CORPORATE GOVERNANCE PRACTICES AND PERFORMANCE OF COFFEE FARMERS' COOPERATIVE SOCIETIES IN BUNGOMA COUNTY

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Reg; D61/9055/2006

Research project Proposal submitted towards partial fulfillment of the Masters in Business Administration Degree of the University of Nairobi School of Business

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DECLARATION

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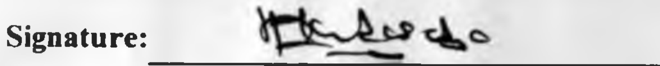
Signature:  Date: 16\11\2010

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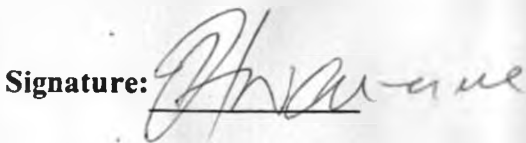
Signature:  Date: 16-11-2010

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DEDICATION

I would like to dedicate the research project to my family Mukoya Musuya Nandasaba, Elizabeth Nandasaba, Margaret, and Chenjeni Musuya.

ABSTRACT

broad objective of the study was to determine the relationship between various ponents of corporate governance and performance of coffee farmer's cooperative ety in Bungoma County .The study was guided by the following specific objectives ; establish the relationship the between board size, board composition and Chief cutive Officer (CEO) status on performance of coffee farmer's co-operative societies 3ungoma County between 1999 and 2008; To determine the role of the corporate cials in Bungoma County between 1999 and 2008; To establish the challenges faced he coffee farmer's cooperative societies in practicing of good corporate governance, ungoma County between 1999 and 2008.

study targeted 20 coffee farmer's co-operative society in Bungoma County as at 30th 1996. Data was obtained from the ministry of co-operative offices in Bungoma town the period between 1999 and 2008. The key findings of the study revealed a linear tionship between performance and Board size; Secretary –manager (CEO) status and rd composition.

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ABBREVIATIONS

OECD-Organization for Economic Co-operation and Development

PSGT- Private Sector Corporate Governance Trust

MDG-Millennium Development Goals

ICA – International Cooperative Alliance

ICO – International Chamber of Commerce

ILO- International Labour Organization

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CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

1.1.1 Introduction

A cooperative is a business entity that is member-owned, meaning the business is controlled and owned by the same people who utilize its services. The owners of the cooperative finance and operate the business, striving for a mutual benefit by working together. They combine resources, decrease overall production costs, and through which capabilities and marketing successes are increased. Cooperatives are run similar to other business entities and usually incorporated under state laws.

The cooperative movement in Kenya was one of the nationally organized institutions available for all cadres of persons. Its agenda was usually based on locally determined proposals whose aims were to empower citizens. Often, co-operative societies bring together various classes of people regardless of their socio-economic status and their agenda would be one only to share ideas, suggest and implement viable practices.

In Kenya the Center for Co-operative Governance stipulates seven core principles in the code of best practice in mainstreaming corporate governance in cooperatives; voluntary and open membership, democratic member control, economic participation by members, autonomy and independence, education, training and information, co-operation among co-operatives and concern for community in general

The corporate governance principles in Kenya borrow heavily from the OCED principles which focus on publicly traded companies, both financial and non-financial. However they are applicable to improve corporate governance in non-traded companies including cooperative societies (OECD, 2004). For public listed firms in Kenya the Capital Markets

Authority has a code of conduct for observance in order to enhance corporate governance amongst them.

1.1.2 Corporate Governance and the Performance of Coffee Farmer's Cooperative Society

Corporate governance could be defined as "ways of bringing the interests of investors and managers into line and ensuring that firms, co-operatives included, are run for the benefit of investors (Mayer, 1997). It is concerned with the relationship between the internal governance mechanisms of corporations and society's conception of the scope of corporate accountability. Corporate governance can also be viewed as the structures and processes laid down by a corporate entity to minimize the extent of agency problems as a result of separating ownership and control. Good governance is now accepted as vital to achieving the Millennium Development Goals and as a pre-condition for sustainable economic growth. In Kenya, little attention has been paid to the governance of co-operative societies needs, despite their considerable contribution to the economy. The co-operative sector as a whole remains poorly understood and its specific governance challenges remain as yet largely unexplored (Shaw, 2007).

Empirical studies widely claim that good corporate governance enhances a firm's performance (Brickley and James, 1987; Byrd and Hickman, 1992; Rosenstein and Wyatt, 1990; Weisbach, 1988). However other studies have reported negative relationship between corporate governance and firm performance (Bathala and Rao, 1995; Hutchinson, 2002) and others have not found any relationship (Singh and Davidson, 2003; Young, 2003). Arguments in favor of the conflicting results are that they come about because of the use of either publicly available data or survey data all which are restricted in scope. Besides measures such as return on assets (ROA), return on equity (ROE), return on capital employed (ROCE) or restrictive use of market based measures

(such as market value of equities) could also have contributed to the inconsistency (Gani and Jermias, 2006).

Coleman (2007) concluded that the direction and the extent of impact of governance is dependent on the performance measure being examined. Specifically, the findings showed that large and independent boards enhance firm value and that combining the positions of Chief Executive Officer (CEO) and board chair had a negative impact on corporate performance. He also found out that CEO's tenure in office enhances a firm's profitability whiles board activity intensity affects profitability negatively. The size of audit committees and the frequency of their meetings had positive influence on market based performance measures and that institutional shareholding enhances market valuation of firms. Finally, the results pointed out that both country and sector characteristics influence the impact of governance on corporate performance. For enhanced performance of corporate entities, he recommended a clear separation of the positions of CEO and board chair and also the maintenance relatively independent audit committees.

1.1.3 Cooperative Societies in Bungoma County

Bungoma County was one of the leading coffee-producing regions in Kenya, and thus had a number farmer's cooperative societies, all members of the Kenya National Federation of Co-operatives (KNFC). The country has had a success story in respect to the development of the co-operative movement and as at the turn of the millennium there were over 10,800 registered co-operative societies with a membership of about 6 million and out of which, 46% were agricultural based (Mudibo, 2005).

However, the performance of the co-operatives has been on the decline as shown by a drop in production yields and deliveries to the cooperative societies. As an example the

once giant Kabisi Coffee Farmer's Co-operative Society in Bungoma North, now defunct had a net asset worth of £5500 in 1978 (KNFC,2008).

Generally the coffee industry was centered on a government-run auction system whereby lots of coffee would be put up for bidding, and the highest paying buyer would purchase the lot. The performance of the industry has been steadily declining in terms of both output and quality since its peak in 1987. Exports fell from 2.1 million to 0.9 million bags for period1987-2007 and world market share declined from 3.1% in 1986 to 0.6% in 2006 (ICO, 2008). Moreover, the quality of Kenyan coffee had fallen, making it harder for Kenya to demand a premium over commodity prices.

A study to asses the governance situation in cooperatives in Kenya was commissioned in 1997 by the KNFC in collaboration with the Center for Corporate Governance. The study recommended management and governance reforms that would improve the performance of co-operatives and contribute to transform them into modern businesses able to meet the needs of their members. This would happen in a competitive liberalized global economy and hence the urgent need promote corporate governance mechanisms.

1.2 Problem Statement

Corporate governance is about the organization of a company by taking into account the outcome of a good corporate governance practice in an accountable board of directors who ensures that the investors' interests are not jeopardized. The accountability and transparency component of corporate governance would help companies gain shareholders' and investors' trust. These stakeholders need assurance that the company will be run both honestly and cleverly (Morck and Steier, 2005).

Many companies are run mostly for the benefit of the shareholders, the rightful owners. There exists another model, where companies are run for the benefit of other significant groupings as well - such as customers, the general public or employees. The stakeholder model involves a board for each of these models - or something in between - requires people with different backgrounds and outlooks (ICO, 2008).

Gama & Komo (2002) attributed under-performance to the fact that most co-operatives were unprepared for liberalization. The same sentiments were echoed by Wanyama (2009) that indeed the resulting policy framework and legal environment from liberalization negatively impacted on the performance of most co-operative societies. Furthermore Nyoro and Ngugi (2008) in a study done on Kiambu County coffee farmer's co-operatives found out that 67% of the respondents attributed poor performance on the difficult business environment as a result of liberalization

Empirical recent studies on co-operative forms of business have remained relatively limited however studies on the governance modes of firms, including labour managed firms and co-operative business models have addressed the question of why co-operative and other worker owned business models are relatively rare (Hansmann, 1996). Typically the failure of the co-operative model is explained by its democratic governance structures which prevent effective control over managers and profit distribution systems that lead to shorter time horizons (Shaw, 2006).

However specific studies into corporate governance issues as they impact on co-operatives performance in the Kenya and other developing nations are very few and this presents considerable difficulty in reaching any definitive conclusions. However the starting points for an analysis of the key issues can be derived from existing studies of the co-operative sector in general and other useful empirical studies on firms (ILO 2000; 11).

Empirical studies in Kenya on governance have mainly dwelt on other firms and not farmer's co-operative societies as such. Variables such as board activity in terms of board size, board composition, meetings of the board and CEO compensation all had an impact on performance for listed manufacturing firms (Gathura, 2007). The findings further stated that firms with a big proportion of non-executive directors serving on the board exhibited improved performance.

Mwangi (2003) investigated the determinants of corporate governance practices; and kegode (2005) investigated the application of corporate governance on the performance of the Kenya sugar board. Langat (2006) did study on the effect of corporate governance on performance for listed firms; and lastly Gathura (2007) studied corporate governance structure and performance of manufacturing listed firms on the Nairobi Stock Exchange. The latest study findings were in agreement to previous empirical studies conducted in Kenya (Lang'at, 2006; Mululu, 2005; Kegode 2005 and Mwangi; 2003). Mudibo (2005) argued that indeed the lack of implementation of corporate governance principles by most cooperative societies led to their failure to such an effect that board members succumbed to political pressure from external forces. There was lack of accountability from the management to members in running the society's affairs.

The research investigates relationship of the application of corporate governance mechanisms by the management of coffee cooperative societies in Bungoma County as a possible explanation of performance. The study therefore seeks to answer the following research questions;

a) What is the relationship between the practice of corporate governance and performance in the coffee farmer's co-operative society in Bungoma County?

b) What are the roles of corporate governance practice in mitigating the agency conflict in coffee farmer's cooperative society in Bungoma County?

c) What are the challenges faced by the coffee co-operative societies in practicing of good corporate governance in Bungoma County?

1.3 Objectives of the Study

(i) To establish the relationship the between board size, board composition and Chief Executive Officer(CEO) status on performance of coffee farmer's co-operative societies in Bungoma County between 1999 and 2008.

(ii) To determine the role of the corporate governance practice in mitigating the agency conflict of interest among coffee cooperative officials in Bungoma County between 1999 and 2008.

(iii) To establish the challenges faced by the coffee farmer's cooperative societies in practicing of good corporate governance, in Bungoma County between 1999 and 2008.

1.4 Significance of the Study

The study findings will assist in the enactment of appropriate governance reform structures and policies for farmer's cooperative societies in Kenya. The management of the coffee cooperative societies will benefit from the study findings especially when it comes to restructuring of their cooperatives. This will enable them enhance performance and compete effectively as other business entities.

In the long run the findings will assist the government in building a strong and viable cooperative movement able to give maximum benefit and contribute to the socio-economic development of the country. In the long run the study findings will go along way in assisting the government achieve the vision 2030 goals. Furthermore the research findings may assist government policies in rural development to achieve the MDG's of

halving poverty levels by 2015. Finally to academicians; students of MBA, scholars and researchers may find the study useful in further research based on the findings of this study.

CHAPTER TWO: LITERATURE REVIEW

2.1 Corporate Governance

Corporate governance can be viewed from various theoretical perspectives such as agency theory, stewardship theory, stakeholder theory, transaction cost theory and political theory (Abdullah & Valentine, 2009). The theories address the cause and effect of variables, such as the composition of board members, audit committee, independent directors and the role of top management. Therefore, it can be argued that corporate governance is more of a social relationship rather than a process orientated structure. The theories focus on the view that the shareholders aim to get a return on their investments. Corporate governance has to constantly change and evolve because of changes driven by both the internal and external environmental dynamics and Shleifer and Vishney (1997) described it as a way in which suppliers of finance assure themselves of getting a return on their investment.

Good corporate governance mitigates the agency conflict, meaning that there is little expropriation of corporate resources by managers or controlling shareholders, which contributes to better allocation of resources and better performance. Agency theory suggests that the firm can be viewed as a nexus of contracts between resource holders. An agency relationship arises whenever one or more individuals, called principals, hire one or more other individuals, called agents, to perform some service and then delegate decision-making authority to the agents. The primary agency relationships in farmer's co-operatives are those (ii) between farmer members and managers and (ii) between debt holders and managers. Jensen and Meckling (1976) argued that agency costs play an important role in financing decisions of a business entity due to the conflict that may exist between shareholders and debt holders.

The agency costs will be incurred by investors in trying to align the interests of management to those of other stakeholders. As a matter of fact investors and lenders will be more willing to put their money in firms with good governance as they will face lower costs of capital, another source of better firm performance. Low agency costs enabled by the application of corporate governance principles will lead other stakeholders, including employees and suppliers, want to be associated with and enter into business relationships with such firms. Such relationships are likely to be more prosperous, fairer, and longer lasting than those with firms with less effective governance. According to (OECD, 2004) good governance means little expropriation of corporate resources by managers or controlling shareholders, which contributes to better allocation of resources and better performance.

2.2 The Concept of Corporate Governance

Corporate governance is defined as the system by which a corporation is directed, controlled and held to account for the manner in which power is exercised in the stewardship of its assets and resources, to increase and sustain shareholder value and satisfy the needs and interests of all stakeholders (Cadbury, 2000). The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation such as, the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on firm's affairs. The principles of corporate governance cover the rights of owners, the equitable treatment of shareholders, the role of stakeholders, disclosure and transparency and the responsibilities of the board (OECD, 2004).
The objectives of corporate governance are simply to hold the balance between economic and social goals. They also aim to align the interests of all stakeholders to achieve increased profitability and efficiency (PSGT, 2009). Lastly the overriding pillars are transparency, accountability and probity of business enterprises.

2.2.1 Effect of Board of Size on Corporate Governance

The most important thing for any public listed company is that it should be headed by an effective board to offer strategic guidance, and be accountable to its shareholders (Capital Markets Authority, 2005).The size and composition of the board of director's act as a corporate governance mechanism. Limiting board size is believed to improve firm performance because the benefits of larger boards (increased monitoring) are outweighed by the poorer communication and decision making. There are two components that characterize the independence of a board, the proportion of non-executive directors and the separated (or not) roles of CEO and chairman of the board. Non-executive or outside directors, through their expertise and independence, can play an important role at a cooperative level through transferring knowledge.

Jensen (1993) argued that the preference for smaller board size stems from technological and organizational change which ultimately leads to cost cutting and downsizing. Hermalin and Weisbach (2003) argued the possibility that larger boards can be less effective than small boards. When boards consist of too many members agency problems may increase, as some directors may tag along as free-riders. Lipton and Lorch (1992) recommended limiting the number of directors on a board to seven or eight, as numbers beyond that it would be difficult for the CEO to control. A large board could also result in less meaningful discussion, since expressing opinions within a large group is generally time consuming and difficult and frequently results in a lack of cohesiveness on the board (Lipton and Lorch, 1992). In addition, the problem of coordination outweighs the advantages of having more directors (Jensen, 1993) and when a board becomes too big, it often moves into a more symbolic role, rather than fulfilling its intended function as part of the management (Hermalin and Weisback, 2003).

Large boards are less effective, difficult to coordinate and not able to process and tackle strategic problems of an organization (Theodore, Wells and Sundgren, 1998).The study

results found a significant negative correlation between board size and profitability in a sample of small and midsize Finnish firms, and this is much applicable to the coffee cooperative societies. More precisely an optimum board size composed of 5 directors was found by Mak and Yuanto (2003) using sample firms from Malaysia and Singapore, where firm performance was highest.

Jensen (1986) suggested that when boards get beyond seven or eight people, they are less likely to function effectively and are easier for the Chief Executive Officer (CEO) to control. A similar view was suggested by Swanstrom (2006) who stated that the norms of behavior in most boardrooms are dysfunctional because directors rarely criticize the policies of the top managers or hold candid discussions about corporate performance. Believing that these problems increase with the number of directors, they recommended limiting the membership of boards to 10, with a preferred size of 8 or 9.

Limiting board size to a particular level is generally believed to improve the performance of a firm because the benefits by larger boards of increased monitoring are out weighed by the poorer communication and decision making of larger groups. Empirical studies on board size seem to provide the same conclusion that a fairly clear negative relationship appears to exist between board size and firm value. In Africa a study done in Nigeria, a developing economy such as Kenya, by Sanda, Aminu & Garba (2003) reported that firm performance is positively correlated with small, as opposed to large boards.

2.2.2 Effect of Board Composition on Corporate Governance

Enhanced director independence, according to Jaskwicz & Uhlenbunck (2003) is preferred because a director with ties to a firm or its CEO would find it more difficult to turn down an excessive pay packet, challenge the rationale behind a proposed merger or bring to bear the skepticism necessary for effective monitoring. The paper further suggests that independent outsider dominated boards will effectively monitor managers

and improve firm performance. In contrast, dependent, insider dominated boards are detrimental to firm performance because personal relationships reduce the incentives of insiders for effective monitoring of managers.

Empirical studies done on Kenyan listed firms gave conflicting results.Gathura (2007) did a study on listed manufacturing firms and found out that those with a significant proportion of independent directors exhibited improved performance. On the other hand Barako, Hancock & Izan (2006) did not establish any significant relationship between non-executive directors and performance. An explanation given was that although non-executive directors were presumed to be independent, in fact they may not be, and are therefore, not effective as monitors.

In Kenya the capital markets Act stipulates that the board should be composed of balanced executive directors and non-executive directors (including at least one third independent and non-executive directors) of diverse skills or expertise. This is in order to ensure that no individual or small group of individuals can dominate the boards' decision-making.

2.2.3 Effect of Chief Executive Officer Status on Corporate Governance

Most corporate governance principles including the East African code of best practice highlight the importance of separating the roles of the Managing Director and Board Chair. Other studies have examined the separation of CEO and chairman of the board, saying that agency problems are higher when the same person occupies the two positions. Using a sample of firms in USA between 1984 and 1991, Yermack (1996) shows that firms are more valuable when the CEO and the chairman of the board positions are occupied by different persons.

Companies whose CEOs also serve as board Chair are more likely to have certain troubling corporate governance characteristics than companies where the roles are

separated Lacroix (2009).The report concluded that as a corporate governance best practice, companies should ensure that there is a Chairman-CEO split after an incumbent who holds the dual roles leaves.

A study done on Kenyan listed firms by Barako,Hancock & Izan (2006) revealed that the major issue often discussed is whether the chair of the board of directors and CEO positions should be held by different persons (dual leadership structure) or by one person (unitary leadership structure). Agency theory suggests that the combined functions (unitary leadership structure) can significantly impair the boards' most important function of monitoring, disciplining and compensating senior managers. It also enables the CEO to engage in opportunistic behaviour because of his/her dominance over the board.

The study findings were that in the Kenyan context, companies were performing poorly and some failing partly due to weak corporate governance structure, and one of such attributes was the combined role of board chair and CEO. The concern was that such enormous powers vested in an individual make the board ineffective in its oversight and monitoring role. An example was given with regard to the board leadership whereby the Capital Markets Authority (CMA) in the Guidelines of Corporate Governance Practices, expressed a view that companies should consider separating the role of the chair and CEO, and where the two roles are combined.

2.3 Firm -Level Performance

Performance measures can be grouped into two basic types: those that relate to results (outputs or outcomes such as competitiveness or financial performance) and those that focus on the determinants of the results (inputs such as quality, flexibility, resource utilization, and innovation). They serve to align an organization's efforts to the achievement of its mission. As part of a company's evaluation and control program, they quantifiably monitor important characteristics of the company's products and services and the performance of the individuals and processes creating them. Furthermore support

managerial decision-making by providing useful information regarding ;how efficient and effective are the company's processes and the individuals implementing them, if product or service improvements are necessary, if the company's customers and stakeholders are satisfied and if the company is meeting its stated goals.

Performance measures best serve an organization when they are understandable, broadly applicable, uniformly interpreted, and economic to apply. They should cascade through and organization's hierarchy such that achievement of lower tiered performance goals support higher tiered goals that in turn ultimately support achievement of the company's mission. This suggests that performance measurement frameworks can be built around the concepts of results and determinants. Most studies of organizational performance define perfomance as a dependent variable and seek to identify variables that produce variations in performance (March & Sutton, 1997).

While financial measures of performance are often used to gauge organizational performance, some firms have experienced negative consequences from relying solely on these measures. Traditional financial measures are better at measuring the consequences of yesterday's actions than at projecting tomorrow's performance. Therefore, it is better that managers not rely on one set of measures to provide a clear performance target. Many firms still rely on measures of cost and efficiency, when at times such indicators as time, quality, and service would be more appropriate measures. To be effective, performance yardsticks should continuously evolve in order to properly assess performance and focus resources on continuous improvement and motivating personnel. In order to incorporate various types of performance measures some firm's develop performance measurement frameworks

The most widely used measure in the academic literature, the Jensen Measure, is the intercept from a regression of the excess return (return minus the risk-free rate) of the

managed portfolio on the excess return of a benchmark portfolio. Despite its wide use, this measure has been subject to considerable criticism (Grinblatt, 1993).

2.4 Performance Measurement for Coffee Farmer's Cooperative Societies

Most coffee cooperative societies were not able to generate enough cash flows to meet their obligations and this explains their underperformance measure of the ability to generate sufficient cash flows would be quite significant. Therefore performance measure documented for the research is the Cash Coverage Ratio which simply measures a company's ability to generate cash flows from operations. It is used as a measure of cash flow available from operations available to meet financial obligations (Ross, Westerfield & Jordan, 1998).

An advantage of the cash coverage ratio is that it is a very useful indicator of a company's general financial health and one that can be quickly calculated using the most up-to-date financial data available. The ratio will be calculated by dividing a society's earnings before interest and taxes (EBIT), depreciation added, by the cooperative society's interest expenses for the same period. The lower the ratio, the more the company is burdened by financial obligations. When a company's interest coverage ratio is only 1.5 or lower, its ability to meet interest expenses may be questionable.

The second measure is the return on assets (ROA) which shows how profitable cooperative society assets are in generating revenue. Furthermore it is an indicator of how profitable a farmer's cooperative society is before leverage, and can be compared with farmer's cooperative society in the same industry. However this ratio is easily manipulated as it depends on what to include in revenues and costs but used in conjunction with cash ratio a good analysis can be found.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Research Design

This study will be a survey design as it describes respondents to questions about a phenomena or situation with the aim of understanding perception from which truism is constructed (Ngumo, 2009). This research design means that it would be exploratory in nature where several respondents will be interviewed at one point in time. Macmillan and Sally (2001) contends that descriptive survey techniques are considered the most appropriate businesses and research approaches as they seek to find out factors associated with certain occurrences, outcomes and conditions of behaviors.

The choice of the design and methodology as based on the framework will enable the research to gain an understanding on the impact of corporate governance practices in coffee farmer's cooperative societies. The survey technique is cost effective and allows respondents to remain anonymous.

3.2 Population of the Study

The population of the study will be 20 coffee farmer's cooperative societies as per records of the district cooperative office in Bungoma on 30th July 1996. In order to give a comprehensive picture of corporate governance practice and performance in the coffee farmer's cooperative societies in Bungoma County the research will embark on the census approach.

3.3 Data Collection

The research shall employ both primary and secondary data based on the audited financial statements of the coffee cooperative societies in Bungoma County, on profit after tax and sales turnover. Data for the study covers the 10 year period from 1999 to 2008. The research shall equally embark on the survey technique through the use of

structured and unstructured questionnaires to obtain governance mechanisms data. The number of respondents shall be 90 i.e. 3 from each society; Secretary, Executive director and non-executive director.

3.4 Data Analysis

Performance of the co-operatives was proxied by the cash coverage ratio and return on assets ratio, the dependant variables of the research, against the independent variables, the corporate governance mechanisms. The research will regress the variables using the following model; $Y = \beta 0 + \beta X + E$-- (1)

Where Y is the dependent variable. β0 is constant; β is the coefficient of the independent variable X and E is the error term. This economic model adopted in the study is in line with what has been mostly and successfully used in other literature (Kajola, 2008).The ratios were computed at the end of calendar years 1999,1997,1998,1999,2000,2001,2002,2003,2004,2005,2006,2007 and 2008 . The two variables will be measured as in Table 1a and 1b.

Table 1A: Dependent Variable Definition and Measurement

Variable	Definition	Measurement
CR	Cash coverage ratio	[Earnings Before Interest & Taxes + Depreciation]/Interest
ROA	Return on assets	Net profit as a percentage of total assets

Table 1B: Independent Variable Definition and Measurement

Variable	Definition	Measurement
BSIZE	Board size	Total no. of directors
CEO status	Chief Executive role	Role separate = 0tal directors * 100

		Role separated = 1

The following conceptual and analytical model represented by equation (2) & (3) respectively develops atomically from the economic model (eq 1)

Performance = f (Board Size, CEO status, Board Composition) ----------------------- (2)

$SOCIETYPERF_{ij} = \beta_o + \beta 1 BSIZE + \beta_2 BCOMP + \beta_3 CEO + \varepsilon_{it}$ ------------------------ (3)

Whereby ($SOCIETYPERF_{ij}$) represent performance of the ith cooperative in j^{th} year; and ε_{it} is the error term.

Equation (3) specifies three independent variables; the number of directors serving on the board (Board Size); Board composition signified by the ratio of outside to internal directors (Composition); Chief Executive Officer role (CEO status). The equation was estimated two times; for the cash coverage ratio and ROA. The statistical software, XLSTAT 2010, was used for the analysis of the descriptive results obtained from the regression analysis.

CHAPTER 4: DATA ANALYSIS AND PRESENTATION

4.1 Performance and Governance Measures

The findings presented in Table 2 indicate the average scores of the coffee cooperative societies performance measures and the governance mechanisms for the period 1999-2008.The RoA measure indicated the societies had a 16.18 mean(std Dev. 27.46) return and the cash coverage ratio was about 3.25 times(4.650). As much as some cooperatives performed better in terms of RoA, a number of them over the period performed poorly. The mean number of board size was about 10 (std Dev. 2.78). The average number of non-executive directors serving on the various boards was about 18% (std Dev.11.04) and finally CEO status score was 0.5 (std Dev .548).

Table 2: Average Scores For Performance and Governance Measures (1999-2008)

Descriptive Statistics		
Variable	**Mean**	**Std Dev.**
RoA	16.185	27.406
Cash R	3.254	4.650
BSIZE	9.833	2.787
BCOMP.	18.122	11.048
CEO status	0.500	0.548

4.2 Governance and Performance of the Coffee Farmer's Cooperative Societies

4.2.1 Cash Coverage Measure Approach

The relationship between the society's governance structures and performance was measured by multiple linear regression model specified by equation (3) with the cash coverage ratio as the dependant variables. F-test was performed at 95% to establish the significance of the model which implies a linear significance between the dependent and independent variables. The test was based on the null hypothesis that there exists no linear relationship between Cash Coverage Ratio and the governance mechanisms. The

decision rule was to reject Ho if the P-value was less than 0.05. The findings in Table 3a indicate that there is a significant relationship between Cash Coverage Ratio and Board size; CEO status; and Board composition.

Table 3A: Cash Coverage as a Dependant Variable

(Cash Coverage Ratio)$_{ij}$ = $\alpha_0 + \alpha_1$ (Board Size) $+\alpha_2$ (Board Composition) $+ \alpha_3$ (CEO status) + ε_{ij}

ANOVA					
Source	**Sum Sq.**	**D.F.**	**Mean Sq.**	**F**	**Prob.**
Regression	56.086	3	18.695	0.719	0.626
Residual	52.014	2	26.007		
Total	108.101	5			

Table 3B: Regression Coefficients of Cash Coverage Ratio

Source	**Coefficient**	**Std Error**	**Std Beta**	**-95% C.I.**	**+95% C.I.**	**t**	**Prob.**
α_0	0.078	11.728		-50.383	50.539	0.007	0.995
α_1	0.240	0.920	0.144	-3.717	4.196	0.261	0.819
α_2	-0.163	0.271	-0.386	-1.331	1.005	-0.599	0.610
α_3	7.532	5.178	0.887	-14.745	29.809	1.455	0.283

Findings in table 3b indicates that regression coefficients for the board size (α_1) and CEO status (α_3) were positive indicating a direct relationship while the one for board composition indicated a negative relationship. The analysis indicates that Cash Coverage ratio, measure of performance, was negatively affected by board composition of the farmers co-operative societies for the period 1999-2008.The only non-executives members of the board were only two serving the whole county; two government ministry officials.

4.2.2 The RoA Measure Approach

The relationship between the societies governance structures and performance was measured by multiple linear regression model specified by equation (3) with the RoA as the dependant variable. F-test was performed at 95% to establish the significance of the model which implies a linear significance between the dependent and independent variables. The test was based on the null hypothesis that there exists no linear relationship between RoA and the governance mechanisms. The decision rule was to reject Ho if the P-value was less than 0.05. The findings in Table 4a indicate that there is a significant relationship between RoA and Board size; CEO status; and Board composition.

Table 4A: RoA as the Dependant Variable

$(ROA)_{ij} = \alpha_0 + \alpha_1$ (Board Size) $+ \alpha_2$ (Board Composition) $+ \alpha_3$ (CEO status) $+ \varepsilon_{ij}$

ANOVA					
Source	**Sum Sq.**	**D.F.**	**Mean Sq.**	**F**	**P-value**
Regression	2723.598	3	907.866	1.760	0.001
Residual	1031.877	2	515.939		
Total	3755.476	5			

Table 4B: Regression Coefficients of RoA

Source	Coefficient	Std Error	Std Beta	-95% C.I.	+95% C.I.	t	Prob.
α_0	7.818	52.236		-216.935	232.571	0.150	0.895
α_1	-0.463	4.096	-0.047	-18.085	17.158	-0.113	0.920
α_2	-0.613	1.209	-0.247	-5.816	4.590	-0.507	0.662
α_3	48.075	23.061	0.961	-51.148	147.298	2.085	0.172

Findings in table 4b indicates that regression coefficients for the for board size (α_1) and board composition (α_2) were negative indicating an inverse relationship while the one

for CEO status (α_3) indicated a positive relationship. This analysis indicates that ROA depended on board size limit. Societies with a board size larger than the study index size had the least ROA.

4.3 Relationship of Performance & Governance Variables

The analysis in Table 5 shows that there was a positive correlation between Cash Coverage measure and board composition; CEO status and board size. RoA had a positive correlation with board composition and CEO status; however the correlation was negative with board size. However measure was positively correlated with both board size and the status of the Secretary-Manager/CEO. Still board size showed a negative relationship with the performance.

Table 5: Correlation Co-efficient

	ROA	BSIZE	BCOMP	CEO status
ROA	1.000	-0.251	0.341	0.830
BSIZE	-0.251	1.000	-0.449	-0.328
BCOMP	0.341	-0.449	1.000	0.590
CEO status	0.830	-0.328	0.590	1.000

	Cash R	BCOMP	CEO status	BSIZE
Cash R	1.000	0.073	0.612	0.027
BCOMP	0.073	1.000	0.590	-0.449
CEO status	0.612	0.590	1.000	-0.328
BSIZE	0.027	-0.449	-0.328	1.000

4.4 Survey Results

The survey targeted 90 respondents, 3 from each society and Table 6a and Table 6b the following table gives a summary of the findings;.

4.4.1 Challenges of Corporate Governance Practice

Results in Table 6a were obtained from 20 respondents who were serving as Executive Directors for each of the cooperative society under investigation. Most respondents were

in agreement that wrangles, controls, resources and ways of recruitment were the challenges facing corporate governance practice.

Table 6A: Corporate Governance Challenges

Challenge	Strongly Agree Respondents No.	Agree Respondents No	Not Sure Respondents No	Disagree Respondents No	Strongly Disagree Respondents No	Total
(i) Political interference	0	10	0	5	0	**20**
(ii) Wrangles & litigations	15	10	0	5	0	**20**
(iii) Lack of adequate controls	15	10	0	5	0	**20**
(iv) Salaries for the staff are not competitive	15	10	0	5	0	**20**
(v) Unprofessional process of recruitment	15	10	0	5	0	**20**
(vi)Inadequacy of resources	15	10	0	5	0	**20**
MEAN	15	10	0	5	0	**20**

4.4.2 Corporate Governance & Agency Conflict

Table 6b presents responses from the 20 Secretaries of the board of the cooperatives societies under investigation. The results show that most of the fairly agreed that seperation of the roles of the CEO and Board chair could mitigate the agency conflict. The results are in agreement with most empirical studies.

Table 6B: Corporate Governance & Agency Conflict

Corporate Governance Practice	1	2	3	4	5	Total
(i) Separation of roles of Board Chair & MD	0	15	4	1	-	**20**
(ii) Appointment of non-executive directors	2	12	5	1	-	**20**
(iii) Board Size limit	14	6	-	-	-	**20**

Key: **1**- Strongly Agree; **2**- Agree; **3**- Not Sure; **4**-Diasgree; **5**- Strongly Disagree

4.4.3 Board Members Duty

Table 6c shows the survey results administered on all the 60 respondents, 3 from each society that evaluated board members understanding of their duty. The survey results in Table 6c indicated that most of the board members duly understood their duty towards acting in due diligence to ensure the cooperatives met their obligations

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Table 6C: Board Members Understanding of Duty & Obligations

	No. of Responses
All board members	0
Most of the board members	45
Only some	10
None were aware	5
Total	**60**

4.4.4 Board Composition Skills

Table 6d shows the survey results skills of the board members of the 20 respodents, one from each society (non- executive director). The non-executive directors were only two each acting as ex-officio members of the Board. The official from the ministry of cooperative development was trained in matters of marketing and financial reporting but due to the work overload under him, the research found out that the impact of the non-executive director on the board was not significant.

Table 6D: Experience skills of Board Members

	1	2	3	4	5	TOTAL
Finance & Accounting	-	2	-	-	-	2
Human Resource	1	1	-	-	-	2
Marketing	-	-	2	-	-	2

Key: 1- Very Adequate; 2- Adequate; 3- Not Adequate; 4- Very Inadequate; 5-Not Relevant

CHAPTER 5: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Discussion of Findings

The study investigated the application of the corporate governance framework to farmer's cooperative societies in Bungoma County. The broad objective of the study was to determine the relationship between various components of corporate governance and performance of coffee farmer's cooperative society in Bungoma County .The study was guided by the following specific objectives ; To establish the relationship the between board size, board composition and Chief Executive Officer (CEO) status on performance of coffee farmer's co-operative societies in Bungoma County between 1999 and 2008; To determine the role of the corporate officials in Bungoma County between 1999 and 2008; To establish the challenges faced by the coffee farmer's cooperative societies in practicing of good corporate governance. in Bungoma County between 1999 and 2008.

Results from the all the societies investigated showed a correlation between performance and the governance mechanisms. On Board composition there were only two ex-officials who acted as non-executive directors that sat on board meetings to deliberate decisions. One was the co-operative officer representing the ministry at the county and the other was an official from the ministry of agriculture. Notably the ex-officials were not full time employees and were constrained to serve on all the boards. Most societies had a board size of 7 and 8 comprising of farmers representing the geographical coffee production regions. The survey showed that most of the directors somehow did not understand their duty towards creating value for the farmers they represented. The results revealed that the role separation of the office of the CEO and Chairman significantly had the most impact on performance. The findings indicate that the average cash coverage ratio was 12 times while the lowest was below zero. The average score was 3.14 and the results revealed that there was a deviation of 10.6. By this was the most important

measure of performance for the study determining the ability of the cooperatives to generate cash to meet their obligations.

5.2 Conclusions

5.2.1 Corporate Governance and Performance

The findings indicate that the co-operative societies that had clearly separation of the roles of the board chair and CEO, showed improved performance. However board composition did not significantly show improved performance. The non-executive directors were not independent since they both came from the government side being ex-officials from the ministry of cooperative development and ministry of agriculture. But generally the research has found that corporate governance compliance enhances performance. The study findings are in agreement to previous empirical studies for firms in the mainstream industry (Lang'at, 2006; Mululu, 2005; and Mwangi, 2003).

5.2.2 Corporate Governance & Agency Conflict

The data results showed that cooperatives had that did attempt to separate the role of the chairman from that of the manager- secretary standing in as the CEO, performed better during the period. The secretary-manager was responsible to the board in implementing resolutions and in charge of the day to day business activities. The agency costs were significant in cooperatives that did not attempt to structure the offices of the chairman and the secretary-manager. The survey also indicated that separation of roles of Board chair & CEO, appointment of non-executive directors and board size limit mitigates the agency conflict. Therefore corporate governance practice mitigates the agency conflict.

5.2.3 Corporate Governance Practice Challenges

The survey findings indicated that a majority of the respondents regardless of their education levels and period of experience strongly agreed to the challenges in corporate governance practice being political interference, wrangles and litigations; lack of

adequate controls; lack of a mixed of skills of individuals on the board and lack of access to financial resources. The research also did indicate that a number of board members were not aware of their duty towards creating value for the cooperative as a whole and this was a challenge too.

5.3 Recommendations

5.3.1 Management of the Coffee Cooperative Societies

The value of the cooperatives will be enhanced only if they comply with the corporate governance principles on board size limit, CEO status and board composition. Infact investors like capital providers, banks, are willing to do business with cooperatives that have complied with corporate governance principles. The cooperatives would also benefit by being offered fewer debt covenants and lower interest rates. The research further recommends for the establishment of farmers cooperative societies code of best practice based on the governance formulated in the study.

5.3.2 Suggestion for Further Research

The research suggests that further investigation on the interrelationships between the variables themselves and performance of the coffee cooperative societies. The research should further be extended to performance and frequency of board meetings and directors compensation

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APPENDIX I: Questionnaires for Board Secretary

Dear respondent as part of my requirements to the award of the Masters Degree in Business Administration of the University of Nairobi, am administering this questionnaire to collect information on **"Corporate governance practices in coffee farmer's cooperative societies in Bungoma County"** The data obtained for this research is only for the achievement of the study objectives. Therefore your co-operation in answering the questionnaires will be highly appreciated and follow the following instructions; (i) do not t write your name on the questionnaire (ii) If not sure of about a question feel free to ask for clarifications but the research has made questions simple to understand, (iii) Thank you in advance for your time and effort in answering this questionnaire (iv) Tick where applicable

Age; ---

Gender: □ Male □ Female

Co-operative Society ;---

No. of terms served in the cooperative society ; [A] Two [B] three [C] four [D] less than two

Educational level; (A) Primary (B) O' Level (C) A' level (D) Graduate

(a) Do you believe that the Board members understand their duty towards acting with due diligence to ensure the cooperative meets its obligations;

[A] All Board members aware

[B] Most of the Board members are aware

[C] Only some Board members aware

[D] None are aware

(b)Are you in agreement that the following corporate governance practices could mitigate the agency conflict amongst the cooperative officials?

1- Strongly agree **2**- agree **3**- not sure **4**-diasgree **5**- strongly disagree

Corporate governance practice	**1**	**2**	**3**	**4**	**5**
(i) Separation of roles of Board Chair & MD					
(ii) Appointment of non-executive directors					
(iii) Board Size limit					

APPENDIX II: Questionnaires for Executive Director

Dear respondent as part of my requirements to the award of the Masters Degree in Business Administration of the University of Nairobi, am administering this questionnaire to collect information on **"Corporate governance practices in coffee farmer's cooperative societies in Bungoma County"** The data obtained for this research is only for the achievement of the study objectives. Therefore your co-operation in answering the questionnaires will be highly appreciated.

Instructions; (i) do not write your name on the questionnaire (ii) If not sure of about a question feel free to ask for clarifications but the research has made questions simple to understand (iii) Thank you in advance for your time and effort in answering this questionnaire (iv) Tick where applicable

Personal Data;

Age; ---

Gender: □ Male □ Female

Co-operative Society; ---

No. of terms served in the cooperative society ; [A] Two [B] three [C] four [D] less than two

Educational level; (A) Primary (B) O' Level (C) A' level (D) Graduate

(a) Are you in agreement that the following have been the governance challenges facing the co-operative society?

1- Strongly agree **2**- agree **3**- not sure **4**-diasgree **5**- strongly disagree

Problem	**1**	**2**	**3**	**4**	**5**
(i) Political interference					
(ii) Wrangles & litigations					
(iii) Lack of adequate controls					
(iv) Salaries for the staff are not competitive					
(v) Unprofessional process of recruitment					
(vi) Inadequacy of resources					

(b) Do you believe that the Board members understand their duty towards acting with due diligence to ensure the cooperative meets its obligations;

[A] All Board members aware

[B] Most of the Board members are aware

[C] Only some Board members aware

[D] None are aware

APPENDIX III: Questionnaires for non-executive Director

Dear respondent as part of my requirements to the award of the Masters Degree in Business Administration of the University of Nairobi, am administering this questionnaire to collect information on **"Corporate governance practices in coffee farmer's cooperative societies in Bungoma County"** The data obtained for this research is only for the achievement of the study objectives. Therefore your co-operation in answering the questionnaires will be highly appreciated.

Instructions;

(i) Do not write your name on the questionnaire

(ii) If not sure of about a question feel free to ask for clarifications but the research has made questions simple to understand,

(iii) Thank you in advance for your time and effort in answering this questionnaire.

(iv) Tick where applicable

<u>Personal Data:</u>

Age; ---

Gender: □ Male □ Female

Co-operative Society; --

No. of terms served in the cooperative society ; [A] Two [B] three [C] four [D] less than two

Educational level; (A) Primary (B) O' Level (C) A' level (D) Graduate

(a) How do you describe your experience skills on the Board, as a group in each of the following areas;

1- Very adequate **2-** adequate **3-** not adequate **4-** very inadequate **5**-not relevant

skill	1	2	3	4	5
Finance & Accounting					
Human Resource					
Marketing					

(b) Do you believe that the Board members understand their duty towards acting with due diligence to ensure the cooperative meets its obligations;

[A] All Board members aware

[B] Most of the Board members are aware

[C] Only some Board members aware

[D] None are aware

APPENDIX IV: List of Coffee Cooperative Societies in Bungoma County

1	Makhanga
2	Khalaba
3	Chepkube
4	Khamulati
5	Mabanga
6	Sang'alo
7	Kamukuywa
8	Cheptais
9	Kabisi
10	Sirisia
11	Kabuyefwe
12	Naitiri-Lungai
13	Khachonge
14	Kaptola
15	Kamusinde
16	Sichei
17	Kituni
18	kiminini
19	Chwele
20	Lukusi

Source: District Cooperative office, Bungoma

APPENDIX V: Data Collection Sheets

Year--

No	Name of the Coffee Farmer's cooperative Society(	EBI T	Depreciation	Interest	Total asset
1	Makhanga				
2	Khalaba				
3	Chepkube				
4	Khamulati				
5	Mabanga				
6	Sang'alo				
7	Kamukuywa				
8	Cheptais				
9	Kabisi				
10	Sirisia				
11	Kabuyefwe				
12	Naitiri-Lungai				
13	Khachonge				
14	Kaptola				
15	Kamusinde				
16	Sichei				
17	Kituni				
18	kiminini				
19	Chwele				
20	Lukusi				

No	Name of the Coffee Farmer's cooperative Society	No. of executive directors	No. of independent directors	CEO status	Size of the Board	Corporate governance index score
1	Makhanga					
2	Khalaba					
3	Chepkube					
4	Khamulati					
5	Mabanga					
6	Sang'alo					
7	Kamukuywa					
8	Cheptais					
9	Kabisi					
10	Sirisia					
11	Kabuyefwe					
12	Naitiri-Lungai					
13	Khachonge					
14	Kaptola					
15	Kamusinde					
16	Sichei					
17	Kituni					
18	kiminini					
19	Chwele					
20	Lukusi					

APPENDIX VI: Corporate Governance Index Score

Mechanism	Measure	Score
Board size	Max of 5	1
	More than 5	0
CEO status	Separate role = 1	1
	Not separated = 0	0
Board composition	Independent < 30%	0
	30%-60% independent	1
Total score for good corporate governance		3

Source: The Capital Markets Act, Kenya Gazette notice no.3362

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Date 11th October 2010

TO WHOM IT MAY CONCERN

The bearer of this letter... Mr. DAVID NANDASABA MUSUYA

REGISTRATION NO: D61/9055/2006

The above named student is in the Master of Business Administration degree program. As part of requirements for the course, he is expected to carry out a study on **Corporate Governance Practices and Performance of Coffee Farmers' Cooperative Societies in Bungoma County**

He has identified your organization for that purpose. This is to kindly request your assistance to enable him complete the study.

The exercise is strictly for academic purposes and a copy of the final paper will be availed to your organization on request.

Your assistance will be greatly appreciated.

Thanking you in advance.

THE COORDINATOR
UNIVERSITY OF NAIROBI
SCHOOL OF BUSINESS
KISUMU CAMPUS
P.O.Box 825 - KISUMU.

Sincerely,

MR. ALEX JALEHA
COORDINATOR, SCHOOL OF BUSINESS, KISUMU CAMPUS