatory requirements on corporate governance such as those imposed on commercial banks by the Central Bank of Kenya. Therefore, the study recommends that further research should be conducted with the view of performing proper inter-sectoral comparison across various market segments. Further research may also incorporate other fundamental characteristics of board committee's members such as age diversity and skills diversity within the research model of equation (4).

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APPENDICES

Appendix I: Data Observation Sheet

Year ___________ Board Committee Type ____________________ Market Sector ________________________

Firm Name	Annual turnover	Net Profit	Total Assets Turnover	Earnings per Share	Total committee size	No. of executive members	No. of ethnic minority members	Number of female members

Appendix II: List of Sample Firms

1. Athi River Mining Limited
2. British American Tobacco Limited
3. Baumann East Africa Limited
4. Barclays Bank of Kenya Limited
5. CMC Motors Limited
6. Crown Berger Limited
7. Diamond Trust Bank Limited
8. East African Cables Limited
9. East African Breweries Limited
10. Express Kenya Limited
11. Housing Finance Company
12. Jubilee Holdings Limited
13. Kakuzi Limited
14. Kenya Commercial Bank Limited
15. Kenol Limited
16. Kenya Power and Lighting Company
17. Kenya Airways
18. Limuru tea Limited
19. Marshals East Africa Limited
20. Mumias Sugar Company
21. Nation Media Group
22. National Bank of Kenya
23. Rea Vipingo Plantations Limited
24. Sameer Africa Limited
25. Sasini Limited
26. Standard Chartered Bank
27. Standard Group Limited
28. Total Kenya Limited
29. TPS East Africa
30. Unga Group Limited
31. Williamson Tea Limited