

**THE RELATIONSHIP BETWEEN CORPORATE GOVERNANCE AND
FINANCIAL PERFORMANCE:
A STUDY OF INSURANCE FIRMS IN KENYA**

**SUBMITTED BY;
OPANGA BENARD OPANGA
D61/62892/2011**

**A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILMENT OF THE
REQUIREMENTS FOR THE AWARD OF DEGREE IN MASTER OF BUSINESS
ADMINISTRATION, UNIVERSITY OF NAIROBI
SCHOOL OF BUSINESS**

NOVEMBER, 2013

DECLARATION

I hereby declare that this research project is my original work and has not been submitted for a degree in any other learning institution

Signed:

Date:

BENARD OPANGA OPANGA

D61/62892/2011

The research has been submitted for examination with my approval as the university supervisor

Signed:

Date:

Dr. Josiah Aduda

DEDICATION

To my Mother Veronicah Mosinya and Grandmother Teresia Opanga who continue to inspire me throughout my work.

ACKNOWLEDGEMENT

I am thankful to all colleagues and friends who supported me throughout. I am highly indebted to different insurance companies and friends who work in these insurance companies for their facilitation in getting the data I used in this research. I also owe my sincere gratitude to all individuals who assisted and supported me directly or indirectly during the entire period I worked in this research including my dear parents, brothers and sisters.

Secondly, I am very grateful to my advisor and supervisor Dr. Josiah Aduda and my research moderator Mr. Mirie Mwangi for their invaluable input, support, patience, encouragement, and guidance in conducting, presenting and successfully completing my research work. Thank you for taking your time throughout whenever I needed your support. You were available, ready to listen, guide and provide me with a limelight from the onset of this research till completion. I also extend my gratitude to the University of Nairobi, more so, the School of Business for providing a conducive environment with adequate resources from which I got reference materials which were vital in making this research a success from the start to the end.

Lastly, I am thankful to the Almighty God for giving me good health, sound mind, strength, blessings and an insight to pursue and complete the degree of Master in Business Administration. Finally to all those whom I may not have specifically mentioned but contributed their resources in different forms to make this research a success. Thank you.

TABLE OF CONTENT

DECLARATION.....	ii
DEDICATION.....	iii
ACKNOWLEDGEMENTS	iv
ABSTRACT.....	ix
ABBREVIATIONS	x
CHAPTER ONE:INTRODUCTION	1
1.1 Background to the Study.....	1
Financial Performance	5
1.1.2 Insurance Companies in Kenya	6
1.1.3 Corporate Governance and Financial Performance	7
1.2 Statement of the problem	8
1.3 Objectives of the Study.....	9
1.4 Significance of the study.....	9
CHAPTER TWO:LITERATURE REVIEW.....	11
2.1 Introduction.....	11
2.2. Theoretical Review	11
2.2.1 Agency Theory.....	11
2.2.2 Stewardship Theory	13
2.2.3. Resource Dependency Theory	14
2.3 Empirical Studies	15
2.5 Conclusion	20

CHAPTER THREE: RESEARCH METHODOLOGY	21
3.1 Introduction.....	21
3.2 Research Design.....	21
3.3 Population and Sample Design	22
3.4 Data Collection	22
3.5 Data Analysis and presentation.....	22
3.6 Data Validity and Reliability	25
CHAPTER FOUR:DATA ANALYSIS AND PRESENTATION OF FINDINGS	26
4.1. Introduction.....	26
4.2. Data Presentation	26
4.3 Summary and Interpretation of Findings	29
4.3.1Regression Analysis.....	29
4.4 Discussion.....	32
CHAPTER FIVE:SUMMARY, CONCLUSION AND RECOMMENDATIONS	34
5.1. Introduction.....	34
5.2. Summary of Findings.....	34
5.3. Conclusions.....	35
5.4. Policy recommendations.....	36
5.5. Limitations to the study	37
5.6. Suggestions for further studies.....	38
REFERENCES.....	40
APPENDICES	45

LIST OF FIGURES

Figure 4.2.5 Number of Resolutions.....	29
Figure 4.2.2 Board Committees	27
Figure 4.2.3 Board Meeting Frequency	28
Figure 4.2.4 Number of Directors.....	28
Figure 4.2.1 Financial Performance.....	26

LIST OF TABLES

Table 4.17 Model Summary	30
Table 4.18 ANOVA Results	30
Table 4.19 Coefficients Results	31

ABSTRACT

The aim of the research was to find out the nature of relationship between corporate governance and financial performance of registered insurance companies in Kenya. The study aimed at establishing how the number of directors, number of resolutions passed in general meetings, number of committees and the frequency of holding meetings affect the insurance firms' financial performance in Kenya. The research design used was a cross-sectional survey of insurance companies licensed in Kenya and this design is one of the correlation designs used to establish the relationship between two or more variables. In this study, there was one dependent variable namely firm performance and four independent variables namely board size, number of resolutions passed in the AGM, frequency of holding meetings in a year and number of committees. The population of interest was all the 45 insurance firms listed in Kenya during the period of 2010-2012 but the study covered 80% of the population target and data was analyzed using the SPSS statistical package.

The study established that the number of board committees, board meeting frequency, number of resolutions passed in an AGM and number of board of directors all are positively correlated with financial performance. The number of board committees caused the greatest change of 0.577 followed by board meeting frequency by 0.157 while number of directors and resolutions passed caused the least changes of 0.082 and 0.021 respectively. In conclusion each of the independent variable studied plays a key role in the financial performance of insurance firms in Kenya.

The study recommends that because the elements of corporate governance practices studied contribute positively to the financial performance of insurance companies, they should be embraced by all insurance firms in Kenya. The study suggests further studies to be conducted on other elements of corporate governance and their influence on financial performance. Further studies should also be conducted on other factors that may influence financial performance of insurance firms apart from corporate governance and other ways of measuring financial performance in order to find out if the outcomes will be identical with that of this study.

ABBREVIATIONS

AKI	Association of Kenyan Assurers.
BOD	Board of Directors.
CCG	Centre for Corporate Governance.
CIPE	Centre for International Private Enterprise.
CEO	Chief Executive Officer.
CMA	Capital Market Authority.
EV	Enterprise Value.
EAT	Earnings after tax
IRA	Insurance Regulatory Authority.
OECD	Organization for Economic Co-operation and Development.
ROE	Return On Equity.
ROA	Return On Assets.

CHAPTER ONE

INTRODUCTION

1.1 Background to the Study

Julia (1998) defines corporate governance as the composition of general meeting, board of directors, board meeting, independency meeting frequency election and composition of the board. The BOD is set up to monitor managers such as the CEO on behalf of the shareholders with common objectives in mind of increasing shareholder value and profitability. Shuk (1998) affirms that presence of corporate governance as a way to improve board efficiency in order to reduce principal-agency conflicts while other researchers argue that it may lead to bureaucracy and increase in operational costs. Increase in agency problems may lead to poor firm performance hence decrease in firm value in the long run. While a large body of literature relates board size, board composition and ownership structure to the efficacy of management decisions and their impact on performance, there is less literature on general meeting, frequency of holding meeting, members of the board and director's attendance in meetings and their effect on firm value on insurance firms listed at NSE in Kenya has not received as much attention in the literature even though there is a growing interest to practitioners, academics and shareholders in this area. Good operational corporate governance is expected to increase the value of the firm.

According to OECD (2004), corporate governance is one key element in improving economic efficiency and growth as well as enhancing investor confidence. It further defines corporate governance as a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders and should facilitate effective monitoring. The presence of an effective corporate governance system, within an individual company and across an economy as a whole, helps to provide a degree of confidence that is necessary for the proper functioning of a market economy. As a result,

the cost of capital is lower and firms are encouraged to use resources more efficiently, thereby underpinning growth and increasing growth. This coincides with CIPE (2009) which emphasizes that corporate governance contributes to the sustainable development prospects of countries, increased economic sustainability of nations and institutional reforms that come with it provide the necessary basis for improved governance in the public and private sector. Alternatively, corporate governance failures can undermine development efforts by misallocating much needed capital and resources and developmental fallbacks can reinforce weak governance in the private sector and undermine job and wealth creation.

The Capital Market Authority (CMA) reaffirms that corporate governance as being one of the mechanisms of corporate governance practices that should aim at directing and managing the business affairs of a company towards enhancing prosperity and corporate accounting with the ultimate objective of realizing long-term value while taking into account the interest of other stakeholders. According to the business dictionary, the framework of rules and practices are set by the board of directors and these ensure accountability, fairness and transparency in a company's relationship with all its stakeholders. It further explains that its framework consist of; explicit and implicit contracts between the company and the stakeholders for distribution of responsibilities, rights and rewards; procedures for reconciling the sometimes conflicting interests of stakeholders in accordance with their duties, privileges and roles; procedures for proper supervision, control and information flows to serve as a system of checks and balances.

The topic of corporate governance and its components has remained critical for academic researchers and policy makers for the last few decades especially in the context of firm's value. Various factors influence the structure of corporate governance but regardless of the structure, it is assumed to increase the value of the firm; CEO duality, board composition, size of board of directors and ownership structure like controlling shareholders, managerial and institutional shareholders etc. However, the current study mainly focuses on the components of corporate governance. Firm value is one of the most important areas in corporate finance that can affect the whole operations of a firm.

It means the gain shareholders get which can be measured in share value in the long run (capital gain) and short term gain measured by gains made by each share yearly (dividends). This study focuses on the long term gain. Previous studies mainly focus to explore the relationship between corporate governance and performance mostly in emerging economies like Kenya while their counterparts in developed countries have explored the components of corporate governance statement and firm value and performance. Listed firms must show the corporate governance statement and its elements while other firms' especially private ones may not necessarily publish theirs because of little or no control by the securities market.

The top two leadership roles in the American corporation are the chief executive officer and the chairperson of the board of directors and there is a large body of literature that examines the impact of the CEO's compensation and stock ownership on the company's performance. *Thuy-Nga T. (2010)*. Less attention has been given to the governance structure in which corporate governance is mandatory to be prepared and published annually especially for listed insurance firms in Kenya and its effect on firm value. The pervasiveness of corporate governance in Kenya underlies the importance of understanding this leadership structure and its impact on corporate performance. This study analyzes the impact of corporate governance elements on firm value in Kenyan insurance firms listed at NSE in order to establish whether there is a relationship and if any, the nature of the relationship will be established. Corporate governance structure with a non-executive chair, instead of a dual CEO-chair, is better suited to the fulfillment of the directors' fundamental responsibilities to oversee business operations and monitor management for the purpose of enhancing shareholder value.

The New York Times (1992) reported that 75% to 80% of U.S. firms have implemented corporate governance practices. Corporate scandals, such as Enron and WorldCom, and the 2001 recession raised the alarm for more board vigilance and decentralization of power and led to the enactment of Sarbanes-Oxley Act in the year 2002. Critics of corporate governance argue that some structures compromise board effectiveness in monitoring the board members. They affirm that some corporate governance

structures are more likely to pursue selfish interests that are inconsistent with shareholders' values. Proponents of corporate governance assert that different structures provide directional clarity and judgment that is lacking within an independent leadership structure and entrepreneurship in ventures that can increase firm value because the board's decisions are consistently monitored due to the implementation of corporate governance practices.

From the foregoing analysis, it can be argued that corporate governance is represented by structures and processes which are laid down by a corporate entity to minimize the extent of agency problems as a result of separation between ownership and control. World Bank (1999) stated that board members are governed by external and internal corporate governance mechanisms with the corporate governance taking a dominant stage. The difference between them is that internal mechanisms are able to supervise managers directly. Internal corporate mechanism includes the rights of shareholders, participation in decision making, independent character of the board of directors and supervisors while external governance is related to laws and stakeholders of the organization. However the main purpose of the study is to explore the relationship between frequency of holding meetings, number of resolutions, state of ownership, change of CEO, board of directors i.e. number and composition, number of committees and the firm value. Therefore firm size, firm age, business environment and prior performance will be assumed to remain constant.

In our Kenyan context, there is little information on studies done to establish the relationship between key elements of corporate governance and firm performance of insurance firms in Kenya. A study by CCG 2004 found that there was very minimal disclosure and financial reporting in the insurance industry. According to CIPE, good corporate governance practices contributes to the sustainable development prospects of countries, increased economic sustainability of nations and institutional reforms that come with it provide necessary basis for improved governance in the public and private sector. The findings from the study by CCG of insurance companies such as Standard Assurance Company and the United insurance company shows the need to establish

corporate governance structures and practices in the insurance industry that will guarantee improved performance and eventually higher value. Companies such as WorldCom and Enron have taught the public that corporations do not always act in the best interests of their shareholders.

Insurance market in Kenya is a very crucial sector in the economy principally because it enables policyholders to transfer and manage their risks. The insurance industry plays an important role in the financial system by indemnifying financial risk in the economy. The sector players also serve as institutional investors for both capital and money market instruments. An insurance policy is a legal document that defines circumstances in which the claim amount must be paid to the insured given that proper care has been taken by the insured to avoid losses that have been incurred. The insurance industry in Kenya, like other developing countries, is characterized by very low penetration rate due to low disposable income and other economic factors. There are 45 registered insurance companies in Kenya as per IRA December 2012, six of them listed at NSE which represents 13.3%

1.1.1 Financial Performance

Financial performance can be termed as a subjective measure of how well a firm can use assets from its primary mode of business and generate revenues. It is also referred to the 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. Financial performance can be measured using proxies like profitability, return on equity, liquidity, solvency and sales growth and all these can be extracted from the financial statements (Levasseur, 2002). Information on financial performance is useful in predicting the capacity of the enterprise hence analyzing how well or poorly an enterprise is doing against its set objectives, the same observation regarding the measurement of financial performance is made by (Avkira, 1995) when he states that generally financial performance of business organizations can be measured using a combination of financial ratios analysis, benchmarking, measuring performance against budget or a mix of these methodologies.

Financial performance improvement is a key target for all businesses irrespective of their size (large, medium or small), type (listed or not listed) or sector (private or public). This is why companies always do try to remain competitive by improving their products or services thus reducing production costs and investing in new manufacturing technologies (Trai, 2005)

1.1.2 Insurance Companies in Kenya

Insurance in Kenya is known to have been in existence for over sixty years now with the first insurance companies believed to have been owned by British insurers during the colonial times. The industry is governed by the Insurance Act and regulated by the Insurance Regulatory Authority (IRA). The Insurance Regulatory Authority (IRA) was created by the Insurance (Amendment) Act of 2006 and came into operation on 1st May 2007 but the insurance industry is not as much developed as financial institutions like banks.

The Authority was established with the mandate of regulating, supervising and developing the insurance industry. Before the establishment of IRA, these functions were performed by the Department of Insurance in the Ministry of Finance. Association of Kenyan Insurers (AKI) was set in 1987 as an advisory body for insurance companies in Kenya. According to the IRA Insurance Report for the year 2012, there were 45 licensed insurance companies, majority offering life and non-life insurance policies. There were 148 licensed insurance brokers, 4084 insurance agents. Other licensed players included 126 investigators, 78 motor assessors, and 18 loss adjusters, 2 claims settling agents, 11 risk managers and 26 insurance surveyors. The industry's contribution to the country's GDP is still low although there has been notable growth for the last 9 years. The gross written premium by the industry was Kshs55.03 billion compared to Kshs44.48 billion in 2011, representing a growth of 23.7 % (IRA Report, 2012)

1.1.3 Corporate Governance and Financial Performance

Good corporate governance practices can improve firms' stock returns in the long run and this can translate into a higher financial performance. Each element of the corporate governance statement e.g. board size, non -directorships, insider holding, board meeting frequency, number of resolutions passed in every meeting, presence of the chair in the meeting, rate of changing the CEO and composition of the board is assumed to increase the financial performance of a firm.

CEOs have a sole obligation of making decisions which can affect the firm they control positively or negatively in relation to its financial performance. They are given all the rights to work in the best interests of the shareholders who have committed their funds in the business and the main objective is to maximize shareholders wealth. Investors believe that their interests are more likely to be protected by founder controlled firms than non-founder controlled firms (Lijun, 2008) and this is likely to safeguard their value hence improve the financial performance.

Corporate governance is expected to lead to increased financial performance of firms than those which do not practice it or vice versa (Hafiza & Susela, 2008). Absence of corporate governance practices may hinder board's ability to monitor management and thereby increase the agency cost (Fama & Jensen, 1983) and (Jensen, 1993). But Stoeberl and Anthony (1986) asserts that implementing corporate governance will provide clear-cut leadership strategy in leadership strategy formulation and implementation and will therefore lead to better performance. Poor implementation may create information sharing costs, conflicts between CEO and other board members hence inefficiency of the board; it will be costly to communicate the firm's specific information to others in a timely manner; decision making process and execution may both be less efficient; it may be more difficult to assign blame for bad company value, Kim K-H, et al, (2008)

1.2 Statement of the problem

There is increased debate whether corporate governance statement should be included in the financial statements of insurance firms. This is important because its main elements like board composition, board committees, frequency of holding meetings and resolutions discussed in the general meetings can influence the financial performance either directly or indirectly. In case there is an element in the statement which affects the firm performance negatively, then there is no need of it to be included in the statement while those elements which add value to the shareholders by increasing its financial performance, there is need to facilitate full implementation and need for regular monitoring thus the basis of this study is to establish the relationship between each element in the corporate governance statement and financial performance for insurance firms in Kenya. The United Nations Conference on Trade and Development (2003) concluded that insurance industry in Kenya which is regulated by a department of government, IRA has not made much progress in enhancing the legal and regulatory framework and this can greatly affect the firms' performance.

Mwanzia (2010) concluded that proper governance of public sector organizations in developing countries can result to value addition in form of improved financial performance. This study is aimed at finding out if the major elements of the corporate governance statement have any impact on firm value in specific to insurance companies in Kenya. Wanjiku et al (2011) on their study found that leadership positively influence corporate growth and recommended companies listed in NSE to adopt leadership that would ensure proprietary use of shareholder's equity. The study recommends that further research should be done on the effect of the corporate governance to the company in other areas of the Kenyan public sector thus the focus of this study being Kenyan insurance companies

Ongore et al (2011) and Miringu (2011) concluded that there is a positive relationship between foreign, institutional and diverse ownership forms and firm performance but ownership concentration and government and firm performance was negative. Koriata (2010) did a study on the effects of corporate governance practices on firm value on

listed firms in Kenya and concluded that there is a strong positive correlation between the overall corporate governance index and firm value. One area recommended for further studies is the effects of corporate governance on financial performance for unique firms. This study seeks to address this for the insurance companies listed at NSE in Kenya. Nthama (2010) concluded that board size, shares held by insiders, board composition and number of board meetings positively influence a firm's value while percentage of inside directors negatively correlates with the value of the firm. He proposed a further research on reliance of primary data and ascertainment of what the industry captains as well as the regulators think about prioritization of stakeholders' interest thus this study will focus on insurance industry in Kenya.

Kimosop (2011) did a study on the relationship between corporate governance and financial performance of insurance companies in Kenya. He concluded that there is a significant relationship between board size, non-executive directorships, insider shareholding and board meeting frequency with both ROA and ROE. He suggested further research on corporate governance and other financial performance measures for example firm value hence the basis of this study. The guiding questions are; how corporate governance enhances firm value; is there a relationship between corporate governance elements and firm value. The contribution towards the gap of knowledge is trying to analyze whether there is a predefined way in which the effects of corporate governance affect firm value in the market and if so to what extent does the effects whether good or bad in terms of increase in the firm value or decrease depending on outcome.

1.3 Objectives of the Study

This study aimed at establishing the nature of the relationship between corporate governance and financial performance of insurance firms registered in Kenya. The study was guided by the following specific objectives:

- i. To establish how the frequency of holding meetings affects a firm's financial performance.

- ii. To establish how the number of directors a firm has affects a firm's financial performance.
- iii. To establish how the number of resolutions passed in general meetings affect a firm's financial performance.
- iv. To establish the effect of number of committees a firm has on financial performance of the firm.

1.4 Significance of the study

The study will help employees in understanding the importance of corporate governance elements in order to improve their firm image thus translate into increase in firm financial performance. Most of the firms engage at activities which are aimed at improving the corporate image of the firm and the best person to champion these are employees of the firms.

It will also help corporate managers and policy makers in analysis of the issues of corporate governance within their organization with an aim of improving the image of their organization thus installation of discipline in the management of the firms. Corporate governance is a very critical issue in both the private and public sector and this continue to be an issue of great importance to firms in both short and long run survival of firms will be determined by what they engage in whether questionable or unquestionable thus enhancing transparency.

The study also will benefit the scholars who would wish to undertake further studies aimed at improving corporate governance structures in Kenya. Thus, a major responsibility lies on the shoulders of academicians who are considered as intellectuals in imparting the elements of corporate governance in the minds of young professionals especially exploring other elements of corporate governance on firm performance in other industry players.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

In this chapter both theoretical and empirical literature will be reviewed. Empirical studies on effects of corporate governance on firm performance and theories thereon discussed as they relate to the objective of the study. This section reviews previous studies that have been conducted related to the present study. These subsections review the theory and empirical evidence on the relationship between corporate governance and firm value. The objective of this section is trying to identify the potential gaps on the studies that have been conducted on corporate governance and financial performance as the main variables

2.2. Theoretical Review

2.2.1 Agency Theory

Agency theory having its roots in economic theory was expounded by Alchian and Demsetz (1972) and further developed by Jensen and Meckling (1976). Conflicts arise when a firm's owners perceive that professional managers are not managing the firm in the best interests of the owners and these conflicts can spill over to other stakeholders of the same firm. According to the agency theory, superior information available to professional managers who are given full responsibility to run the firm may enable them act in a manner which will enable them gain more instead of adding value to shareholders and people are self-interested rather than self-sacrificing and cannot be trusted to act in the best interests of others hence they seek to maximize their own utility.

Daily et al (2003) argued that two factors can influence the prominence of agency theory. First, the theory is conceptually and simple that reduces the corporation to two participants of managers and shareholders. Second, agency theory suggests that employees or managers in organizations can be self-seeking. The agency theory shareholders expect the agents to act and make decisions in the principal's interest. Contrary to this, the agent may not necessarily make decisions in the best interests of the principals (Padilla, 2000). Such a problem was first highlighted by Adam Smith in the

18th century and subsequently explored by Ross (1973) and the first detailed description of agency theory was presented by Jensen and Meckling (1976). Indeed, the notion of problems arising from the separation of ownership and control in agency theory has been confirmed by Davis, Schoorman and Donaldson (1997). The principals have three core responsibilities in agency governance namely selecting and putting in place the governors, auditors and ensuring that there is an effective governance system in place which is adhered to by all involved parties.

Separation of ownership and control (Bhimani, 2008). Holmstrom and Milgrom (1994) argued that instead of providing fluctuating incentive payments, the agents will only focus on projects that have a high return and have a fixed wage without any incentive component. This theory proposes that CEO and chair roles should be carried out by two distinct persons. Although this will provide a fair assessment, it does not eradicate or even minimize corporate misconduct. Here, the positivist approach is used where the agents are controlled by principal-made rules, with the aim of maximizing shareholders value. Hence, a more individualistic view is applied in this theory (Clarke, 2004). Indeed, agency theory can be employed to explore the relationship between the ownership and management structure. However, where there is a separation, the agency model can be applied to align the goals of the management with that of the owners.

The model of an employee portrayed in the agency theory is more of a self-interested, individualistic and are bounded rationality where rewards and punishments seem to take priority (Jensen & Meckling, 1976). This theory prescribes that people or employees are held accountable in their tasks and responsibilities. Employees must constitute a good governance structure. Therefore, the agency theory advocates that the purpose of corporate governance is to minimize the potential for managers to act in a manner contrary to the interests of shareholder. Agency theory suggests that corporate governance practices should be well implemented and monitored to facilitate more effective and control of the board as well as the CEO.

2.2.2 Stewardship Theory

The stewardship theory, also known as the stakeholders' theory, adopts a different approach from the agency theory. It starts from the proposition that organizations serve a broader social purpose than just maximizing the wealth of shareholders. This theory holds that corporations are social entities that affect the welfare of many stakeholders where stakeholders are groups or individuals that interact with a firm and that affect or are affected by the achievement of the firm's objectives (Donaldson & Preston, 1995; Freeman, 1984). Successful organizations are judged by their ability to add value for all their stakeholders.

Stewardship theory has its roots from psychology and sociology and is defined by Davis, Schoorman & Donaldson (1997) as "a steward protects and maximizes shareholders wealth through firm performance, because by so doing, the steward's utility functions are maximized". In this perspective, stewards are company executives and managers working for the shareholders. They protect and make profits for the shareholders. Unlike agency theory, stewardship theory stresses not on the perspective of individualism (Donaldson & Davis, 1991), but rather on the role of top management being as stewards, integrating their goals as part of the organization hence advocating for CEO-duality as practices an integral part of corporate governance

The stewardship perspective suggests that stewards are satisfied and motivated when organizational success is attained. Agyris (1973) argues agency theory looks at an employee or people as an economic being, which overwhelms an individual's own aspirations while stewardship theory recognizes the importance of structures that empower the steward and offers maximum autonomy built on trust (Donaldson and Davis, 1991). It stresses on the position of employees or executives to act more autonomously so that the shareholders' returns are maximized. Indeed, this can minimize the costs aimed at monitoring and controlling behaviors (Davis, Schoorman & Donaldson, 1997). Daily et al. (2003) argued that in order to protect their reputations as decision makers in organizations, executives and directors are inclined to operate the firm to maximize financial performance as well as shareholders' profits. In this sense, it is

believed that the firm's performance can directly impact perceptions of their individual performance.

Indeed, Fama (1980) contend that executives and directors are also managing their careers in order to be seen as effective stewards of their organization, whilst, Shleifer and Vishny (1997) insists that managers return finance to investors to establish a good reputation so that that can re-enter the market for future finance. Moreover, stewardship theory suggests unifying the role of corporate governance so as to reduce agency costs and to have greater role of stewards in the organization and better safeguard the interest of the shareholders. Directors can be classified into four categories of insiders, business experts, support specialists and community influencers. First, the insiders are current and former executives of the firm and they provide expertise in specific areas such as finance and law on the firm itself as well as general strategy and direction. Second, the business experts are current, former senior executives and directors of other large for-profit firms and they provide expertise on business strategy, decision making and problem solving.

2.2.3. Resource Dependency Theory

Resource dependency theory concentrates on the role of board directors in providing access to resources needed by the firm. Hillman, Canella and Paetzold (2000) contend that resource dependency theory focuses on the role that directors play in providing or securing essential resources to an organization through their linkages to the external environment and how well these resources are utilized for maximum output from the firm. Indeed, Johnson et al, (1996) concurs that resource dependency theorists provide focus on the appointment of representatives of independent organizations as a means for gaining access in resources critical to firm success. It has been argued that the provision of resources enhances organizational functioning, firm's performance and its survival (Daily et al, 2003). In general, directors are resourceful to the firm in terms of providing resources such as information, skills, access to key constituents such as suppliers, buyers, public policy makers, social groups as well as legitimacy.

Directors can be classified into four categories of insiders, business experts, support specialists and community influencers whom provide diversified resources for the better operation of an organization. It means that corporate governance should put mechanisms in place to ensure that resources are well utilized to get maximum output from these resources which can eventually increase firm value.

2.3 Empirical Studies

Majid et al (2012) study on the impact of corporate governance concluded in their 1st hypothesis that there was no meaningful relationship between board size and CEO duality while the 2nd proved a positive relationship between board's independency and CEO duality. It means that the board of directors and all the decisions will be highly acceptable and all members are likely to work for a common interest of the firm they lead. Sajid et al (2012) studied impact of corporate governance on capital structure and concluded that corporate governance is positively correlated with tangibility, risk and size except profitability which proved a negative relationship. Zhang et al (2007) did a study on corporate governance practices and Firm Performance during China's Institutional Transitions covering 403 publicly listed firms. They found a strong support for stewardship theory and relatively little support for agency theory, but also call for a contingency perspective to specify the nature of conditions such as resource scarcity and environmental dynamism under which CEO duality may be especially valuable. Waseem et al (2011) study on the effect of corporate governance on performance of Jordian industrial companies found that there is a significant relationship between DPS, ROA leverage and corporate performance

Noor & Ayoib (2011) found that some of the board mechanisms influence the family companies' performance. The findings explain that family businesses with larger board size, low number of experts and duality leadership lead to higher family companies' performance but Nor et al (2008) found a small percentage of companies (10.3%) where the CEO is also the Chairman of the company. The majority of the sample (89.7%) had separated the role of the two positions among different individuals. Private firms may not really practice corporate governance practices because of the high degree of trust they

may have on their own in relation to value creation and accountability of the value created and because of the small ownership structure characterized in most private firms.

Saleh et al (2005) found that in 2001 nearly 45% of firms analyzed have their CEO-Chairman roles combined. The result in his study shows that significantly more firms comply with the best practice benchmark in 2002 and 2003 compared to 2001. Majid et al (2012) found that there is no non-linear relationship between institutional ownership and firm performance. The findings from the third hypothesis test of the study shows a positive and meaningful relationship between corporate governance and firm performance, which proves the active monitoring hypothesis. Girle (2012) concluded that CEO duality as an element of corporate governance has no impact on the CEO pay. The results also indicate a positive relationship between corporate governance and the performance measures in the model (although not significant) which is consistent with the fundamental premise of stewardship theory. Nganga et al (2003) Corporate Governance in Africa; A survey of publicly listed companies and concluded that Kenya is the best country in East Africa where corporate governance practices have been implemented for investor protection

Deepak Singh (2012) demonstrated that a smaller board, having the CEO acting as the board chairman and with more independent directors is desirable for corporate class funds as far as investors are concerned and the results regarding the impact of corporate governance are consistent with the stewardship theory. Norazian & Radiah (2012) results showed a weak evidence to indicate that companies which adopted good corporate governance practices performed better than others. However, companies with an independent chairman had a significant relationship with firm performance. This showed that having an outsider to monitor the overall performance was crucial to increase shareholders' wealth. The effective monitoring role by an independent chairman would lead to a better performance. Dung (2011) noted that dual position of CEO and Chairman affects positively firm's financial performance and does not affect ROA in Vietnam. This reverse result is explained under the common reality that former top executive also being a Chairman of the Board and also a major shareholders in the equalized companies.

Hence, the Chairman CEO usually become more active in management process, decisions making and hence the firm's financial performance though it is positively related to inequity implying more powerful CEOs have larger inequality in compensation (Allan, 2012)

Ying (1998) concluded that the separation of ownership and control creates conflict of interests between managers and shareholders. Firms with higher agency costs of equity and debt are more likely to have split positions because the needs for splits are higher in these firms while ownership by CEOs and institutional holders and holdings by debt holders are negatively related to split positions. Thuy-NgaT.Vo (2010) concludes that having corporate governance practices in place provides a governance framework that is better suited to the fulfillment of the board's fundamental responsibilities to oversee business operations and monitor management conduct for the purpose of enhancing shareholder value. Firms with corporate governance practices should consider instituting stronger executive mechanisms to compensate for this increase in power.

Obongo et al (2011) examined the interrelations among ownership, board and manager characteristics and firm performance in a sample of 54 firms listed at the NSE. Their conclusion was that there is a significant negative relationship between ownership concentration and firm performance. They suggested the need to diversify shareholding as a way of attracting more skills and competencies among the shareholders that can be tapped to improve firm performance. There is a positive relationship between insider ownership and firm performance because when managers own shares in their company, they become more committed to the organization since they have a stake in the residual income of the firm, and are likely to bear the cost of mismanagement leading to superior performance. Kitetei (2009) examined the effect of corporate governance practices on the financial performance of deposit taking microfinance institutions in Kenya. He found out that 67% of these firms had their CEO and board chairman roles being performed by different persons while only 33% had a dual CEO structure and concluded that those firms with non-dual CEO performed better than those with CEO duality. This research

will assume the same that corporate governance practices can lead to higher firm value since some measures of financial performance can be used to measure firm value.

Ongoro (2011) did a study on a study on the relationship between corporate governance practices and performance of commercial banks in Kenya and found that corporate governance practices have a positive relationship with bank performance and it is assumed to be positively correlated with firm performance for the insurance firms in Kenya which is the intent this study aims to establish. Linner (2009) conducted a research on corporate governance practices and challenges for international non-governmental organizations in Kenya. He found out that with the exception of one, the organizations had a governing body (under different names) in place that is different from the management and whose roles and responsibilities are also distinct from those of the management. He further found that the chair of the board is not the CEO, a fact crucial for the independence of the board (Rosenstein & Wyah, 1990). The importance of the independence of the board is the separation of the chair from the CEO and this was proposed by Adrian Cardbury's report of 1992 (Tricker, 2000). The practice of good corporate governance is determined by the existence of a board. Governance body by going by different names exists and it consists of external directors who are separate from the management and the CEO is not the chair of the board. The roles of the board and that of the management are separate and distinct and each group understands their roles well and this research is to establish if this can result to increase in firm value for insurance firms in Kenya.

Ngumi (2008) study on corporate governance practices in housing finance company in Kenya and established that there exists a clear separation of the role and responsibilities of the chairman and the managing director to ensure balance of power of authority and provide for checks and balances such that no one individual has unfettered powers of decision making. Washe (2010) conducted a research on the relationship between corporate governance practices and financial services of teachers' Sacco in Coast province of Kenya and concluded that there is need to create an independent body responsible for overseeing corporate governance practices separate from management

due to problems like fraud and misappropriation of funds they face. Odera (2010) study on the relationship between corporate governance practices and client base in investment banks in Kenya established that there is no clear correlation between corporate governance practices and the number of clients served by these firms.

Gledson & Getulio (2009) examined which corporate elements predict firm value in Brazil and found a negative association between board dependence and firm value and a significant association between governance and market value. Their results suggest that country characteristics importantly influence which aspects of governance are associated with firm market value, and at which firms that association is found. Wong (2010) affirmed that proper governance of public sector organizations in developing countries can result to value addition on part of their numerous stakeholders. Most of public organizations are following what private organizations are doing in relation to corporate governance in order for them to remain equally competitive and entrepreneurial Miringu (2011). Wanjiku et al (2011) survey of companies listed at NSE found that CEO leadership positively influence corporate growth and recommended that leadership of companies listed at NSE should ensure proprietary use of shareholder's equity. Mang'anyi (2011) study on ownership structure and corporate governance and its effects on performance concluded 60% of all banks practice corporate governance and good corporate governance leads to better bank performance.

Pradesh (2012) did a study on emergency of CEO chair in India concluded that organizations cannot create long term value without having appropriate corporate governance policies in place, as the need of the hour is not only to manage earnings but also to create value. Lemmon & Lins (2001) study on ownership structure, CEO duality and firm value concluded that corporate governance crisis represents a negative shock to the investment opportunities. Firms in these markets raise the incentives of controlling shareholders to impound minority shareholders. Dharmapala & Khanna (2009) found a positive effect on CEO duality enforcement on firm value. This differs with Gupta et al (2009) result who did not find a strong association between the composite CEO duality scores and various measures of firm value. Black et al (2002) and (2009) what corporate

governance elements predict and affect firm value concluded that CEO duality index is positively related to market value. Turanta (2010) studied the effect of corporate governance on the value of firms listed at NSE with CEO chair being one of the key elements. He concluded that there is a strong positive correlation between the CEO duality and firm value. This is in agreement with Nthama (2010) and Kimosop (2011) concluded that board size, shares held by insiders, board composition, number of board meetings positively influence firm's value while percentage of inside directors negatively correlates with performance of the firm.

2.5 Conclusion

This chapter has covered past studies as well as theoretical frameworks on the areas of corporate governance and firm value with the objective of gaining a deeper understanding of the history, evolution, direction and gaps in earlier studies. This chapter has also gone a long way to elaborate on various mechanisms of corporate governance practices and measures of firm value, empirical studies carried out in the area of corporate governance and firm value. Governance structures for different countries may vary due to their diversified cultural values, political ideologies, social and historical circumstances. In this sense, governance for developed countries and developing countries can vary due to the culture and economic contexts of individual country. Moreover, an effective corporate governance cannot be explained by one theory but it is best to combine a variation of theories, addressing not only the social relationships but also emphasize on the rules and legislation and stricter enforcement surrounding good governance practice and going beyond the norms of a mechanical approach towards corporate governance.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This study aims at investigating the correlation between corporate governance practices and firm performance for insurance companies registered in Kenya. This section deals with the research design which will be used to conduct the study, the population of the study and sample size to be used as well as data collection methods and analysis.

3.2 Research Design

The research design to be adopted is a cross-sectional survey of insurance companies licensed in Kenya and this design is one of the correlation designs used to establish the relationship between two or more variables. In this study, there is one dependent variable namely firm performance and four independent variables namely board size, number of resolutions passed in the AGM, frequency of holding meetings in a year and number of board committees. Financial performance will be measured by ROA. Marie (2004), in a cross-sectional study, either the entire population or a subset thereof is selected, and from these individuals, data are collected to help answer research questions of interest. It is called cross-sectional because the information about X's and Y that is gathered represents what is going on at only one point. This research design is applicable because the study will target all the 45 insurance companies duly registered and licensed in Kenya as at 31st December, 2012 and data will be collected for a period of three years each year taken independently between 2009 and 2011. The study's objective is to compare the firm's financial performance with the named corporate governance practices variables of insurance companies in Kenya. This is to find out whether there exist a relationship between the dependent variable financial performance and independent variables of corporate governance practice aforementioned above. Information to help in establishing the financial performance and that which relates to corporate governance will be collected from end year financial statements for the period of three years each year taken independently. Firm value is one of the fundamental metrics used in business valuation, financial modeling, accounting, portfolio analysis, etc.

3.3 Population and Sample Design

The population of interest is all the 45 insurance firms listed in Kenya during the period of 2009-2011. The period chosen will be appropriate because it allowed a 5 year's grace period since the publication of the gazette notice No. 3362 that effectively introduced corporate governance in Kenya and this will allow for availability of data because most of the insurance firms have embraced corporate governance practices as a major requirement of the company Act and IRA.

3.4 Data Collection

The study will utilize only secondary data which will be obtained from published and unpublished materials and media reports. The researcher is to request for annual financial statements from IRA, NSE, AKI, CMA or respective insurance company offices. The financial statements will enable us get information which will facilitate calculation of financial performance ratio and the corporate governance practices like board size, board meeting frequency in a year, number of committees and resolutions passed in the annual general meeting. The secondary data shall provide information on financial statements which will help to analyze financial performance. The main sources of secondary data will include past and immediate income statements, statements of the financial position, cash flow statements, budget records, books, journals on insurance and other publications in relation to insurance industry in Kenya. Secondary data is easily available and this saves on time and the information is standardized though past information is prone to changes in inflation and change in accounting standards.

3.5 Data Analysis and presentation

Analysis of data involves inspecting, cleaning, transforming and modeling data with the aim of highlighting useful information, suggesting conclusions and supporting decision making and all these are done after checking if the information used has common variables regardless of the firm taken. This shall be done through scrutiny so as to minimize the variations due to size, time individual firm has been in operation and level of risk faced by each firm. A multiple regression model of firm performance as the dependent variable versus independent variables of corporate governance

practices e.g. board size, non-executive, board meeting frequency, number of directors and the number of resolutions passed in the AGM. The general equation relating the dependent and independent variables will take the form;

$$Y = a + b_1x_1 + b_2x_2 + b_3x_3 + b_4x_4 + b_5x_5 + b_6x_6 + e, \text{ where}$$

Y = Financial performance, a = the intercept, b₁, b₂, b₃, b₄ and b₅ are constants to be determined for years 1 to 5 while x₁, x₂, x₃, x₄, x₅ and x₆ represents The Y's and x's are the data quantities gathered from the population in question and a and b's are unknown parameters (constants) to be estimated from the data. In this research however, the parameters will have the following definition of expressions.

The model will be $F(\text{PERF}) = A + b_1\text{BCS} + b_2\text{BMF} + b_3\text{NOD} + b_4\text{NOR} + e$, where;

F (PERF) = financial performance

BCS = board committees

BMF = board meeting frequency,

NOD = number of directors

NOR = number of resolutions made in AGM

The error term e is poised to be normally distributed. The regression coefficients b's (to be estimated) measures how many units of financial performance would change by a unit change in any other factors that might influence financial performance while A represents other factors which may affect firm's financial performance apart from stated ones in the model.

This model is built on earlier researchers who had used it. Sajid et al (2012) studied impact of corporate governance on capital structure and concluded that corporate governance is positively correlated with tangibility, risk and size except profitability which proved a negative relationship.

Kitetei (2009) examined the effect of corporate governance practices on the financial performance of deposit taking microfinance institutions in Kenya. Wong (2010) affirmed that proper governance of public sector organizations in developing countries can result to value addition on part of their numerous stakeholders. Wanjiku et al (2011) survey of

companies listed at NSE found that CEO leadership positively influences corporate growth. Mang'unyi (2011) study on ownership structure and corporate governance and its effects on performance concluded 60% of all banks practice corporate governance and good corporate governance leads to better bank performance.

Lemmon & Lins (2001) study on ownership structure, CEO duality and firm value concluded that corporate governance crisis represents a negative shock to the investment opportunities. Dharmapala & Khanna (2009) found a positive effect on CEO duality enforcement on firm value. Black et al (2002) and (2009) what corporate governance elements predict and affect firm value concluded that CEO duality index is positively related to market value. Turanta (2010) studied the effect of corporate governance on the value of firms listed at NSE and concluded that there is a strong positive correlation between the CEO duality and firm value. This was in agreement with Nthama (2010) and Kimosop (2011) who concluded that board size, shares held by insiders, board composition, and number of board meetings positively influence firm's value while percentage of inside directors negatively correlates with performance of the firm. These form a strong basis for the use of this model in this study.

Financial performance, FP will be measured using ROA which is calculated by the formula $ROA = \text{Earnings after tax} / \text{total assets} \times 100$ and are to be calculated for each firm yearly. The independent variables will be read directly from the yearly financial statements of each insurance company.

Data will be analyzed using the SPSS statistical package since it is best suited for providing a means of establishing quantitative association between variables. Given that we are looking for the association between firm performance and corporate governance, linear regression will be best suited to quantify the strength of the relationship and firm value. Data presentation will be done by the use of charts, bar graphs, percentages and frequency tables for easy understanding. The final presentation will be both on print and soft mode. β = error variable which represents all the factors that affect the dependent variable but are not included in the model either because they are difficult to measure or not known.

Diagnostic tests

F-test will be tested for joint significance of all coefficients and t-test for significance of individual coefficients. Measures of central tendency (mean) and a measure of dispersion/variation (standard deviation) will also be used to analyze the data.

3.6 Data Validity and Reliability

Validity of measures that the researcher intends to use in the data collection stage is concerned with the question whether the researcher is actually measuring what he anticipates to measure, in order to assess the legitimacy of the applied measures and their appropriateness in achieving the research objective. The sources of secondary data that the researcher intends to use is to assess the validity of measures in line with the known standardized financial statements of listed insurance firms as well as some practitioners and experts in the insurance sector as well as wide consultation with fellow students.

Reliability of a measure is concern with the extent to which a particular measure researcher intends to use in data collection contains variable errors (Chava & Nachmias, 1996), to ensure there is reliability and appropriateness of the measures that the researcher intends to apply. In this research, the researcher intends to use end year audited financial statements. A positive correlation indicates a higher reliability while a negative correlation indicates low or no reliability in the measure. The researcher intends to re-run the data within the population of study and the results will be analyzed and compared for correlation so as to ensure the reliability of the measures in this research.

CHAPTER FOUR

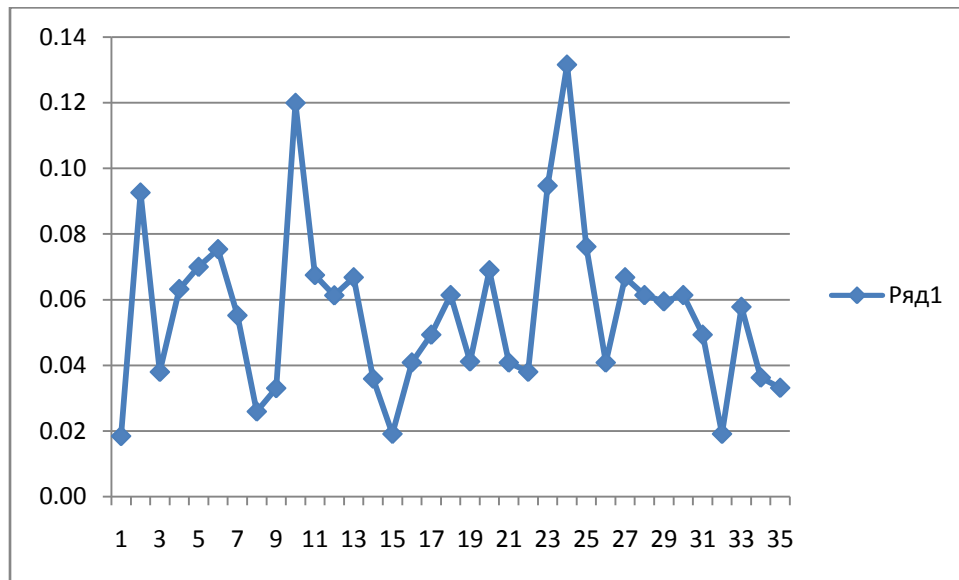
DATA ANALYSIS AND PRESENTATION OF FINDINGS

4.1. Introduction

This chapter provides an analysis of data collected from the secondary sources. Section 4.1 is the introduction of the chapter; section 4.2 presents descriptive statistics of the sample data; 4.3 presents corporate governance index statistics for the firms and section 4.4 presents summary and interpretation of the findings. They are also presented sequentially according to the research objective. The study is descriptive; quantitative analysis was used in the form of mean, median, standard deviation, kurtosis and probability of the variables in respect to the effects of corporate governance practices on financial performance of insurance firms in Kenya.

4.2. Data Presentation

Figure 4.2.1 Financial Performance

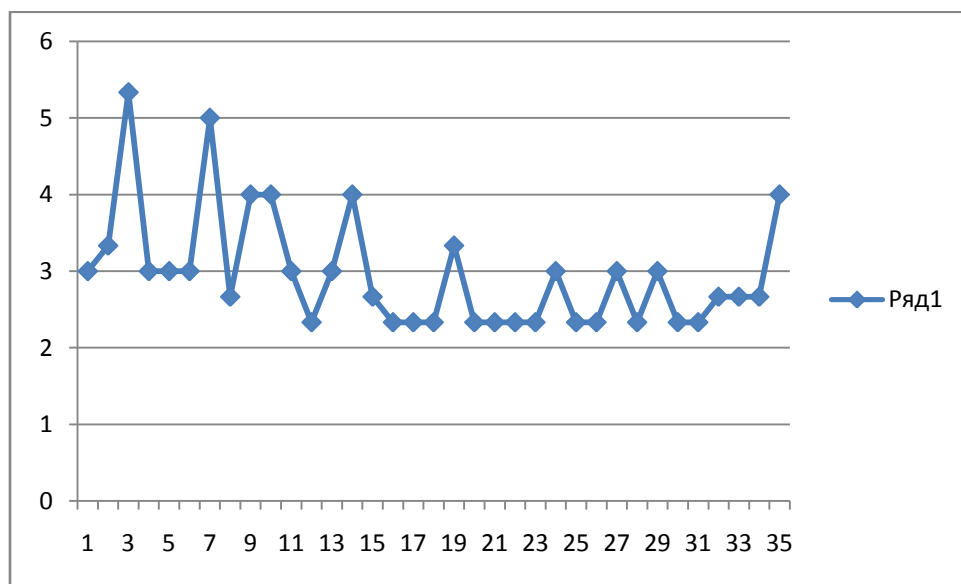


Source: Author

The financial performance for the 35 firms on average is between 4 and 12 percentage with the least firm having an average of 2% while the highest has an average of 13%.

This can be an indication that board meeting frequency, number of directors, number of resolutions passed in the annual general meeting and the number of board committees are all important to the African Merchant Insurance company because of its highest financial performance than the rest while the same variables may not equally be important to CFC and Pan African Insurance companies because they have the least average financial performance for the three years instead there might be important factors other than the mentioned ones.

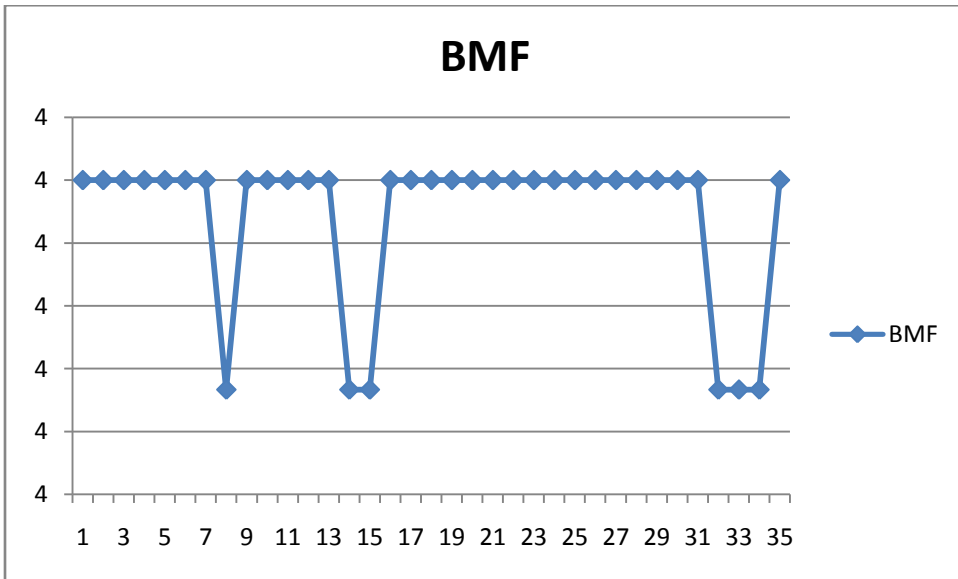
Figure 4.2.2 Board Committees



Source: Author

The average number of board committees for the firms is between 2 and three and the companies with the highest number of board committees are General Accident's insurance and Britam and this can be attributed to the size of their operations. Both have an average of 5 board committees.

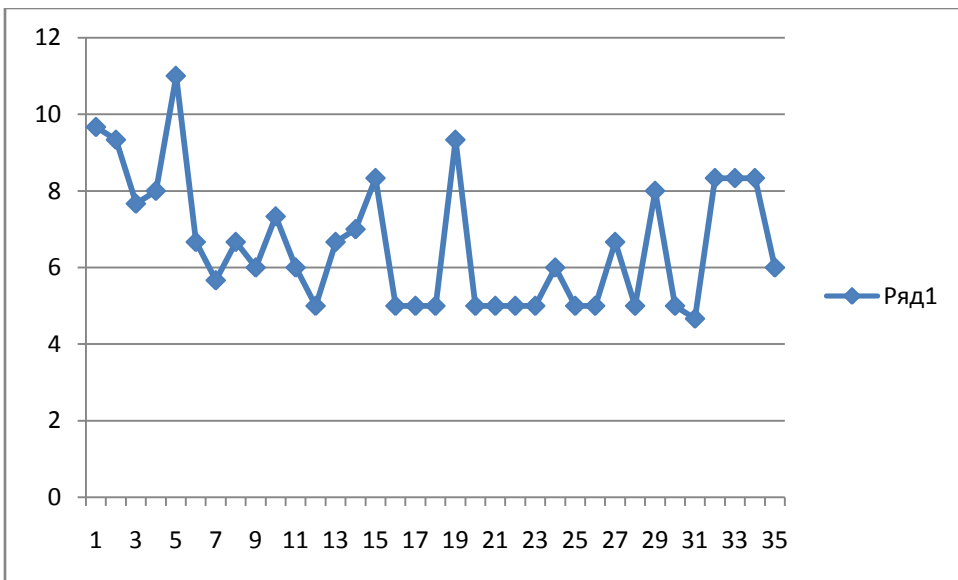
Figure 4.2.3 Board Meeting Frequency



Source: Author

The average number of times for holding meetings is four times in a year and this is well applicable to all the insurance companies under study. This seems to be an important element of corporate governance and seem to play a key role in financial performance to every firm and this might be a compulsory requirement by IRA to all insurance firms.

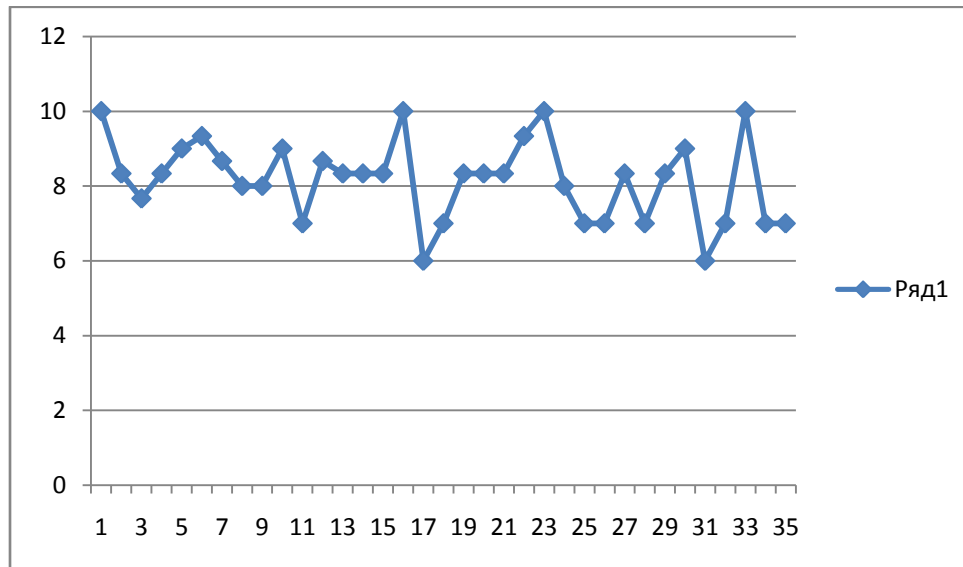
Figure 4.2.4 Number of Directors



Source: Author

Most insurance firms under the study have an average of between 5 and 8 directors. Pan African Insurance has the highest average of 10 directors may be because it may have diversified business compared to other insurance firms under study.

Figure 4.2.5 Number of Resolutions



4.3 Summary and Interpretation of Findings

4.3.1 Regression Analysis

A regression model was applied to establish the form of relationship between the dependent variable (financial performance) and the independent variables (board committees, board meeting frequency, number of directors and number of resolutions made in an AGM)

The regression model was as follows:

$$y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4$$

Where:

y = financial performance

β_0 = Constant Term

$\beta_{1, 2, 3 \& 4}$ = Beta coefficients

X_1 = board committees

X_2 = board meeting frequency

X₃= number of directors

X₄= number of resolutions made in AGM

Table 4.17 Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.845(a)	0.714	0.697	0.257

a) Predictors: (Constant), board committees, board meeting frequency, number of directors, and number of resolutions made in an AGM

The Adjusted R Square is called the coefficient of determination and tells us how financial performance varied with board committees, board meeting frequency, number of directors, and number of resolutions made in AGM. From Table 4.17 above, the value of Adjusted R Squares 0.697. This implies that, the independent variables explain 69.7 % of dependent variable at a confidence level of 95%.

Table 4.18 ANOVA Results

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	11.72	4	2.930	44.231	.000(a)
	Residual	1.98	30	0.066		
	Total	13.37	34			

a) Predictors: (Constant), board committees, board meeting frequency, number of directors, and number of resolutions made in AGM

b) Dependent Variable: financial performance

The study used ANOVA to establish the significance of the regression model from which an f-significance value of $p < 0.05$ was established. This shows that the regression model has a less than 0.05 likelihood (probability) of giving a wrong prediction. This therefore means that the regression model has a confidence level of above 95% hence high reliability of the results.

Table 4.19 Coefficients Results

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	0.116	.186		0.623	.535
Board committees	0.577	.068	.559	8.478	.000
Board meeting frequency	0.157	.043	.257	3.676	.036
Number of directors	0.082	.042	.301	2.252	.020
Resolutions made in AGM	0.021	.002	.245	6.906	.001

a) Dependent Variable: financial performance

The established regression equation was

$$Y = 0.116 + 0.577X_1 + 0.157X_2 + 0.082X_3 + 0.021X_4$$

From the above regression model, if board committees, board meeting frequency, number of directors, and number of resolutions made in AGM were to be held constant, the financial performance would stand at 0.116. It was established that a unit increase in board committees' factor; the financial performance would change by 0.577. A unit increase in board meeting frequency would trigger a change in financial performance by 0.157. Similarly, an increase in the number of directors and resolutions made in AGM would account for a change in the financial performance by 0.082 and 0.021 respectively. The study also established a significant relationship between financial performance and the independent variables; board committees ($p=0.00<0.05$), board meeting frequency ($p=0.036<0.05$), number of directors ($p=0.20<0.05$) and resolutions made in AGM ($p=0.001<0.05$) as shown by the p values.

4.4 Discussion

The study shows that there was a positive and significant relationship between number of directors and financial performance of the insurance firms. This is to mean that an increase in number of board members would always lead to an increase in financial performance. This findings are agrees with the findings of Noor & Ayoib (2011) who found that businesses with larger board size, low number of experts and duality leadership lead to higher family companies' performance. However, Majid et al (2012) study on the impact of corporate governance concluded there was no meaningful relationship between board size and CEO duality. This can be the reason why IRA does not allow the insurance companies to have the CEO Duality concept in the management of the insurance companies whether public or private and separating roles of the CEO and the chairman to the board would mean distinct roles with different personnel which will increase financial performance of the insurance firms which act trustees for the stakeholders it serves.

The regression analysis also found that there was a positive and significant relationship between board committees, board meeting frequency and financial performance of insurance firms. These findings are in line with those of Nthama (2010) and Kimosop (2011) who concluded that board size, board composition, number of board meetings positively influence firm's value; however, according to authors increased number of inside directors negatively correlates with performance of the firm. This concurs with Mululu (2005) who concluded that the board's increase in the frequency of their meetings improves the performance of those firms as captured by the increase in firm value. Langat (2006) developed a regression model test the hypothesis that there is a positive relationship between financial performance and frequency of board meetings. The findings indicated that the test obtained led to the acceptance of the null hypothesis that there is a positive relationship between firm performance of preceding year and frequency of board meetings but Jensen (2001) argued that frequently scheduled board meetings generates opportunity costs in the form of management time consumed and cash costs in the form of travelling allowances and fees for the board members. On the other real benefits from these meetings can be derived from such meetings as directors have the opportunity to confer, set both medium and long-term strategies and monitor

management which can improve financial performance. Gathura (2007) further sought to determine the relationship between various components of corporate governance and performance of manufacturing firms listed at the NSE. The study concluded found a perfect linear relationship between performance measures and frequency of board meetings among other structures which was achieved through regression- based f-test on each of the firm performance measures.

On overall the regression analysis established that there was a significant relationship between corporate governance and financial performance of insurance firms in Kenya. These findings are in agreement with those of Thuy-Nga (2010) who concluded that having corporate governance practices in place provides a governance framework that is better suited to the fulfillment of the board's fundamental responsibilities to oversee business operations and monitor management conduct for the purpose of enhancing shareholder value; this is also consistent with the stewardship theory. A number of local studies done in the financial sectors also confirm this; first, Ongoro (2011) study on the relationship between corporate governance practices and performance of commercial banks in Kenya and found that corporate governance practices have a positive relationship with bank performance. On the other hand, Mang'unyi (2011) study on ownership structure and corporate governance and its effects on performance concluded 60% of all banks practiced corporate governance and good corporate governance led to better bank performance.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1. Introduction

This chapter presents the summary of the research findings, conclusions, recommendations, limitations of the study and suggestions for further study. The conclusions were drawn from the findings of the study in line with the objective of the nature of relationship between corporate governance and financial performance of insurance firms in Kenya.

5.2. Summary of Findings

The question whether corporate governance practices have an effect on financial performance is considered vital by both academicians and stakeholders. According to the study conducted, the number of board of directors, the frequency of holding meetings, the number of committees and the number of resolutions passed in the AGM are independent variables while financial performance is the dependent variable. The study was adopted in an effort to establish the effect of each of independent variable on financial performance of insurance companies in Kenya. Secondary data was collected for a period of 3 years by way of means, standard deviation, correlation, multiple regression, F and T tests.

The financial mode's aim was to ascertain a functional relationship between each of the corporate governance practice and financial performance. From the analysis of the data collected it was proved that the number of board committees, board meeting frequency, number of resolutions passed in an AGM and number of board of directors all are positively correlated with financial performance. A change in one unit in the number of board committees brings the highest positive change in financial performance of 0.577, followed by board meeting frequency which causes a change of 0.157 in financial performance. Lastly a change in one unit in number of directors causes a change of 0.082 while a change in one unit in the number of resolutions passed causes the least change in financial performance by 0.021. In conclusion each of the independent variable

plays a key role in the financial performance of insurance firms in Kenya. The study used ANOVA to establish the significance of the regression model using a 95% confidence level from which an f-significance value of $p < 0.05$ was established for each of the independent variable. This shows that the regression model has a less than 0.05 likelihood (probability) of giving a wrong prediction for each independent variable with dependent variable financial performance. This therefore means that the regression model has a confidence level of above 95% hence high reliability of the results. board committees has a p-value of 0.00 and this is less than 0.05 meaning that the probability that it will cause a positive effect on financial performance is almost certain hence its unit change leads to the highest change in financial performance of 0.577 as shown above. Board meeting frequency ($p = 0.036 < 0.05$) and since the p-value is less than 0.05 its effect of 0.157 on financial performance is till reliable. Number of directors ($p = 0.20 < 0.05$) and resolutions made in AGM ($p = 0.001 < 0.05$) as shown by the p values both have p- reliable values of less than 0.05 and their effect on financial performance of 0.082 and 0.021 respectively are reliable too. In general the ANOVA test analyzed the effect of each of the corporate governance practice on financial performance and the result was a positive output, implying that there exist positive relationship between corporate governance and financial performance for insurance companies in Kenya.

5.3. Conclusions

The objective of this study was to establish the effect of corporate governance on financial performance of insurance companies in Kenya. Considering the results analyzed from the study the following conclusion can be deduced. First a strong positive correlation between corporate governance and financial performance is reported, secondly the positive regression model confirm that corporate governance (independent variables) if consistently applied contribute to increase in financial performance (dependent variable).

Good corporate governance practices can improve firms' stock returns in the long run and this can translate into a higher financial performance companies for insurance companies. Each element of the corporate governance studied e.g. board size, board meeting frequency, number of resolutions passed in every meeting and the number of

committee meetings increases the financial performance of insurance firms. The management should therefore ensure that these elements are well adhered to because they lead to value addition which can translate to wealth maximization to shareholders. The number of committees each firm should have will depend on the size of the respective firm and the nature of operations. Companies should minimize making resolutions which favour management instead of spearheading the firm ahead. Holding meetings frequently can facilitate identification of any loophole which can deter performance and hence make timely decisions by the board of directors.

CEOs have a sole obligation of making decisions which can affect the firm they control positively or negatively in relation to its financial performance but there is need for them to work closely with the board of directors to avoid conflicts. They are given all the rights to work in the best interests of the shareholders who have committed their funds in the business and the main objective is to maximize shareholders wealth.

Financial performance can be used as a yardstick against which to measure how well management has used fixed assets from its primary mode of business and generate revenues. Management can be regarded as ineffective if they hold too much assets which cannot translate to profitability unlike those who can translate less fixed assets into high profits.

Insurance in Kenya is known to have been in existence for over sixty years and the industry is governed by the Insurance Act and regulated by the Insurance Regulatory Authority (IRA) but this sector is characterized by a slow growth compared other sectors.

5.4. Policy recommendations

Given that there is increasing complexity of business today, there is need for financial reports to include a more comprehensive corporate governance statement as investors rely on information they receive from companies in making their investment decisions. Failure of corporate governance practices have intensified incidences where management

manipulates financial reports for different purposes and thus making it difficult for shareholders to build confidence in them.

Insurance companies act as important trustees to diversified stakeholders who are not involved in running the core activities of these firms. To reduce chances of conflicts among different stakeholders, insurance companies should implement fully the corporate governance practices. The insurance regulatory authority should make it compulsory for any registered insurance company to make public the statement of corporate governance especially for those firms which are not listed because the listed firms it is a basic requirement as per the Nairobi Securities Exchange market. The listed firms have the statement of corporate governance incorporated with the yearly financial statements but this lacked in most of the unlisted firms. There are 44 insurance firms duly registered by IRA as at December 31, 2012 but at the same time only 6 are listed and this represents approximately 14% which is a small percentage. The insurance regulatory authority need to encourage more insurance companies to be listed by giving them some incentives and requirements for listing should fair to the firms and this means IRA should work closely with the NSE to facilitate listing. Increasing the number of insurance firms at the NSE will increase transparency of their services and easy to monitor them and even enhance competition among them and other firms from different sectors e.g. banking sector and at the same time their services will be widely known.

5.5. Limitations to the study

The study targeted all the 44 registered insurance companies in Kenya. Only 35 insurance companies were studied which represents approximately 80% of the total firms which is a good response rate as it accounts above average of the total targeted population and the unaccounted 9 firms which represents 20% their financial statements were not available. This study assumes homogeneous roles among all insurance companies in Kenya regardless of ownership, listed or unlisted and size of the firm hence the results of the study will be assumed to equally apply to those insurance firms not covered in the study.

The insurance firms under study each was registered at different times by IRA. The different timings of registration and starting operations can give different values of assets and consequently different earnings after tax and this could lead to different financial performance measure and thus a cross sectional analysis cannot adequately be carried out for decision making. Thus the study takes averages for both dependent and independent variables for a period of 3 years to suit the main objective of the research.

On the other hand the firms under study are made up of private, public, listed and unlisted. These diversified forms of the insurance firms can give diversified focus of corporate governance practices even though they are under one umbrella body, IRA. For example requirements of corporate governance practices for publicly limited companies can be different from privately owned unlisted unmonitored insurance firms. The study assumes all these to be constant for all the firms under study.

Insurance companies are assumed to engage solely in providing insurance services. Contrary to these most of them have investments which are different from selling of policies. The dependent variable financial performance is measured as the ratio of earnings after tax to total average fixed assets. The total average fixed assets are not differentiated from those originating from insurance services and non-insurance services and this applies to the total earnings after tax shown in the income statements. But for the purpose of achieving the objective of the study, these two variables are both assumed to originate from insurance services as the main purpose of all insurance companies in Kenya.

5.6. Suggestions for further studies

The objective of the study was to establish the nature of corporate governance and financial performance of insurance firms in Kenya. The elements of corporate governance studied are number of board members, frequency of holding meetings, number of resolutions passed in an annual general meeting and the number of committee meetings. There is need to explore other components of corporate governance practices and how their effect on financial performance.

There is also need to conduct research on other factors which can influence financial performance apart from corporate governance practices. A study need to be conducted to establish the effect of other factors influencing financial performance apart from corporate governance practices.

The dependent variable for the study was financial performance and it used one ratio of measuring financial performance i.e. the ratio of earning after tax to total assets expressed as a percentage. There is need to conduct a research on other ratios of measuring financial performance and how it is affected by the corporate governance practices studied in this research for all insurance companies to establish whether results will be consistent with this study.

There is also need to conduct a research on the effect of corporate governance practices on financial performance in other sectors of the economy to establish if there exist consistencies with results of this study.

REFERENCES

- Abdulla (2009); Fundamentals and Ethics, Theories of Corporate Governance Middle Eastern Finance and Economics Issue; Euro Journals Publishing, Inc.
- Adam, B. & Harborne S. (2007). Biform Games. *Management Science* 53(4): 537-. 549.
- Allan G. (2012); CEO compensation and corporate Governance Surrounding Mergers and Acquisitions. A Thesis in the John Molson School of Business; Corcordia University, Montreal, Quebec, Canada.
- Bhimani, A. (2008). "Making Corporate Governance Count: The Fusion of Ethics and Economic Rationality" .*Journal of Management and Governance* 12(2), 135-147.
- Black et al (2009) What Corporate Governance Elements Predict Firm Value: Evidence from Brazil; University of Texas at Austin, Law School and McCombs Business School.
- Clarke, T. (2004). '*Theories of Corporate Governance: the Philosophical Foundations of Corporate Governance*', London: Routledge Taylor and Francis Group.
- Damgaard et al (2004). International Monetary fund; Paper on valuation of unlisted direct investment equity.
- Davis, J.H., Schoorman, F.D. & Donaldson, L. (1997). Toward a stewardship theory of management. *Academy of Management Review*, 22: 20-47
- Deepak S. (2012). The effect of governance mechanism and structure on fees and performance of Mutual Funds in Canada
- Dharmapala&Khanna (2008). Corporate Governance, Enforcement, and firm value: Evidence from India.
- Donaldson, L. & Davis, J. H. (1991). Stewardship theory or agency theory: CEO governance and shareholder returns. *Australian Journal of Management*, 16, 49-64.
- Donaldson, T. and Preston, L. E. (1995). The stakeholder theory of the corporation: Concepts, evidence and implications. *Academy of Management Review*, 20 (1), 69-95

- Dung T. (2011). Corporate Governance– Empirical Research On Board Size, Board Composition, Board Activity, Ownership Concentration And Their effects On Performance.
- E-Majid A, Elham K, HamidehAbbasi (2012). Impact of Corporate Governance Mechanisms on Firm Value; evidence from the Food Industry of Iran, Text Road Publication
- Frans V. H. & Nick, H. (2011); Merger and Acquisitions, Firm Performance and Corporate Governance; the effect of a Firm’s Board structure on M&A and firm performance Master Thesis Business Administration – Financial Management Track.
- Freeman, R. E., Wicks, A. C. Parmer, B. (2004). Stakeholder theory and “corporate objective revisited”, *Organization science* 15 (3), 364 – 369.
- Gregory, Holly J., (2001). International Comparison of Corporate Governance: Guidelines and Codes of Best Practice in Developed Markets, Weil, Gotshal&Manges LLP.
- Gupta et al (2011) Corporate Governance and firm value: Evidence from Canadian Capital Markets Corporate Ownership & Control / Volume 6, Issue 3, spring 2009 (Continued - 2
- HafizaAishahHashim, S. Susela Devi (2008) Board Independence, CEO Duality and Accrual Management: Malaysian Evidence *Asian Journal of Business and Accounting*, 1(1), 2008, 27-46
- Holmstrom, B. and P. Milgrom (1994), “The Firm as an Incentive System,” *American Economic Review* (Sept): 972-991.
- Jensen, J. &Meckling, W. (1976). Theory of the firm: Managerial behavior, agency costs, and ownership structure.*Journal of Financial Economics* 3, 89-128.
- Jensen, M. C. (1986). Agency costs of free cash flow, corporate finance and takeovers. *American Economic Review*, 76 (2), 15-40. *Journal on Corporate Ownership & Control / Volume 6, Issue 1, Fall 2008*
- Journal of Economic & Administrative Sciences* Vol. 23, No. 2, December 2007 (71-93)
- Julia S. K. (1998) Does CEO Duality Matter: An Integrative Approach

- Kalantari et al (2012) The Impact of Corporate Governance on Chief Executive Officer (CEO) Duality in Iranian Banking Sector.
- KhaledAljifri& Mohamed Moustafa (2007). The Impact of Corporate Governance Mechanisms on the Performance of UAE Firms:
- Kim K-H, et al, (2008) CEO duality leadership and corporate diversification behavior, J Bus Res, doi:
- Kipkurui (2011).A study on the relationship between Corporate Governance and financial performance of insurance companies in Kenya. MBA unpublished, University of Nairobi.
- Kitetei (2009). The effect of corporate governance practices on financial performance of Deposit Taking Microfinance Institutions in Kenya.
- Koriata (2010).A study on the effects of corporate governance practices on firm value; an empirical Assessment of listed firms in Kenya. MBA unpublished University of Nairobi
- Li, H., Wang, Z., & Deng, Z. (2008). Ownership, independent directors, agency costs and financial distress: Evidence from Chinese listed companies. *Corporate Governance*, 8, 148-192.
- Lijun Xia² (2008) Founder Control, Ownership Structure and Firm Value: Evidence from Entrepreneurial Listed Firms in China. *China Journal Of Accounting Research*, Vol 1 Issue.
- Lindashaw (2006). Paper on overview of corporate governance issues for co-operatives
- Majid Abbasi¹, ElhamKalantari, HamidehAbbasi (2012). The impact of Corporate Governance on Chief Executive Officer (CEO) *Kuwait Chapter of Arabian Journal of Business and Management Review Vol. 2, No.1; Sep 2012*
- Mang'anyi (2011) Ownership Structure and Corporate Governance and its Effects on Performance: A Case of Selected Banks in Kenya: May 16, 2011 Accepted: July 21, 2011. www.sciedu.ca/ijba International Journal of Business Administration Vol. 2, No. 3; August 2011 2 ISSN 1923-4007 E-ISSN 1923-4015
- Maretno (2011) Corporate Governance and Firm Value; The impact of Corporate Social Responsibility Middle Eastern Finance and Economics Issue.

- Miringu (2011) Analysis of the Effect of Corporate Governance on Performance of Commercial State Corporations in Kenya.
MSc in Management Program; Thesis Submitted in partial fulfillment of the requirements for the degree of Master of Science in Management (Finance) Faculty of Business, Brock University
- Naibo, L. (2006). "A survey of corporate governance structures and practices in insurance underwriting sector". (Unpublished MBA thesis). University of Nairobi, Kenya
- Ndoro, G. (2012). Executive compensation and firm performance: evidence from the UK charities. PhD thesis, University of Nottingham.
- Ngeno (2009) MBA unpublished University of Nairobi; Corporate governance practices and challenges of International Non-governmental organizations in Kenya.
- Noor AfzaAmran&AyoibChe Ahmad (2011); Board Mechanisms and Malaysian Family Companies' Performance Asian Journal of Accounting and Governance 2: 15–26 (2011) ISSN 2180-3838.
- Nor HashimahJohari,NormanMohdSaleh,RomlahJaffar and MohamatSabri Hassan (2008); the Influence of Board Independence, Competency and Ownership on Earnings Management.Int. Journal of Economics and Management 2 (2); 281-306(2008).
- Norazian, H. &Radiah, O. (2012); Code of Corporate Governance and Firm Performance
- Nthama, (2010). MBA unpublished; A study on the effects of corporate governance on the value of the firm; an empirical study of firms listed in the Nairobi Securities Exchange.
- Ongore (2011) Effects of Selected Corporate Governance Characteristics on Firm Performance: Empirical Evidence from Kenya
- Pradesh (2012); Emergency of Corporate Governance in India Excel International Journal of Multidisciplinary Management Studies volume 2 issue 5, May 2012
- Ross, S. (1973). "The Economic Theory of Agency: The Principal's Problem," American Economic Review 63, No. 2, May 1973, 134-139, reprinted in *Readings in Applied Microeconomic Theory*

- Sajid et al (2012). The Impact of CEO Duality on Capital Structure: A Case from Non-Financial Sector of Pakistan. EuroJournals Publishing, Inc.
- Sam Nganga et al (2003) Corporate Governance in Africa; A survey of publicly listed companies. D E C E M B E R 2 0 0 3.
- Sampson, (2008). Is CEO/Chair Duality Associated with Greater Likelihood of an International Acquisition? Indiana University
- Shleifer, A. & Vishny, R.W. (1997). A survey of corporate governance journal of finance, 52 (2), 737-783.
- Simplicious (2011); The relationship between corporate governance practices and performance of commercial banks in Kenya. MBA unpublished University of Nairobi Kenya.
- The Capital Markets Act Gazette Notice No. 3362 (cap. 485a); Guidelines on Corporate Governance Practices by Public Listed Companies in Kenya
- The Organization for Economic Co-operation and Development (OECD) 2012; United Nations Conference on Trade and Development; Case study on corporate governance disclosures in Kenya
- Wanga, (2010). MBA unpublished; the moderating influence of corporate governance on the relationship between capital structure and the firm value of companies quoted at the securities exchange
- Wanjiku et al (2011). Relationship between corporate governance and growth of organization; a survey of companies listed in NSE.
- Waseem M. Y. et al (2011) The Effect of Corporate Governance on the Performance of Jordanian Industrial Companies: An empirical study on Amman *Fainternational Journal of Humanities and Social Science Vol. 1 No. 4; April 2011* 55
- Wong (2010). Corporate Governance Practices in Developing Countries: The Case for Kenya www.sciedu.ca/ijba International Journal of Business Administration Vol. 2, No. 1; February 2011

APPENDICES
RESEARCH TOOL

	<i>2011</i>	<i>2010</i>	<i>2009</i>
No. of Board of Directors			
No. Meetings held in a year			
No. of Committees			
No. of resolutions passed in Annual General Meeting			
Profit before tax and interest(1-tax)			
Profit after tax			
Total average assets			
Total equity			

**THE INSURANCE ACT (Cap.487) LICENSED INSURANCE COMPANIES In
pursuance of section 184 of the Insurance Act, the Commissioner of Insurance
publishes the list of registered insurance companies for the year 2012.**

Reg. No.	Name	Address	Town
1.	APA InsurancLimited	P.O. Box 30065 – 00100,	NAIROBI
2.	Africa Merchant Assurance Company Limited	P.O. Box 61599 – 00200,	NAIROBI
3.	Apollo Life Assurance Limited	P.O. Box 30389 – 00100,	NAIROBI
4.	British-American Insurance Company (K) Limited,	PO Box 30375 – 00100,	NAIROBI
5.	Cannon Assurance Limited	P.O. Box 30216 – 00100,	NAIROBI
6.	CfC Life Assurance Limited	P.O. Box 30364 – 00100,	NAIROBI
7.	Chartis Kenya Insurance Company Limited	P.O. Box 49460 – 00200,	NAIROBI
8.	CIC General Insurance Limited	P.O. Box 59485 – 00200,	NAIROBI
9.	CIC Life Assurance Limited	P.O. Box 59485 – 00200,	NAIROBI
10.	Concord Insurance Company Limited	P.O Box 30634 – 00100,	NAIROBI
11.	Corporate Insurance Company Limited	P.O. Box 34172 – 00100,	NAIROBI
12.	Directline Assurance	P.O. Box 40863 –	NAIROBI

13. Company Limited 00100,
East Africa P.O. Box 20196 – **NAIROBI**
Reinsurance 00200,
Company Limited
14. Fidelity Shield P.O. Box 47435 – **NAIROBI**
Insurance Company 00100,
Limited
15. First Assurance P.O. Box 30064 – **NAIROBI**
Company Limited 00100,
16. GA Insurance P.O. Box 42166 – **NAIROBI**
Limited 00100,
17. Gateway Insurance P.O. Box 60656 – **NAIROBI**
Company Limited 00200,
18. Geminia Insurance P.O. Box 61316 – **NAIROBI**
Company Limited 00200,
19. ICEA LION General P.O. Box 30190 – **NAIROBI**
Insurance Company 00100,
Limited
20. ICEA LION Life P.O. Box 46143 – **NAIROBI**
Assurance Company 00100,
Limited
21. Intra Africa P.O. Box 43241 – **NAIROBI**
Assurance Company 00100,
Limited
22. Invesco Assurance P.O. Box 52964 – **NAIROBI**
Company Limited 00200,
23. Kenindia Assurance P.O. Box 44372 – **NAIROBI**
Company Limited 00100,
24. Kenya Orient P.O. Box 34530- **NAIROBI**
Insurance Limited 00100,
25. Kenya Reinsurance P.O. Box 30271 – **NAIROBI**

26. Corporation Limited 00100,
Madison Insurance P.O. Box 47382 - **NAIROBI**
Company Kenya 00100,
Limited
27. Mayfair Insurance P.O. Box 45161 - **NAIROBI**
Company Limited 00100,
28. Mercantile Insurance P.O. Box 20680 - **NAIROBI**
Company Limited 00200,
29. Metropolitan Life P.O. Box 46783 - **NAIROBI**
Kenya Limited 00100,
30. Occidental Insurance P.O. Box 39459 - **NAIROBI**
Company Limited 0063,
31. Old Mutual Life P.O. Box 30059 - **NAIROBI**
Assurance Company 00100,
Limited
32. Pacis Insurance P.O. Box 1870 - **NAIROBI**
Company Limited 00200,
33. Pan Africa Life P.O. Box 44041 - **NAIROBI**
Assurance Limited 00100,
34. Phoenix of East P.O. Box 30129 - **NAIROBI**
Africa Assurance 00100,
Company Limited
35. Pioneer Assurance P.O. Box 2033 **NAIROBI**
Company Limited 00200,
36. REAL Insurance P.O. Box 40001 - **NAIROBI**
Company Limited 00100,
37. Shield Assurance P.O. Box 25093 - **NAIROBI**
Company Limited 00100,
38. Takaful Insurance of P.O. Box 1811 - **NAIROBI**
Africa 00100,
39. Tausi Assurance P.O. Box 28889- **NAIROBI**

40. Company Limited 00200,
The Heritage P.O. Box 30390 – **NAIROBI**
Insurance Company 00100,
Limited
41. The Jubilee P.O. Box 30376- **NAIROBI**
Insurance Company 00100,
of Kenya Limited
42. The Kenyan P.O. Box 30170 – **NAIROBI**
Alliance Insurance 00100,
Co Ltd
43. The Monarch P.O. Box 44003 – **NAIROBI**
Insurance Company 00100,
Limited
44. Trident Insurance Company Limited