THE EFFECTS OF CORPORATE GOVERNANCE PRACTICES ON FIRM VALUE: AN EMPIRICAL ASSESSMENT OF LISTED FIRMS IN KENYA

BY

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DECLARATION

I declare that this Management research paper is my original work and, to the best of my knowledge, has not been submitted to any university for a degree.

SIGNED.. DATE..

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This MBA Research Project has been submitted for presentation with my approval as the University Supervisor.

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DEDICATION

This Management Research Paper is dedicated to my parents Rukuti Ole Koriata and Sereya Koriata for the sacrifice to educate me and for teaching me the discipline and value of hard work and also the need for education as the pillar of hope in any given society.

Further dedication to the great Ole Koriata family for knowing the importance of education in the present period.

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ABSTRACT

The main aim of this study is to investigate empirically the effects of corporate governance practices on the value of firm in the Kenya perspective using a Tobin's Q approach. Like many of the developing /emerging markets, the Nairobi Stock Exchange has initiated the application of international standards of corporate governance as a part of its merge with the global economy. This study utilizes a sample of 20 firms using accounting and market data available for 2009.The sample firms are all listed in the Nairobi Stock Exchange in the main investment segment market. The Study used both primary and secondary data. Primary data was collected through a structured questionnaire while secondary data were obtained from the Nairobi Stock Exchange handbooks for 2006.

From the study the adjusted R^2 is the coefficient of determination and tells us how the Tobin's Q in companies listed at the Nairobi stock exchange varied with Corporate Governance Index, Sales/Revenue, Age of the firm in the market and the financial leverage ,the value of adjusted R^2 is 0.511.This implies that, there is a variation of 51.1% on Tobin's Q with Corporate Governance Index, Sales/Revenue, Age of the firm in the market and the financial leverage at a confidence level of 95%.There is a positive relationship between the Firms Tobin's Q with respect to Corporate Governance index and Financial leverage while also a negative relationship do exists between Sales/Revenue, and the age of the firm in the Nairobi stock exchange.

CHAPTER ONE

1.0 INTRODUCTION

1.1 BACKGROUND

The topic 'Corporate Governance' has gained worldwide prominence due to recent corporate collapses, such as, Enron and WorldCom in the United States and Heath International Holdings Insurance in Australia (Monks and Minow, 2004, Roberts's et.al, 2005, Child and Rodriguez, 2003). As confidence in financial reports diminished among investors and creditors, a sense of urgency was felt among regulators in different countries to restore public confidence and to protect shareholders and investors (Lambert and Sponem 2005, Gordon, 2002). Apart from corporate scandals, there has been a normative pressure for better governance as the business environment became more volatile, less predictable, more globalised and risky. As it was evident that the existing governance framework was inadequate, the usual response was to bring new legislation intended to improve transparency, accountability and integrity (Parker et.al, 2002, Zandstra, 2002, Vinten, 2000, 2005, Doost and Fishman, 2004). Several commentators (Anderson and Chapman, 2002, Seal, 2006) viewed such an approach to corporate governance was limited, as it viewed governance from a narrow perspectives and produced a checklist of governance requirements which they felt were unlikely to solve accountability problems.

Amidst the culture of compliance and a checklist approaches to improving corporate governance, much of the accounting research approach has concentrated on how ownership structure and Board composition affects financial reporting, audit committees, earnings restatements and disclosure (Eng and Mak, 2003; Ajinkya, Bhoraj and Sengupta (2005), Karamanou and Vafeas, 2005; Beekes and Brown, 2006) Such an approach, although consistent with deductive research using agency theory, is seen as only partial (Daily et.al, 2003, Pettigrew and McNulty, 1995, Finkelstein and Mooney, 2003) as it fails to address how external requirements can be accommodated through organisational processes.

It will be argued here that this main stream accounting research has failed to project a balanced view; and that by integrating governance to internal organisational processes to promote organisational performance, value can be enhanced. As a series of financial crisis and accounting scandals occur around the world, many media and investment institutions have regarded corporate governance as an important indicator for investment. Subsequently the government, institutional investors and the general public have put great emphasis on corporate governance. Alkhafaji (1990) defined corporate governance was a kind of company's structure and the distribution of power. And it was to decide the responsibility and the relationship among different stakeholders in the organizational operations. Shleifer & Vishny (1997) indicated that corporate governance could make sure the investors to gain investment return in organization. And it can help the company improve its financial and human resource through the law, economy and standard of corporate operation. Thus, from a financial perspective, corporate governance is a system that is used to reduce the agency problem between the managers and shareholders. On the other hand, from the corporation's viewpoint, corporate governance can assure the company's information to be exposed correctly and immediately. World Bank (1999) stated corporate governance was composed by external and internal corporate governance mechanisms.

The difference between external and internal corporate governance mechanisms is that internal mechanism is able to supervise managers directly. Internal corporate governance mechanism includes the rights of shareholders, participation decision-making, independent character of the board of directors and supervisors. External corporate governance mechanism is related to laws and stakeholders of organizations. However, the main purpose of the study is to explore the relationship between corporate value, intellectual capital and corporate governance. Therefore, government related law and environment of market are not discussed in the scope of the study.

The key indexes to measure relationship between corporate value and corporate governance adopted by most research are referred to the measurement system of corporate governance proposed by Yeh, Lee & Ke (2002) in Taiwan. The indexes are

ratio of the board of external directors, number of supervisors, ownership of the board of internal directors and controlling right ratio of large shareholders.

Millestein & MacAvoy (1998) pointed out a company with a better corporate governance policy implied the appointment of higher proportion of external directors, which would make the average performance higher. And if larger shareholders who are not managers have more controlling rights, the company value is higher (Lins, 2003). Kesner (1987) proved the ownership ratio of internal directors of a company is significantly and positively related to organizational performance. Yeh et al. (2002) indicated supervisors of the board have a positive relationship with corporate value.

"The primary role of all corporate governance participants centers around the fundamental theme of protecting investors, creating long-term shareholder value, restoring investor confidence, and supporting strong and efficient capital markets" (Rezaee, 2007). Corporate governance measures (e.g., independent directors, competent and ethical executives, effective internal controls, credible external audits) can play an important role in minimizing the agency problem and ensuring that management's interests are aligned with those of shareholders. The occurrence of financial scandals and the related loss of billions of dollars of shareholder value have received extensive media coverage and attention from regulators and standards setters (Michelman and Waldrup, 2008).

Companies such as WorldCom and Enron have taught the public that corporations do not always act in the best interests of their shareholders/owners. In order to minimize this problem, organizations are now taking steps to monitor management's behaviour and increase shareholder awareness of the firm's financial and internal condition. "Corporations must earn back investor confidence and demonstrate a proactive stance on ensuring accurate and reliable financial reports to their shareholders" (Rezaee, 2007). Corporate governance measures mandated by Sarbanes-Oxley can play an important role in minimizing the agency problems and ensuring that management's interests are aligned

with those of shareholders. Sarbanes-Oxley, with its emphasis on shareholder value, has brought many benefits as well as costs to the corporate organizational structure.

1.2 STATEMENT OF THE PROBLEM

Corporate Governance has grown very rapidly in the last decade and is now viewed as an important attribute of the corporate sector. "Poor" Corporate Governance and "lack" of transparency of corporate Governance have frequently been identified as some of the root causes of the financial crisis. Thus, the need for a major improvement in transparency, both "in the public and private sector becomes imperative where several basic reasons for the growing interest in corporate governance.

In the first place, the efficiency of the prevailing governance mechanisms has been questioned (see for instance, Jensen, 1993, Miller, 1997 and Porter, 1997). Secondly, this debate has intensified following reports about spectacular, high-profile financial scandals and business failures (e.g. Polly Peck, BCCI), media allegations of excessive executive pay (see for example, Byrne, Grover and Vogel, 1989), the adoption of anti-takeover devices by managers of publicly-owned companies and, more recently, a number of high visibility accounting frauds allegedly perpetrated by managers (Enron, WorldCom). Thirdly, there has been a surge of antitakeover legislation (particularly in the US) which has limited the potential disciplining role of takeovers on managers (see Bittlingmayer, 2000, for a description of this regulation). And, finally, there has been a considerable amount of debate over comparative corporate governance structures, especially between the US, Germany and Japan models (see Shleifer and Vishny, 1997, for a survey of this debate) and a number of initiatives taken by stock market and other authorities with recommendations and disclosure requirements on corporate governance issues.

During the 1990s, a number of high-profile corporate scandals in the USA (viz., Lehman Brothers, AIG Insurance, Xerox, Arthur Anderson, Enron, WorldCom, Tyco, etc.), and also elsewhere in the world, triggered an in-depth reflection on the regulatory role of the government in protecting the interests of shareholders. Thus, to redress the problem of

corporate misconduct, ensuring ‘sound’ Corporate Governance is believed to be essential to maintaining investors’ confidence and good performance. In view of the growing number of scandals and the subsequent wide-spread public and media outcry, a plethora of governance ‘norms,’ ‘codes,’ ‘best practices,’ and ‘standards’ have sprouted around the globe. For instance, the Sarbanes-Oxley legislation in the USA, the Cadbury Committee recommendations for the European Union (EU) companies, and the OECD principles of corporate governance, are perhaps the best-known among these.

After the Enron debacle of 2001, came other scandals involving large US companies such as WorldCom, Qwest, Global Crossing, and the auditing lacunae that eventually led to the collapse of Andersen. These scandals triggered another phase of reforms in corporate governance, accounting practices and disclosures-this time more comprehensive than ever before.

Shleifer and Vishny (1997) define corporate governance by stating that it “deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment”. A similar concept is suggested by Caramanolis- Cotelli (1995), who regards corporate governance as being determined by the equity allocation among insiders (including executives, CEOs, directors or other individual, corporate or institutional investors who are affiliated with management) and outside investors. John and Senbet (1998) propose the more comprehensive definition that “corporate governance deals with mechanisms by which stakeholders of a corporation exercise control over corporate insiders and management such that their interests are protected”.

They include as stakeholders not just shareholders, but also debt holders and even non-financial stakeholders such as employees, suppliers, customers, and other interested parties. Hart (1995) closely shares this view as he suggests that “corporate governance issues arise in an organization whenever two conditions are present. First, there is an agency problem, or conflict of interest, involving members of the organization these might be owners, managers, workers or consumers. Second, transaction costs are such that this agency problem cannot be dealt with through a contract”.

The following questions will guide this study in the attempt to meet its objectives as stipulated.

i. How does corporate governance practice enhanced firm value?
ii. Whether there is a relationship between corporate governance practice and its firm value?

The contribution towards the gap of knowledge is trying to analyse whether there is a predefined way in which the effects of corporate governance practices affect firm value in the market and if so to what extent does corporate governance affects whether good or bad in terms of increase in the firm value or decreases depending on outcome.

1.3 OBJECTIVES OF THE STUDY

This study highlights the importance of analysing and improving the existing corporate governance practices in the Kenya Firms.

i. To explore the effects of corporate governance practice on the value of firms listed in Kenya.

1.4 SIGNIFICANCE OF THE STUDY

The Significance of corporate governance in this scenario is, in our minds, unquestionable. It will of great significance to the following:

It helps Employees in understanding the importance of corporate governance in order to improve their firm image thus translate into increase firm value. Most of the firms engage at activities which are aim at improving the corporate image of the firm and the best persons to champion these are employees of the firms.

This study will help corporate managers and policy makers in analysis the issues on corporate governance in order to improve 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 both in the short run and long run survival of firms will be

determined by what they engage in whether questionable or unquestionable, which will be relied upon by policy makers to make critical decision on firms.. Thus good corporate governance practice will enhance transparency to firms.

The study will also be of benefit to 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 concept of corporate governance in the minds of young professionals. The study aims to understand the perception of academicians regarding reasons for failure of corporate governance in Kenya.

CHAPTER TWO

2.0 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 value and theories thereon discussed as they relate to the study objectives. Section 2.1 is the introduction, section 2.2 theoretical background, section 2.3 other issues relevant to the study, section 2.4 empirical literature review and section 2.5 is the conclusion of the study on the effects of corporate governance practices on firm value.

2.2 THEORITICAL BACKGROUND

A theory comprises a collection of concepts, including abstractions of observable phenomena expressed as quantifiable properties, together with rules (called scientific laws) that express relationships between observations of such concepts. A scientific theory is constructed to conform to available empirical data about such observations, and is put forth as a principle or body of principles for explaining a class of phenomena.

The main underline function of a theory in any research will include the following; it aid in better decision making for managers and researchers in any field and also put information and raw data into practical aspect by analysing them into meaningful concepts in research.

The concept of finance theory involves studying the various ways by which businesses and individuals raise money, as well as how money is allocated to projects while considering the risk factors associated with them. The concept of finance also includes the study of money and other assets, managing and profiling project risks, control and management of assets, and the science of managing money. In simple terms, 'financing' also means provision and allocation of funds for a particular business module or project.

The theoretical framework upon which this study is based is the firm valuation theories and the agency theory which looks how the effects of corporate governance practice affects the value of any firm in the market. The accurate valuation of a firm is arguably the most important application of valuation theory in corporate finance. Agency theory is generally considered as the starting point for any discussion on Corporate Governance. Jensen and Meckling (1976) defined agency relationship as a contract under which one party (the principal) engages another party (the agent) to perform some services on the principal's behalf. The principal will delegate some decision-making authority to the agent. Based on this agency relationship and in the context of public listed companies, the directors are agents to the shareholders, who are the principals. The shareholders delegate authority to the directors to monitor the management of a company.

2.2.1 Agency Theory

It is an acknowledged fact that the principal-agent theory is generally considered the starting point for any debate on the issue of corporate governance emanating from the classical thesis on The Modern Corporation and Private Property by Berle and Means (1932). According to this thesis, the fundamental agency problem in modern firms is primarily due to the separation between finance and management. Modern firms are seen to suffer from separation of ownership and control and therefore are run by professional managers (agents) who cannot be held accountable by dispersed shareholders. In this regard, the fundamental question is how to ensure that managers follow the interests of shareholders in order to reduce cost associated with principal-agent theory? The principals are confronted with two main problems. Apart from facing an adverse selection problem in that they are faced with selecting the most capable managers, they are also confronted with a moral hazard problem: they must give agents (managers) the right incentives to make decisions aligned with shareholder interests.

Adam Smith's (1776) 'Wealth of Nations' is perhaps the major driving force for several modern economists to develop new aspects of organizational theory. Among other things, Smith predicts that if an economic firm is controlled by a person or group of persons other than the firm's owners, the objectives of the owners are more likely to be diluted

than ideally fulfilled. Berle and Means (1932) consider Smith's (1776) concern to specifically examine the organizational and public policy ramifications of ownership and control separation in large firms. They argue that as ownership gets increasingly held by different individuals, the industry becomes consolidated and hence the checks to limit the use of power tend to disappear (McCraw, 1990).

Jensen and Meckling (1976) develop the concern of ownership-control separation into a fully fledged agency problem comprised within the economic 'theory of the firm'. In their paper, Jensen and Meckling (1976) identify the costs of the agency problem and trace who bears the costs and why. Agency costs are described as follows. Assuming that the principal and the agent are mainly concerned about maximizing their personal wealth, agency theory believes that the agent may not always act in the best interests of the principal. Added to this, long term contingencies are also not amenable to be predicted, which makes the principal build only incomplete contracts with the agent. Note that incomplete contracting set up makes the study of agency relationship critical. The principal needs to set appropriate incentives for the agent and also establish monitoring mechanisms to control any deviant activities of the agent, which are classified as the 'monitoring costs'. Jensen and Meckling (1976) clarify that the term 'monitoring' is comprehensive as it includes controls, such as setting budget restrictions and operating rules, beyond merely observing and measuring the agent's performance.

Further, the agent may also spend resources in guaranteeing that he or she would not take actions which would harm the principal (an example is the bond provided by the agent) which is included under 'bonding costs'. Even after incurring monitoring and bonding costs, the principal may suffer loss since the agent's decisions may be different to those that would maximize the principal's welfare. The monetary equivalent of such loss is classified as the 'residual loss'.

Thus, agency costs are the total of; monitoring costs, bonding costs and residual loss. Williamson (1988) further clarifies that residual loss is the key cost that the principal

would seek to reduce. To help achieve this objective, the principal incurs monitoring costs and makes the agent incur bonding costs.

Hence, the “irreducible agency costs are the minimum of these three costs”. Prior to examining the wealth effects of these agency costs, Jensen and Meckling (1976) clarify that they do not look into the normative aspect of how to structure an optimal contract between the parties but only the ‘positive’ aspect of the incentives of the principal and the agent to enter into a contractual relationship, given the circumstances under which the contract is designed.

Agency costs are the total of monitoring costs, bonding costs and residual loss .Typically, ownership and control get separated whenever a firm’s owner dilutes his ownership rights by selling a small portion of the firm to new buyers. This may be because the owner may like to gain better utility (either pecuniary or non-pecuniary) by dispensing some of his or her ownership rights. The new owners do not hold a controlling interest in the firm which is still held by the old owner. Note here that the old owner continues to run the firm as an agent to protect the interests of the new owners who are the principals. Expecting a divergence of interests with the old owner, the new owners may believe that the old owner’s decisions may need to be monitored. A practical way for the new owners is to deduct potential monitoring costs from the purchase price payable to the old owner. Often called ‘pricing-out’ strategy, such ‘net’ payments reduce the wealth of the old owner. In addition, the old owner may also need to spend moneys on bonding to offer guarantees to the new owners. In short, the agency costs or the wealth-effects of the separation of ownership and control are borne by the old owner-and-controller, who has all the incentives to ensure that the agency costs are kept at a minimum level.

The same explanation can be extended to even a situation where an owner sells the entire firm to a number of buyers but continues to run the firm merely as a manager, along with other professional managers. The buyers (hereafter, the new owners) and the managers hold specialized experience and skills in financing and managing, respectively. This is an important reason for the existence of large modern corporations. The new owners

contract to pay the managers risks of acquiring firm-specific knowledge and experience whose value is more within the firm and less elsewhere. The managers agree to compensate the new owners for potential contractual defaults. However, Jensen and Meckling (1976) believe that the degree to which the original owner may dilute his or her ownership status depends upon factors such as the amount of monitoring and bonding costs associated with the separation and the owner's aptitudes and interests in relation to controlling totally-owned as against partially-owned resources.

In summary, the underlying argument under the agency theory is that shareholders inevitably surrender the control and full access to information when they delegate power and authority to corporate management. Transferring control to unethical and self-interested managers coupled with loss of power destroy firm's value. In the context of debt holders, they do not have effective control on the use of the funds they provide. Funds provided can be diverted from the intended objective when the managers are self-interested. Corporate governance mechanisms are subsequently needed to mitigate the potential loss of value to shareholders and debt holders alike.

2.2.2 Stakeholders Theory

One argument against the strict agency theory is its narrowness, by identifying shareholders as the only interest group of a corporate entity necessitating further exploration. By expanding the spectrum of interested parties, the stakeholder theory stipulates that, a corporate entity invariably seeks to provide a balance between the interests of its diverse stakeholders in order to ensure that each interest constituency receives some degree of satisfaction (Abrams, 1951). The stakeholder theory is therefore appears better in explaining the role of corporate governance than the agency theory by highlighting the various constituents of a firm. Thus, creditors, customers, employees, banks, governments, and society are regarded as relevant stakeholders. Related to the above discussion, John and Senbet (1998) provide a comprehensive review of the stakeholders' theory of corporate governance which points out the presence of many parties with competing interests in the operations of the firm. They also emphasize the

role of non-market mechanisms such as the size of the board, committee structure as important to firm performance.

Stakeholder theory has become more prominent because many researchers have recognized that the activities of a corporate entity impact on the external environment requiring accountability of the organization to a wider audience than simply its shareholders. For instance, McDonald and Puxty (1979) proposed that companies are no longer the instrument of shareholders alone but exist within society and, therefore, has responsibilities to that society. One must however point out that large recognition of this fact has rather been a recent phenomenon. Indeed, it has been realized that economic value is created by people who voluntarily come together and cooperate to improve everyone's position (Freeman et al., 2004).

Jenson (2001) critique the Stakeholders theory for assuming a single-valued objective (gains that accrue to a firm's constituencies). The argument of Jensen (2001) suggests that the performance of a firm is not and should not be measured only by gains to its stakeholders. Other key issues such as flow of information from senior management to lower ranks, inter-personal relations, working environment, etc are all critical issues that should be considered. Some of these other issues provided a platform for other arguments as discussed later. An extension of the theory called an enlightened stakeholder theory was proposed. However, problems relating to empirical testing of the extension have limited its relevance (Sanda et al., 2005).

2.2.3 Stewardship Theory

This theory, arguing against the agency theory posits that managerial opportunism is not relevant (Donaldson and Davis, 1991; Davis, Schoorman and Donaldson, 1997; Muth and Donaldson, 1998). According to the stewardship theory, a manager's objective is primarily to maximize the firm's performance because a manager's need of achievement and success are satisfied when the firm is performing well. One key distinguishing feature of the theory of stewardship is that it replaces the lack of trust to which agency theory refers with respect for authority and inclination to ethical behaviour.

Quite opposite to the agency theory however, Davis, Schoorman and Donaldson (1997) argue that stewardship theory would suggest that control be centralized in the hands of firm managers. It would appear that stewardship theory readily lends itself for application in motivation of top management. The theory, however, fails to take cognizance of the rampant cases of failures of managerial integrity (moral hazard) and managerial competence (adverse selection). This glaring omission makes stewardship theory inadequate as a framework for analyzing corporate governance mechanisms in the modern corporation.

The brief analysis of stakeholder theory, democratic theory, stewardship theory and management theory, reveals inherent weaknesses, particularly with regard to the crucial areas of control, monitoring and accountability structure. Agency theory, on the other hand, appears to effectively mitigate all the glaring inadequacies of the other governance theories. The principles of agency theory are applicable not just to private sector firms, but to all social organizations. Public sector corporations, cooperatives, and mixed governance models can all benefit from the basic principles and lines of authority and accountability that are embedded in agency theory. Jensen and Meckling (1976), argue that there exist governance mechanisms by which to minimize conflicts arising from agency relationships in firms. Hence, agency theory lends itself as the most appropriate framework for analyzing the relationship between ownership structure and firm performance.

2.2.4 Firm Valuation Theories

A review of the valuation literature indicates there are several fundamental concepts involved in estimating the intrinsic value of a stock, a bond and a firm. In the late 1930s Professor John Burr Williams (1938) developed a theory for estimating the value of a stock based on the idea of discounting a constant stream of dividends to infinity (DIV) that is the future cash flows that stockholders would receive. In the early 1960s, Gordon (1962) extended Williams DIV by allowing the stream of dividends to grow at a constant forecasted rate from time period zero to infinity. The Gordon constant growth model is widely used in the investment management profession. Also it has been extended to

incorporate dividends growing at uneven rates. The estimation of bond value is similar to the Dividend Discount Model (DIV), in that the bond value equals to a discounted stream of interest payments and the final maturity value at the yield to maturity, Homer and Leibowitz (1972).

Market-driven economy investors are looking for the most profitable placement of their capital. This leads to a redistribution of the recourses on economy-wide scale from industries and companies which use investor's capital inefficiently and destroy wealth to industries and companies which use investor's capital efficiently and create wealth. For corporate managers, wealth creation is fundamental to the economic survival of the firm. As suggested by Rapport (2006) managers that fail (or refuse) to see the importance of this imperative in an open economy do so at the peril of the organization and their own careers.

There are several analytical tools which can help to make wise decisions in this field. They range from traditional Dividend Discount model and Free Cash Flow (FCF) model to not so long ago created Economic Value Added (EVA) model of enterprise valuation. At the same time in line with theoretical models for valuing companies there is a market value for companies derived from market supply and demand for their stocks. In general, if we again refer to "one value principle" described in Grant (2003), both theoretical and market approaches have to lead to the same results. But in reality there is always some discrepancy in those two values which is a result of the influence of the number of factors. Identification and analysis of those factors is of key importance for investors to discover the most profitable investments and for the economy to ensure the most efficient use of capital. The discrepancy between theoretical and market value of the company, however, should not last forever. If it happens then capital market will be sending wrong signals to the investors about on the one hand industries with high potential which use capital productively and create economic profit and on the other hand industries with low potential who waste capital and achieve economic loss. This would lead to a situation when productive industries will face a deficit of capital and unproductive industries will

face a surplus of capital. Such inefficient distribution of capital finally would be a threat for the development of a real sector of the economy.

2.3 OTHER RELEVANT ISSUES

2.3.1 Corporate Governance and Firm Valuation

A firm's various corporate governance practices shape its behaviour and eventually affect its stock market performance and accounting performance (Chow G. 2005). Various researchers examined the relation between state ownership and firm performance. Tian (2002) finds that government ownership worsens a firm's performance when government ownership is small, but improves a firm's performance when government ownership gets significantly larger.

Several other studies examine the impact of other governance mechanisms on listed firms' performance. Ning and Zhou (2005) find that employee stock ownership does not improve firm performance significantly in China, suggesting that a negligible fractional ownership does not provide a meaningful employee incentive. Kato and Long (2005) find evidence that CEO turnover-firm performance sensitivities are larger for privately controlled listed firms than for state controlled firms, indicating the inefficiency of state ownership from the CEO turnover perspective.

Bai et al. (2004) offer a comprehensive analysis of the impact of various governance mechanisms on firm market valuation. They find evidence that the degree of concentration of shares held by other large shareholders positively affects firms' market valuation. It is argued that when shares are concentrated in the hands of other large shareholders, they are more likely to monitor the largest shareholder and prevent him from tunneling a firm's resources. Bai, Lin and Song (2004) provide evidence that the degree of concentration of shares by other large shareholders is a good proxy for the likelihood of an emerging corporate control market. As such, it captures the effects on firm performance of an active takeover market, which has been widely touted as an effective external governance mechanism. Bai et al. (2004) find that issuing shares to foreign investors helps to improve firms' valuation, partly due to the monitoring effect of

the relatively more sophisticated foreign investors, and partly due to more transparent financial disclosure required for cross-border listings. Among other governance mechanisms, they find that CEOs being the chairmen of boards negatively affect firm valuation, indicating that increasing the independence of boards of directors helps to enhance firm performance. They also find that when the largest shareholder is the state, the firms tend to have lower market valuation.

The control-based corporate governance model may hurt the performance and corporate governance of newly listed state enterprises. Chen, Fan and Wong (2004) find that the 3-year post-IPO average stock returns of these politically connected firms under-perform the market by almost 30 percent. They conclude that the appointment of politically connected CEOs does not enhance shareholder value but rather fulfils the political goals of politicians. Corporate governance practices shape a firm's behaviour. It is therefore natural to expect that they also affect a firm's stock returns (Gompers et al. 2003). Wang and Xu's (2005) argue that due to the speculative nature of the capital markets and low quality of the accounting information, book-to-market does not reflect fundamentals in the stock market. Instead, they suggest that a firm-specific floating ratio is a good proxy for expected corporate governance, which helps to predict a firm's future cash flow.

2.3.2 Corporate Governance and Firm Performance

It is widely acclaimed that good corporate governance enhances a firm's performance (Brickley et al, 1994; Brickley and James, 1987; Byrd and Hickman, 1992; Chung et al, 2003; Hossain et al, 2000; Lee et al, 1992; Rosenstein and Wyatt, 1990; Weisbach, 1988). In spite of the generally accepted notion that effective corporate governance enhances firm performance, other studies have reported negative relationship between corporate governance and firm performance (Bathala and Rao, 1995; Hutchinson, 2002) or have not found any relationship (Park and Shin, 2003; Prevost et al. 2002; Singh and Davidson, 2003; Young, 2003).

Several explanations have been given to account for these apparent inconsistencies. Some have argued that the problem lies in the use of either publicly available data or survey

data as these sources are generally restricted in scope. It has also been pointed out that the nature of performance measures (i.e. restrictive use of accounting based measures such as Return On Assets (ROA), Return On Equity (ROE), Return On Capital Employed (ROCE) or restrictive use of market based measures (such as market value of equities) could also contribute to this inconsistency (Gani and Jermias, 2006).

Furthermore, it has been argued that the "theoretical and empirical literature in corporate governance considers the relationship between corporate performance and ownership or structure of boards of directors mostly using only two of these variables at a time" (Krivogorsky, 2006). For instance, Hermalin and Weisbach (1991) and McAvoy et al. (1983) studied the correlation between board composition and performance, whiles Hermalin and Weisbach (1991), Himmelberg et al. (1999), and Demsetz and Villalonga (2001) studied the relationship between managerial ownership and firm performance.

To address some of the aforementioned problems, it is recommended that a look at corporate governance and its correlation with firm performance should take a multivariate approach. The present study adds to the literature by employing both market based and accounting based performance measures such as return on assets and Tobin's q and test the relationship between them and selected governance variables. In addition to board characteristics, we also include board activity intensity as well as audit committee practices and characteristics and institutional shareholding as an extended arm of governance.

2.3.3 The Impact of Corporate Governance Disclosures on Firm Performance

Better corporate governance is likely to improve the performance of firms, through more efficient management, better asset allocation, better labour practices, or similar other efficiency improvements (Claessens, 2006). Drobetz et al. (2004) argue that agency problem, the foundation of agency theory, is likely to exert impact on a firm's stock price by influencing expected cash flows accruing to investors and the cost of capital. Firstly, low stock price result from the investors' anticipation of possible diversion of corporate resources. Theoretical models by La Porta, Lopez-de-Silanes, Shleifer and Vishny (2002)

and Shleifer and Wolfenzon (2002) also predict that in the existence of better legal protection, investors become more assured of less expropriation by controlling bodies and hence, they pay more for the stocks. Secondly, through reducing shareholders' monitoring and auditing costs, good corporate governance is likely to reduce the expected return on equity which should ultimately lead to higher firm valuation.

There exists a well number of anecdotal evidence of a link between corporate governance practices and firm performance. But the empirical studies mainly focus on specific dimensions or attributes of corporate governance like board structure and composition; the role of non-executive directors; other control mechanisms such as director and managerial stockholdings, ownership concentration, debt financing, executive labour market and corporate control market; top management and compensation; capital market pressure and short-termism; social responsibilities and internationalization.

Though the relationship between shareholders, directors and management has been the central topic of corporate governance research for a long time, focusing merely on the legal company and the firm as the agent of the shareholder seems no longer sufficient and time has come to view the governance of the firm as a whole (Van den Berghe, 2002). Moreover, as Ho (2005) argues, evaluating corporate governance on individual dimension or attribute may not capture the total effect of corporate governance as much as the case where all the attributes are considered collectively. Hence, researchers often attempt to measure overall corporate governance and try to identify the relationship between corporate governance and firm performance.

2.3.4 Measuring Firm Performance

Three main approaches to firm level performance are found in social science research: research based on market prices, accounting ratios and total factor profitability. Market prices are readily obtained from national stock exchanges for all listed firms and are either in levels or first differences. These data are commonly used in the economics and finance literatures, whereas Tobin's Q is frequently the variable of choice in management and strategy research. Moreover, is it clear that not all markets are efficient, particularly

in developing and emerging countries with emerging stock markets that are known to be illiquid and lacking in breadth and depth.

The popular Tobin's Q is a ratio comprised of a continuous time variable in the numerator and an annual, or semi-annual, value in the denominator. Neither ensures robustness or stability in an estimating equation; however a number of studies relating governance systems within the firm are modelled in this way. Measuring firm performance using accounting ratios is also common in the corporate governance literature, in particular, return on capital employed, return on assets and return on equity. Similarly, economic value added can be used as an alternative to purely accounting-based methods to determine shareholder value by evaluating the profitability of a firm after the total cost of capital, both debt and equity, are taken into account.

2.3.5 Corporate Governance Indices

Corporate Governance indices have been developed by many companies and researchers. However, the majority of these are relevant only to developed economies. This is a flaw that is quickly being corrected since developing economies also need to have proper Corporate Governance measures. Of the notable Corporate Governance indices that have been formulated are the following: the Corporate Governance index developed by Ananchotikul (2008), the index developed by Black, Jang and Kim (2003a and 2003b), the Financial Times-Stock Exchange -ISS Corporate Governance index (2005), the Gompers, Ishii and Metrick (2003) index, the Corporate Governance Index developed by Khanna et al (2001), and by Klapper and Love (2002). Of these, only the index developed by Ananchotikul (2008) was specifically formulated for developing countries.

According to Cornelius (2005) the Financial Times-Stock Exchange and Institutional Shareholder Services have partnered to create a Corporate Governance Index. According to their publication there are five major aspects of Corporate Governance that a firm should prepare for: (1) Compensation systems for Executive & Non Executive directors (2) Executive and non executive stock ownership (3) Equity structure (4) Structure and independence of the board (5) Independence and integrity of the audit process. Although the Financial Times-Stock Exchange Institutional Shareholder Services index is very

well thought out and relevant, it is only constructed for developed economies and this is a major flaw in the index.

Gompers et al (2003) construct an index by adding one point for every firm for every provision by the firm that restricts shareholder rights and by extension, increases managers' power. Sub indices are also created: delay, protection, voting, other, state. The index totals 28 provisions in all, 24 of these are exclusive to them.

Black et al (2003a, 2003b) constructed a Corporate Governance based on a survey carried out by the Korea Stock Exchange. They have six sub indices: shareholder rights, board of directors, outside directors, audit committee, internal auditor, disclosure to investors, ownership parity. They allow each sub index to carry a maximum value of 20 with the overall Corporate Governance having a maximum value of 100. If a firm does not report on a particular question it is not considered as a part of the value, in this manner this index differs from others, particularly from Ananchotikul (2008) who uses the zero value to indicate that there is a lack of a corporate governance measure that should have been included by the firm. The authors excluded subjective questions from the construction of the index (these were taken to be questions where the managers were asked to offer an opinion). The authors had 38 survey elements which were usable for constructing the Corporate Governance after they eliminated certain aspects of the survey which would not have contributed to the index such as subjective questions, questions not directly related to Corporate Governance, questions with ambiguous answers, with high overlap, minimal variation between firms, few responses.

According to Ananchotikul (2008) the major aspects of Corporate Governance are: board structure, board responsibility, conflict of interest, shareholder rights, disclosure & transparency. She constructs a firm Corporate Governance index for firms in Thailand which uses only information available from public sources such as company disclosure reports, annual reports, company websites, stock exchange of Thailand databases. Up to 87 criteria are analyzed. The values for Ananchotikul (2008)'s index range from 0 to 100 with 100 being the perfect Corporate Governance score and 0, the worst. The interesting part about this index is the fact that it uses only publicly available information. This, the

author states, is favourable to using the survey collection method for Corporate Governance data since firms instantly believe that they are being judged on the appropriateness of their Corporate Governance structures. This may lead to inaccurate reporting or self selection where only firms with good Corporate Governance structures will be likely to report values. Ananchotikul (2008) uses a weighted average of the sub indices to create a composite Corporate Governance Index. The weights assigned are as follows: board structure – 20%, conflict of interest – 25%, board responsibility – 20%, shareholder rights – 10%, disclosure & transparency – 25%.

The Heidrick and Struggles biennial study (2001 – 2009) first rated firm in ten European countries: Belgium, France, Germany, Italy, the Netherlands, Portugal, Spain, Sweden, Switzerland, and the UK and then expanded to include Austria, Denmark and Finland. These countries are rated on Corporate Governance with a maximum rating of 16 being allowed. The company ratings are used to produce a country average, and the country averages are used to create an overall European rating. The study uses only published information and especially, the annual reports of the companies. The working style of the board, board composition and the disclosure of the firm were considered to be the three driving forces in Corporate Governance in a firm.

Khanna et al (2001) report on several Corporate Governance Indices. In particular they mention the Credit Lyonnais Securities Asia (CLSA) Corporate Governance Index. The index was constructed using a 57 question survey of which 70% was based on facts while 30% required the analyst's opinion. The questions were all answered in the yes/no form and where Corporate Governance information was not available the answer 'no' was used since a lack of information about governance indicates poor governance and should be treated as such. The questionnaire used to formulate the index was broken up into seven parts: fiscal discipline, accounting transparency/disclosure, board independence, board accountability, responsibility, equitable treatment of shareholders, social awareness. One of the limitations of this questionnaire is its reliance on analyst opinion.

Klapper and Love (2002) developed a Corporate Governance Index using the Credit Lyonnais Securities Asia(CLSA) questionnaire data as well as Worldscope data and use six components of the index: management discipline, transparency, independence, accountability, responsibility, fairness. The components are not studied as sub indices since they each have overlapping parts. This index has a maximum value of 100 and a minimum value of zero.

Overall the Corporate Governance Indices have some common themes: Shareholder Rights are important in all cases and almost all the authors (Khanna et al 2001, Black et al 2003, Ananchotikul 2008, Gompers et al 2003) have a sub index devoted to Shareholder Rights. Another major focus is that of the board of directors of a firm. This is shown in two ways–the emphasis on responsibilities of the board of directors (Ananchotikul 2008, Black et al 2003, Cornelius 2005, Khanna et al 2001, Klapper and Love 2002) and the emphasis on the structure of the board (Ananchotikul 2008, Black et al 2003, Cornelius 2005, Khanna et al 2001). Transparency is also very important to a good Corporate Governance system since transparency inspires shareholder confidence in the firm Anandchotikul (2008), Black et al (2003), Khanna et al (2001), Klapper and Love (2002). Another major element of Corporate Governance is that of the audit committee's performance. After the crash of the Arthur Andersen accounting firm, the audit process has been under strict scrutiny. The index constructed by Black et al (2003) includes a sub index on the audit committee and the Financial Times-Stock Exchange Institutional Shareholder Services Index also includes a sub index on the audit committee (Cornelius 2005) while Klapper and Love (2002) have a component titled 'accountability'.

2.4 EMPRICAL LITERATURE REVIEW

There are many empirical studies that try to assess the validity of the effect of corporate governance practice on firm value in various part of the world and also the drawbacks of their findings, whether they are focused on additions to firm value are often contradictory.

Scott Moore and Gary Porter (2007) undertook a study that brings together two important strains of the literature on the relationship between corporate governance and corporate performance. Like Gompers, Ishii, and Metrick (2003) also used an index to summarize the corporate governance regimes of individual firms. Rather than construct their own index, also Corporate Governance Quotient, a commercially produced, widely disseminated governance index to measure the strength of firm governance. The model governance and performance in a simultaneous equations framework to take into account the fact that governance regime and performance may be endogenous. The empirical results are consistent with the proposition that Corporate Governance Quotient captures differences in the strength of governance regime across firms. They also show that unsystematic risk is strongly related to this governance rating. This evidence suggests that business opportunities are an important determinant of cross-sectional variation in governance regime. Like Demsetz and Lehn (1985), however, we do not find governance regime is related to cross-sectional variation in firm performance. They concluded that pursuing governance ratings standards without regard to the firm's operating and financial policies may be unproductive or even counterproductive.

In Korea Black et al. (2006) carried out a research that shows a strong Ordinary least square and instrumental variable evidence that overall corporate governance index is an important and likely causal factor in explaining the market value of Korean Public Firms.

In the India firms, Bhattacharyya, Raychaudhuri and Rao (2008) also undertook a study using event study methodology with quasi-experimental research design, Bhattacharyya et al. (2008) find that increased information disclosure and better corporate governance mechanism resulting from the regulation enforced by the Securities and Exchange Board of India reduce cost of capital of Indian listed companies.

In contrary to the above findings, somewhat different result is reported by Bauer, Guenster and Otten (2004) for Europe and the United Kingdom. Their empirical results suggest a negative relationship between governance standards and earnings based performance ratios (net profit margin and return on equity). In an event study, De Jong,

DeJong, Mertens and Wasley (2005) do not detect any price effects following actions taken by the Netherlands' private sector self-regulation initiative ("The Peters Committee"). In a recent study, Cheung, Jiang, Limpaphayom and Lu (2008) also find no statistically significant correlation between corporate governance practices and market valuation in China in the year 2004.

Several difficulties arise in examining the governance-performance relationship empirically that may contribute to the divergence in the evidence. One is that governance and performance are likely to be jointly determined. For example, a governance mechanism like the ownership stake held by board members may lower agency costs by pumping up the rewards to effective monitoring. This may lead to better firm performance, but better firm performance may also lead board members to hold larger stakes of the firm, creating two-way causality between governance and performance.

Many studies that examine performance and governance structure use a single regression equation framework, failing to account for the potential dual causality between performance and governance structure. Jensen, Solberg, and Zorn (1992), Barnhart and Rosenstein (1998), and Weber and Dudney (2003) tackle this problem by utilizing a simultaneous equations framework that allows firm performance and governance structure to be endogenous.

2.4.1 Global Perspective

The following are the empirical literature based on previous research both in global perspective and local perspective which help in analysis the effects of corporate governance and also testimony on the same.

Studies of the channels through which governance may affect firms' market values or overall value are more limited. Two closely related academic studies focusing on corporate governance and long-term equity returns are Gompers et al. (2003) and Drobetz et al. (2003). Gompers et al. (2003) analyze the impact of 24 governance provisions on stock returns for about 1500 U.S. firms from 1990 till 1999. They construct portfolios

consisting of firms with numerous anti- takeover amendments ("Dictatorship Portfolio") and portfolios including firms with very few amendments ("Democracy Portfolio"). Subsequently, they examine the returns to holding a long position in the Democracy Portfolio and a short position in the Dictator-ship Portfolio. This long-short strategy yields an average annual return of about 8.5% after adjusting for factor exposures of the portfolios using the Carhart (1997) model. Drobetz et al. (2003) analyze the impact of corporate governance on stock returns over the period 1998-2002 in Germany. Due to the fact that their corporate governance data are limited to one observation, March 2002, they assume constant historical ratings. To construct their sample, Drobetz et al. (2003) sent out questionnaires to 253 German firms in different market segments and received answers from about 36% of these firms. In line with Gompers et al. (2003), Drobetz et al. (2003) also build factor portfolios consisting of well- governed versus poorly governed firms. After accounting for different factor exposures of the portfolios, their results show an amazing annual excess return of 16.4% to a corporate governance long-short strategy.

The empirical literature on the relationship between firm value and corporate governance usually analyzes both differences among countries and their impact on firm value or inter-firm variation within a country. The most prominent example of the first type of study is La Porta et al. (2001), who investigate differences in governance standards among 27 countries. Their evidence shows that firms incorporated in countries with better governance standards tend to have a higher valuation. Examples of the second type of studies investigating inter-firm variation within one country are Drobetz et al. (2003) for Germany, Gompers et al. (2003) for the U.S., de Jong et al. (2002) for the Netherlands and Black (2001) for Russia. These studies generally find a positive relationship between governance standards and firm value. Comparing the findings of these studies, it is worth noting that the relationship seems to be stronger in countries with less developed standards.

There are rather fewer empirical literature which examines the impact of a complete set of governance standards on firm performance approximated by profitability ratios. Most studies instead investigate the impact of a single governance characteristic on firm

performance. Again, they used the approach of Gompers et al. (2003). Their evidence shows that superior governance standards positively impact firm performance as measured by Net-Profit-Margin and Return-on-Equity in the U.S.
Klapper and Love (2004) and Mitton (2004) report an association between the Credit Lyonnais Securities Asia governance index and firm profitability; Klapper and Love (2004) also link this index to firm market value. However, the Credit Lyonnais Securities Asia index is based on a 2001 survey of analysts, depends significantly on analysts' subjective views, and includes some questions which relate more to management quality than to governance. Thus, analysts might simply be giving higher scores to firms which have performed better. Joh (2003) finds that Korean chaebol firms with high control-ownership disparity have lower profitability during the pre-crisis period. Black, Jang, and Kim (2006) find no contemporaneous connection for Korean firms between governance and profitability; however, Black and Kim (2008) find evidence of higher profitability for large firms several years after board structure reforms at these firms.

There is also evidence of a link between governance and dividend payout. Mitton (2004), using the Credit Lyonnais Securities Asia index, finds this link primarily in countries with strong investor protection. He also found a stronger negative relationship between dividends and growth opportunities in firms with higher Credit Lyonnais Securities Asia scores. Hwang, Park, and Park (2004) find an association between the governance of Korean firms (measured based on a 2003 Korea). The Credit Lyonnais Securities Asia questions are summarized in an Appendix to Klapper and Love (2004). Korean Corporate Governance index survey and dividends, and that higher Korean Corporate Governance index scores mitigates chaebol firms' tendency to pay out lower dividends. Liu and Lu (2007) find for Chinese firms that better governance is associated with less earnings management, and likely with lower levels of tunnelling.

In Korea one analysis on Corporate Governance effects on firm value were carried out by Black, Jang and Kim (2006a) where they use only cross-sectional data from 2001. They develop the Korean Corporate Governance index for 2001, develop and justify the use of large firm dummy (=1 if firm has assets > 2 trillion won, otherwise) as an instrument for

either Board Structure Sub index or all of Korean Corporate Governance index (with only cross-sectional data, it was unclear which was preferable), and report evidence of a Governance-to-value association between Korean Corporate Governance index and firm market value, and likely causation for large firms, using the large firm dummy instrument. Black and Kim (2008) show that large firm dummy is best understood as an instrument for Board Structure Sub-index, rather than all of Korean Corporate Governance index, and seek to tighten the causal link between the legal shock to Board Structure and an increase in large firms' market values, using a combination of empirical strategies. Black, Jang and Kim (2006b) examine the factors which predict firms' governance choices and find evidence of a large role for idiosyncratic choice.

2.4.2 Local Perspective

The analysis of corporate governance systems has attracted attention in Kenya Market. Some studies have examined the connection between ownership structures and performance, while more recently others have focused on the relationship between corporate governance structures at the firm level and a firm's valuation and performance.

Onyango (2000) undertook a study on the relationship between ownership structure value of firms listed at the Nairobi Stock Exchange and arrive to a conclusion that the relationship between the value of the firm and insider. From the analysis he concluded that the value of the firm increased when insider ownership ranged between 0% and 37% while firm value again increased when the ownership level is more than 50%.

Barako et al (2007) study provides longitudinal examination of voluntary disclosure practices in the annual reports of listed companies in Kenya from 1992 to 2001. Their study investigates the extent to which corporate governance attributes, ownership structure and company characteristics influence voluntary disclosure of various types of information. Due to the panel nature of their data, to estimate the determinants of voluntary disclosure of various types of information, they use pooled Ordinary Least Square (OLS) with Panel-Corrected Standard Errors (PCSEs). The results indicate that, disclosures of all types of information are influenced by corporate governance attributes,

ownership structure and corporate characteristics. In particular, the results also suggest that size and companies in the agricultural sector are significantly associated with the voluntary disclosure of all four types of information disclosures.
Ngumi (2008) looked at the survey of the Corporate Governance Practices in the Housing Finance Company (HFCK) and concluded that a good corporate practices are the best for the banking industry .Whereby he come to the clear conclusion that bank and is the level of commitment will ensure that its business and operations are conducted with high integrity and compliance with the law and the accepted practices in accounting.

Kiamba (2008) study the effects of Corporate Governance on the financial performance of local authorities in Kenya. The study found that financial performance of the local authorities was influenced by political composition in the respective councils and manner in which internal audits are conducted and the managerial approaches applied by the council's chiefs.

Muriithi (2008) documented Corporate Governance and Financial performance of state corporations, the case of the New KCC and drawn a conclusion that better Corporate Governance will improve financial performance in that respect he identified the following Corporate Governance Practices; appointment and leadership of the board structure of the organization, purpose and values, balance of power in the board, corporate communication and the assessment of performance of board and its responsibilities.

Ongore (2008) carried out a research on the effects of ownership structure, Board effectiveness and managerial discretion on performance of listed companies in Kenya where the following conclusion was drawn from this study that; ownership concentration is inimical to a manager creativity and innovation and curtains firm performance, also increase in government shareholding of a firm results in negative performance.

2.5 CONCLUSION

2.5.1 Summary of Literature Views of Past Findings

A number of studies have examined the relationship between Corporate Governance and firm performance. Mitton (2001), in a cross country study of the Asia-Pacific region, found that firm level differences in Corporate Governance have significantly influenced firm performance during the East Asian crisis. The study also showed that higher price performance is related to higher disclosure quality, higher outside ownership concentration, and with firms that are focused rather than diversified. In conjunction, Brown and Caylor (2004) looked at 2327 U.S. firms, and found that better governed firms are also more profitable, more valuable, and pay higher dividends. Similarly, Gompers et al. (2003) found that firms that have strong shareholders' rights have higher firm value, higher profits, and higher sales growth.

To examine the relationship between Corporate Governance and the firm level performance, they used the Corporate Governance score obtained from India Index Services & Products Limited as proxy for firm level governance quality, and select financial indicators/ ratios and Tobin's Q as measure of firm level performance. For our data analysis, we adopted two approaches. In the first approach, the firms were categorized on the basis of Corporate Governance score and their financial indictors/ratios were compared. The indicators/ratios compared, were return on net worth, return on capital employed, profitability ratio (Profit after tax/Income), and interest coverage ratio.

In the second approach, they used the fixed effect regression technique to empirically test the nature of relationship between governance score and market value as measured by Tobin's Q. In Tobin's Q measure, the market value of equity exhibits the discounted present value of a company's expected future income stream. Therefore, Tobin's Q ratio takes into account the future prospects of the firm, and provides a measure of management's ability to generate future income stream from an asset base (Short and Keasey, 1999). Since stock prices move in accordance with changes in expectations about

the future cash flows and the cost of capital, this is a forward looking measure of a firm’s performance. Thus, a higher Tobin's Q indicates higher valuation by the market.

There exist several reasons for the poor quality of corporate governance in Russia. The first is rapid insider privatization. The hopes of privatization supporters that it would give profit incentives and lead to an increase in firms’ performance did not come true. Instead of this privatization in Russia led to massive self dealing by managers and controlling shareholders. Black et al argue that in the absence of mature institutions that can control self dealing privatization could not be successful. The corrupt environment is another reason for poor corporate governance quality in Russia. Lambert-Mogiliansky et al (2001) argue that the regional divisions of arbitrage courts are corrupt and that governors in alliance with top managers of big industrial enterprises use bankruptcy institutions as a mechanism for expropriation of outside investors and the federal government. Moreover, bankruptcy law does not stimulate managers to restructure enterprises but may prevent restructuring.

Fox and Heller (2000) design a topology of consequences of bad corporate governance to the real economy using Russian examples. Similar to the others, Fox and Heller could see insider dominance as a main source of corporate governance failures that are classified and supported by numerous confirmations from the Russian economy. Radygin and Entov (1999) examine a complex system of institutional corporate governance problems in Russia. Most attention is devoted to protection of property rights. This problem probably is the most important in Russia up to now.

On the other hand there are several positive trends in corporate governance in Russia. As survey of Russian enterprises shows, many managers understand necessity of corporate governance practices improvement; believe that it could attract investment in Russian industry and ready to disclose information about correspondence of their activity and recommendations of the Code prepared by Corporate Conduct Code of the Russian Federal Commission for Securities Market.

Since Rajan and Zingales (1996) seminal paper on financial dependence and growth it has been widely accepted that successful development is virtually impossible in the absence of developed capital markets. Relatively small share of the market capitalization of all Russian listed companies in Gross domestic product indicates high financial dependence preventing economic growth.

Corporate Governance and Market Value of Russian Firms .Many investment companies are ready to pay premium for good corporate governance. For example recent poll of more than 200 investment companies in 31 countries by McKinsey indicates that investors are ready to pay more for shares of transparent companies that use international financial standards. The size of this premium varies from 10-15% in USA and West Europe to 40% in Russia. Black (2001) find that companies' market value to potential capitalization ratios depend crucially on the quality of corporate governance. Using corporate governance rankings, Black predicts 700-fold increase in firm value due to a worst to best governance improvement. Therefore, one can relatively easy develop financial market, through a determined effort to improve corporate governance practices.

This direction of research seems fruitful and worth further efforts. One should check Black's results using a bigger sample (Black used a sample of 21 companies) and a different technique of econometric analysis (panel data instead of cross section regressions). This will allow us to get rid of vague concept of potential capitalization and make sure that variation in companies' values is due to variation in quality of corporate governance not to financial or other hidden characteristics.

2.5.2 Justification of the Study

Corporate failures have come about as a result of bad decisions made by its leaders in attempts to expropriate shareholders funds in their own interest, thus as the receipt for good governance across the world the enactment of the codes of good governance has shown the importance to this topic .Policy Makers, the print and electronic media and other interested groups have come to believe that firm value is significantly influenced by good corporate governance practice. However, the study of corporate governance is very

broad and tedious and as result most studies concentrate on a few internal and external controls mechanism. The relationship of corporate governance to firm value has been carried out mostly using valuation measures for listed firms and accounting measures for non-listed firms.

There is need for comprehensive that integrates all these varied study types that have received mentioned above and relevant of corporate governance to firms. There has been a renewed interest within academic circles as well as amongst policy makers in both government and industry in the need to strengthen mechanisms to ensure that managers and directors take measures to protect the interest of a firm's stakeholders. The events at Enron and other cases of spectacular failure have helped to bring to the limelight the important role that the strengthening of governance mechanisms could play to improve firm performance.

CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 INTRODUCTION

In this chapter the methodology to be used in the study is presented. The chapter is divided into two sections: The first section one presents research design. This is followed by a discussion of the data collection procedure and data analysis.

3.2 RESEARCH DESIGN

The study was conducted based on the positivist approach to research. The approach is based on objectivity, neutrality, measurement and validity of results. The roots of positivism lie particularly with empiricism, that is, all factual knowledge is based on positive information and only analytic statements are allowed to be known as true through reason alone. Positivist approach seeks empirical regularities, which are correlations between variables Lather, (1991 and Sanguinetti, (1994). This does not need to be causal in nature, but it does allow laws to be defined and predictions made. This approach is contrasted with the phenomenological approach which does not begin from an established theory, and then proceeds to collect data to either vindicate or reject the theory; the study is designed to be empirical in nature, and proceeds from an established theoretical underpinning.

3.3 POPULATION AND SAMPLE SIZE

The population of interest in this study will be the Listed Kenya firms at the Nairobi Stock Exchange which are 45 firms since two firms are suspended that is Hutching Biemer Limited and Uchumi Supermarket Limited. From the population convenience sampling which is non-probability will be used. As the name suggests convenience sampling refers to the collection of information from members of the population which are conveniently available to provide it. This study will be based on 20 selected sample firms in Kenya where one respondent are taken from each firm (Appendix 4) to find out

whether Corporate Governance practices affect firm value. This study focuses on firms listed in the main market segment of the Nairobi Stock Exchange during the period 2009.

3.4 DATA COLLECTION METHOD

In order to identify the effects of Corporate Governance Practice on firm value, both primary and secondary data will be used. Firm value, Sales /Revenue, Age of the firm and Leverage of the firms will be obtained from the records of the companies which included; Nairobi Stock Exchange (NSE) handbook for 2006,annual reports, director's speech, balance sheet, profit and loss account statements, cash flow statements and other company publications of the selected 20 Listed firms for the year 2009 while newspapers, business column, internet publications about a specific company and other similar researches which have been conducted concerning this topic. Corporate Governance Indices shall be based on the following five Firm value corporate governance Items; Board Responsibility, Board Structure ,Shareholders rights ,Transparency and Disclosure and the Audit Committee where a ranking scale of 1-5 will be assigned as per the Financial Times-Stock Exchange(FTSE)Institutional Shareholder Services Corporate Governance Index.

3.5 DATA ANALYSIS AND PRESENTATION

Data was analysed through descriptive statistics such as percentages, ranking, scales and averages. For each listed firm, CG index will be computed as an equally sum of the 5 corporate governance items. This will be coded into a computer using Software Package for Social Sciences (SPPS) version 17.0 and Eviews5 Quantitative Micro software. The results will then be presented in form of charts, tables and graphs and it is from these presentations that conclusions will be drawn.

3.5.1 Analytical Model

Despite several weaknesses in both financial and market-based measures, more and more studies now rely on market-based measures. For instance, Demsetz et al. (1985) used accounting measures, but Demsetz et al. (2001) shifted to market-based measures. As a result, there is a believe higher reliance on market-based measure is justifiable for two

reasons. First, market-based measure is less prone to accounting variations, and secondly, it reflects investor perceptions about the firm's future prospects. The general form of the panel model can be specified more exactly as:

$Y_{i,t}= \beta_{i+} \beta_{2}X_{i,t}+ \varepsilon_{i,t.}$..(1)

The following regression model will be applicable in this research:

$Q(Y) = \beta_0 + \beta_1 CG\text{-}INDEX + \beta_2 \ln SALES + \beta_3 \ln(AGE)AGE + \beta_4 (DEBT / EQUITY) + \varepsilon_{i,t}$..(2)

$(y= \beta_{0+} \beta_1 X_{1+} \beta_2 X_2 + \beta_3 X_{3+} \beta_4 X_{4+} \varepsilon_{i,t})$

Where:

$\beta_{0,}$ $\beta_{1,}$ $\beta_{2,}$ β_3 and β_4 are constants;

Q = Tobin's Q; CG-INDEX = Corporate Governance Index; SALES = Gross sales/Revenue of the firm; AGE = Year of observation minus Year of incorporation; DEBT/EQUITY = Total debt of the firm divided by the total paid-up capital of the firm and ε= The error term for the $FIRM_i$ in the $period_t$.

3.5.2 Diagnostic Test

The main diagnostics test used in the study were correlation and t- test. These will be used to find out if there is a relationship between corporate governance practice and Value of the firm and if there is, what is the nature of their relationship.

CHAPTER FOUR

4.0 DATA ANALYSIS RESULTS AND DISCUSSION

4.1 INTRODUCTION

This chapter provides an analysis of data collected from the secondary and primary data; Section 4.1 is the introduction, section 4.2 presents descriptive statistics of the sample data, 4.3 corporate governance index statistics for the firms and section 4.4 discussions of the results. They are also presented sequentially according to the research object .The study is descriptive; quantitative analysis was used in the form of mean, median, Standard deviation, Kurtosis, Jarque-Bera and Probability analysis of the variables in respect to effects of corporate governance practice on firm value for listed Kenya firms.

4.2 DESCRIPTIVE STATISTICS

The following table (4.2.1) demonstrates the descriptive statistics for the variables used in this analysis and the descriptive statistics which covers all the five variables enumerated in the model.

Table 4.2.1 Descriptive Statistics of the Relevant Variables Pooled

	TOBIN Q	CG-INDEX	SALES/ REVENUE	AGE OF FIRM	DEBT/EQUIY
Mean	0.659	9.220	2.402	4.035	3.656
Median	0.670	9.195	1.530	4.200	3.690
Maximum	0.980	11.180	7.890	4.700	4.580
Minimum	0.140	7.130	0.320	3.000	2.480
Std. Dev.	0.236	1.262	2.428	0.559	0.670
Skewness	-0.403	0.062	1.193	-0.629	-0.373
Kurtosis	2.285	1.899	3.103	1.981	2.166
Jarque-Bera	0.969	1.023	4.754	2.185	1.042
Probability	0.616	0.600	0.093	0.335	0.594
Sum	13.170	184.390	48.030	80.700	73.110
Sum Sq. Dev.	1.062	30.264	111.990	5.946	8.524
Observations	20	20	20	20	20

Source: Author (2010)

The Descriptive statistics was describe, the basic features of the data in the study. This provides simple summaries about the sample and the measures of the variables. The mean for Tobin Q is 0.659 and the standard deviation 0.236, from the statement estimate that approximately 95% of the scores will fall in the sum square deviation 13.17. This kind of information is a critical stepping stone to enabling us to compare the performance of an individual on one variable with their performance on another, even when the variables are measured on entirely different scales.

Table 4.2.2- The Results of the Regression Model

Variable	Coefficient	Std. Error	t-Statistic	Prob.
SALES/REV	-0.003	0.045	-0.064	0.950
D/E RATIO	0.070	0.019	3.732	0.002
CG-INDEX	0.025	0.116	0.213	0.834
AGE OF THE FIRM	-0.023	0.077	-0.305	0.764
CONSTANT	0.503	0.367	1.368	0.191
R-squared	0.511	Mean dependent var		0.659
Adjusted R-squared	0.381	S.D. dependent var		0.236
S.E. of regression	0.186	Akaike info criterion		-0.313
Sum squared resid	0.519	Schwarz criterion		-0.064
Log likelihood	8.130	F-statistic		3.920
Durbin-Watson stat	1.930	Prob (F-statistic)		0.023

Source: Author (2010)

A regression model was obtained after regressing the variables in respect of the dependent variable which is Tobin Q for the selected 20 Kenya firms. The goal of regression analysis is to determine the values of parameters for a function that cause the function to best fit a set of data observations that you provide. In linear regression, the function is a linear (straight-line) equation.

Intercept is β_0 in the equation. Standard error measures the variability in our approximation of the coefficient and lower standard error means coefficient is closer to the true value of coefficient. Tobin Q is dependent variable and CG-Index, Sales/Revenue, Age of the Firms in the market, is independent variables. Result shows that Sales/Revenue and Age of the firms are not statistically significant, CG-Index and

Debt to Equity ratio are significant at 5%.R square represents the percent of the movement of the dependent variable is captured by the intercept and the dependent variable(s). The results explain roughly 51.1% of the variation in leverage which is captured by independent variables. F-value shows that overall model is satisfied at the 1% level.

The Empirical model was obtained as follows:

TOBIN Q(Y) $=\beta_0+\beta_1$G-SCORE$+\beta_2$ ln SALES $+\beta_3$ ln(AGE)AGE $+\beta_4$ (DEBT / EQUITY)$+\varepsilon_{i,t}$...(2)

$(y= \beta_{0+} \beta_1 X_{1+} \beta_2 X_2+\beta_3 X_{3+} \beta_4 X_{4+} \varepsilon_{i,t})$

Where:

$\beta_0, \beta_1, \beta_2, \beta_3$ and β_4 are constants;

Q = Tobin's Q; CG Index = Corporate Governance Index; SALES = Gross sales/Revenue of the firm; AGE = Year of observation minus Year of incorporation; DEBT/EQUITY = Total debt of the firm divided by the total paid-up capital of the firm and ε= The error term for the FIRM $_i$ in the period $_t$.

The following Empirical model was obtained:

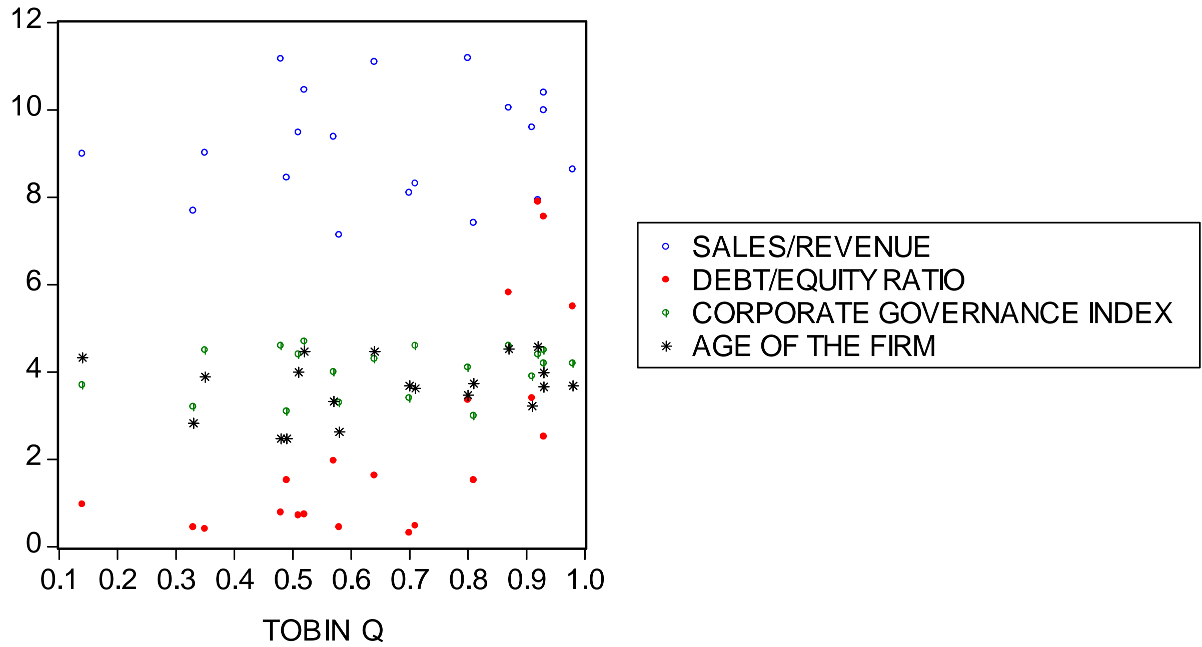
Tobin's Q=0.503+0.025CG-Index-0.003SALES/REVENUE-0.023AGE OF THE FIRMS+0.070D/E

t stat. (1.368) * (0.213)* (-0.064)* (-0.305)* (3.732)*

*Significance at 5% level; F Statistics=3.92

From the Empirical model, CG-Index, sales/revenue, age of the firm in the market, and debt to equity ratio of firms in Kenya constants, Tobin Q for the sampled firms would be 0.503. It is established that a unit increase in CG-Index of the firms would cause an increase in Tobin Q by a factor of 0.025, a unit decrease in sales /revenue would cause an decrease in Tobin Q by a factor of 0.003, also a unit decrease in age of the firm in the market would cause an increase in Tobin Q by a factor of 0.023, further unit increase in debt to equity ratio would cause an increase in Tobin Q by a factor of 0.070.

GRAPH 1-The Scatter Diagram of Tobin's Q versus the Variables



Source: Author (2010)

Scatter plot of Tobin's Q versus sales/Revenue, Debt/Equity, CG-Index and the age of the firm. The fitted line is estimated using all 20 observations for data on the scatter graph. Extreme values (highest and lowest 0.8 of values for Tobin's Q) are suppressed in the scatter plot for better visual presentation.

Table 4.2.3-Correlation Matrix for Main Variables

		Tobin Q	CG-INDEX	SALES/ REVENUE	AGE OF FIRM	DEBT/ EQUITY
Pearson Correlation	Tobin Q	1.000				
	CG-INDEX	-0.242	1.000			
	SALES/REVENUE	-0.403	0.371	1.000		
	AGE OF FIRM	-0.228	0.412	0.220	1.000	
	DEBT/EQUITY	-0.880	0.342	0.261	0.290	1.000

Source: Author (2010)

The Correlation matrix is used to determine the extent to which changes in the value of an attribute (such as corporate governance index) is associated with changes in another

attribute (age of the firm). The data for a correlation analysis consists of two input columns. Each column contains values for one of the attributes of interest. When the values are greater than 0.5 then the variables are correlated and when values are less than -0.5 then the values for are correlated. Collinearity is the term used to explain the dependence of one variable to other.

When variables are highly correlated they both express basically the same information. Statistically we do not need multicollinearity because if they exist, then independent variables are redundant and do not add any predictive value over each other. In general, independent variables having collinearity at -0.52 or less would not be included in regression analysis.

In the data the highest correlation value is -.88 (Table 4.2.3) that means collinearity should not constitute a problem in this regression analysis. The table shows that all variables are negatively correlated with each other.

4.3 CORPORATE GOVERNANCE INDEX STATISTICS FOR THE FIRMS

The following tables demonstrate the summary statistics for the variables used in this analysis and the descriptive statistics which covers all the five variables enumerated in the model. The table 4.3 indicates the Corporate Governance Index for the selected firms in Nairobi stock exchange.

Corporate governance index measures the firm’s attributes in the market and good corporate governance is always a positive result for most firms since investors will always like to get associated with firms which practice this attribute both in the long run and short run thus a good indicator of firm value in any emerging market like the Nairobi Stock Exchange.

Table 4.3.1 Corporate Governance Index

FIRMS	Mean For CG-Index
Barclays Bank of Kenya Ltd	4.6
E.A Portland Cement Co. Ltd.	3.7
E.A. Breweries Ltd.	4.7
Equity Bank Ltd.	3.9
Eveready East Africa Ltd	3.0
Kengen Ltd.	4.4
Kenya Airways Ltd	4.1
Kenya Commercial Bank Ltd.	4.2
Kenya Power & Lighting Co. Ltd	4.3
Kenya Re-Insurance Ltd.	3.1
Mumias Sugar Company Ltd.	4.0
Nation Media Group Ltd.	4.5
National Bank of Kenya Ltd.	4.2
Rea Vipingo Ltd.	3.3
Safaricom Ltd.	4.6
Sameer Africa Ltd.	3.4
Sasini Tea & Coffee Ltd.	3.2
Standard Chartered Bank Ltd.	4.4
Total Kenya Ltd.	4.5
TPS (Serena) Ltd.	4.6

Source: Author (2010)

From the analysis of Table 4.3.1on the Corporate Governance Index; East African Breweries Limited has the highest Mean For Corporate Governance Index of 4.7 meaning good corporate governance while Barclays Bank Kenya, Safaricom follow suit on the firms listed in the Nairobi Stock Exchange while Kenya Re-Insurance had the lowest at 3.1which in isolation mean that the firm need to improve on some aspect which include

the following ; Board Responsibility, Board Structure, Shareholders Rights, Transparency and Disclosure and Audit Committee.

4.4 DISCUSSION OF THE RESULTS

Results obtained from analysis, expressed in terms of the signs and statistical significance of the coefficients for the selected five independent variables are presented in Table 4.2.2. Result discussion below is categorized on the basis of these independent variables and focuses on their associations with the effects of corporate governance practice on firm value this in support of the link between governance and the valuation of companies, Morck et al. (2005) offer a review of literature on connection between country-level rules affecting corporate governance and firm behavior and the strengths of securities markets. Klapper and Love (2004) analyze connection between a measure of firm-level governance and share price on a cross-country basis.

Black made a seminal contribution to the study of the impact of governance on firm valuation in Russia and other emerging markets (Black, 2001; Black et al., 2000). Caprio et al. (2003) deal specifically with the link between the value of a firm and shareholder protection devices and state-imposed controls. Choi and Hasan (2005) examine the effect of ownership and governance on bank performance in Korea. Staryuk (2008) used value-based management concept to research how corporate governance has driven stock market valuation of Russian 'blue chip' companies. (Bokov, Vernikov, 2008) made an attempt to explain the differences in the valuation of Russian banks from a quality of governance point of view.

In this regard the discussion of the variables of the model will support the studies of effects of corporate governance on firm value as in the case of Kenya firms, the exogenous variables also turn out to be significant, but are negatively related with the firm's performance. Although firm size, as measured by sales revenue, should have a positive relationship with firm's value due to the advantages of economies of scale (Baumol, 1959), organizational inefficiency called x-inefficiency (Leibenstein, 1966) leads to loss of profit, a likely situation in larger firms. A firm's age could work either

way. Old firms have a reputation advantage, but they tend to be prone to inertia and bureaucratic rigidities. The finding is that the coefficient of Age to be negative, which means that old firms (typically existing age firms) would necessarily command higher market valuation. In a Modigliani-Miller framework, the market value of any firm is independent of its capital structure. If tax shields are precious, then the firm value should increase with the amount of leverage. However, high level of indebtedness may negatively impact investors' psychology. If the firm fails to credibly project its investment decision leading to a positive NPV, then a higher amount of debt may drive down the value of the firm.

CHAPTER FIVE

5.0 SUMMARY AND CONCLUSION

5.1 INTRODUCTION

This final chapter of the research provide a brief summary of the study's findings that are discussed in light of its objectives. The chapter also provides the researcher with documented conclusions and recommendations thereof.

5.2 SUMMARY OF THE STUDY

This study was conducted with the aim of determining whether corporate governance value has effect on firm value on listed firms for the period 2009. A linear model was applied to explain this effect .The model was found to be statistically significant at 5% level of significance.

The Study used both primary and secondary data. Primary data was collected through a structured questionnaire while secondary data were obtained from the Nairobi Stock Exchange handbooks for 2006.

From the study the adjusted R^2 is the coefficient of determination and tells us how the Tobin's Q in companies listed at the Nairobi stock exchange varied with Corporate Governance Index, Sales/Revenue, Age of the firm in the market and the financial leverage. From the analysis and Table 4.2.2 the value of adjusted R^2 is 0.511.This implies that, there is a variation of 51.1% on Tobin's Q with Corporate Governance Index, Sales/Revenue, Age of the firm in the market and the financial leverage at a confidence level of 95%.

There is a positive relationship between the Firms Tobin's Q with respect to Corporate Governance index and Financial leverage while also a negative relationship do exists between Sales/Revenue, and the age of the firm in the Nairobi stock exchange.

5.3 CONCLUSIONS

Corporate governance is relatively under-researched area. One possible reason behind the fact is lack of global consensus on the definition and imperative list of constituents of good corporate governance. Equally important, there is no widespread corporate governance composite which would be applied consistently and freely available to all capital market participants.

Numerous studies have focused on the relationships between corporate governance practice and firm performance with mixed results indicating that good corporate governance practices may not necessarily lead to better firm performance. The divergence of findings may be because it is difficult to measure corporate governance; a detailed review of changes can be found in Patterson (2000). In the U.S., evidence of correlation between a firm's corporate governance attributes and its value is weak (Black, 2001).

In this paper, there is evidence that corporate governance is an important factor in explaining the market value of listed Kenya firms. To construct corporate governance index (1-5) for 20 of the 45 companies listed on the Nairobi Stock Exchange, relying primarily on responses to a survey conducted by the NSE during the 2009. There is a strong positive correlation between the overall corporate governance index and firm value, which is a least square regression, in sub-samples, in alternate specifications of the corporate governance index, and with alternate measures of firm value.

5.4 LIMITATION OF THE STUDY

The study faced a number of limitations, which include:

One of the limiting factors was the time to carry out research especially could use of longer period to capture the effects of corporate governance practices on firm value: an empirical assessment of Kenya firms

Another difficulty has to do with interpreting the results. Interpretations are more difficult in the context of international standards than from domestic perspective because the

number of confounding factors multiplies when moving out of a strictly domestic setting. Thus, the Kenya is still at infant stage of development and growth; it is therefore faced with problems of measuring Corporate Governance in terms of acceptable Corporate Governance Quotient and Governance Metrics International. Therefore, this finding may not be easily generalized to international context.

The above research involved data analysis, which may have incurred a lot of errors in the analysis and hence deduction may not be satisfactory.

5.5 RECOMMENDATIONS FOR FURTHER RESEARCH

In the context of Kenya, some areas are worth being further researched into: -
The effects of corporate governance practices and free cash flow relation of firms in the Kenya Market.

How unique institutional environments in Kenya Market whereby high block holder and government ownership, weak legal investor protection and lack of active market for corporate control exist have affected corporate governance structure such as board characteristics; and explore alternative model where the roles of foreign institutional investors, fund managers, firm reputation, proxy contest and other voluntary mechanisms may be emphasized.

There are successful family owned or controlled companies in Kenya. More in-depth empirical study on the merits and demerits of family ownership structure and how has it impacted firm value. May be the resource dependency theory can better explain the success of these companies. If so, how corporate governance may evolve in these companies and what can be done to better align the interest of controlling family ownership and other shareholders?

Also the Empirical multi-country study on the differences in legal environments, such as legal investor protection merits and takeover codes and how these differences affect firm liquidity and valuation.

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APPENDIX 1: LETTER TO THE RESPONDENTS

Dear Respondent,

REF: REQUEST FOR RESEARCH STUDY

I am a student at the School of Business, University of Nairobi Pursuing a Master's degree in Business Administration (M.B.A). In partial fulfilment to the award of the Master's degree, I am required to do and write a Management Research Paper. The topic of my research is "**The Effects of Corporate Governance Practices on Firm Value: An Empirical Assessment of Listed Kenyan firms".**

In view of this, I wish to kindly request you to take a few minutes of your busy schedule and complete the attached questionnaire to the best of your knowledge as it applies to your firm. Your participation is greatly appreciated and the information provided will be confidential and used for academic purposes only.

Thank you in advance for your valuable time.

Yours faithfully,

TURANTA OLE KORIATA
D61/70945/2009

APPENDIX 2: QUESTIONNAIRE

The Information in this questionnaire was treated with Confidentiality and will not be used for any other than academic.

SECTION 1: GENERAL INFORMATION

General information about the respondent

1. Firms name: ____

2. The year of incorporation of the firm in Kenya____________________________

3. Please indicate the ownership of your Firm? Tick the appropriate box.

    Locally Owned [ ]

    Foreign Owned [ ]

    Joint Venture [ ]

    Others (Please Specify):____

SECTION 2

This section outline corporate governance index use among firms listed on the Nairobi stock exchange. This index is constructed in an effort to assist investors and firms to determine the corporate governance status of firms. The index is also divided into sub indices which cover the following areas: Board Responsibility, Board Structure, Shareholder Rights, Transparency & Disclosure, and Audit Committee. In this section use the scale 1 – 5 where 1 is to a very low extent, 2 is a low extent , 3 is Neutral ,4 is high extent and 5 is very great extent to answer the following question.

1. To what extent do you think the following justification for corporate governance are applied in your organisation (use the scale) *(Tick where applicable)*

Key 5= very great extent 4= high extent 3= Neutral 2= low extent 1= very low extent

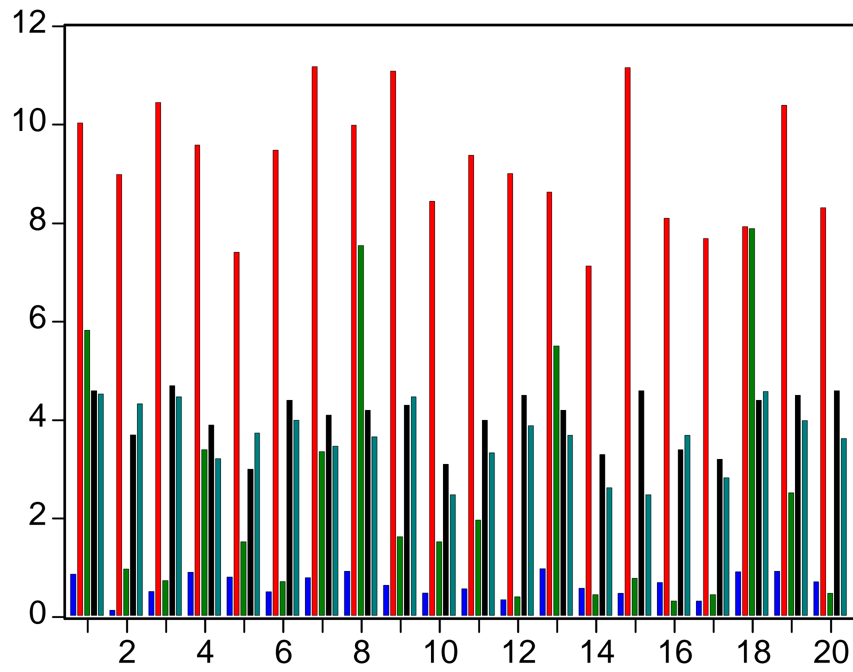
Corporate Governance Index

	1	2	3	4	5
A. Board Responsibility					
To what extent has board stated its business objectives					
The extent to which the board ensure and approve that the compensation of senior management members and key personnel is in keeping with the institution's culture?					
To what extent does the board understand the statutory obligations of the financial institution?					
Does the board ensure that the compliance of these obligations is fulfilled?					
Does the board monitor financial performance of the firm?					
Does the board report to shareholders on the financial condition of the company?					
Does the board report shareholder agreements that might affect their investment decisions?					
Does the board submit compensation reports to shareholders for approval before such compensation packages are implemented?					
Does the board have a formal program for new directors and persons identified as possible successors to senior management and for other critical functions within the firm?					
Does the succession program cover key characteristics and nature of the industry?					
Does the succession program cover the financial regulatory system?					
Are potential successors allowed to have or subject to continued training concerning products, risks, opportunities, emerging trends, industry developments, new laws?					

B. Board Structure					
Are at least two board members independent?					
Is the chairman of the board a different person from the CEO of the company?					
Is the division of their responsibilities clear?					
Are all the board members in keeping with the fit and proper guideline?					
Does the firm define "independence" clearly?					
Does the firm have a remuneration committee?					
Does the firm have a compensation committee?					
C. Shareholder Rights					
Does the firm hold an annual general shareholder meeting?					
Does the firm use the one-share-one-vote rule?					
Does the firm send out notices of general meetings to shareholders at least one week in advance?					
Does the firm have a clearly disclosed dividend policy?					
Does the firm state why the dividend is set a particular value?					
D. Transparency & Disclosure					
Does the full board meet in accordance with the stipulations in the company's by-laws and articles?					
Has the central bank requested more frequent board meetings?					
Do all directors meet when the board meets?					
Does the firm state the attendance of individual directors at meetings?					
Does the company maintain a website?					
Rate overall company index					

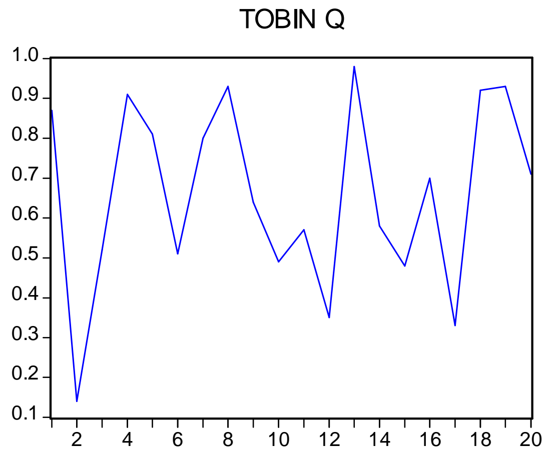
Thank You!

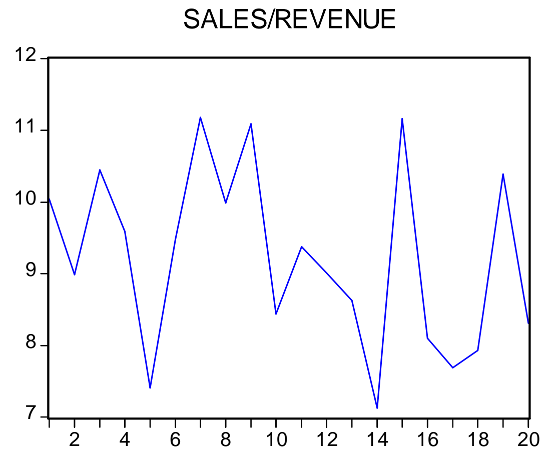
GRAPH 2-DISTRIBUTION OF CORPORATE GOVERNANCE ANALYSIS

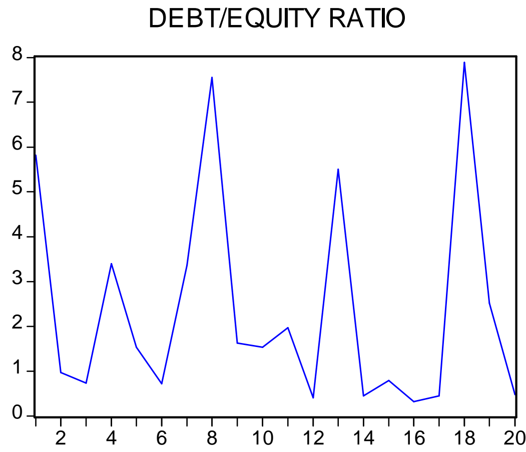


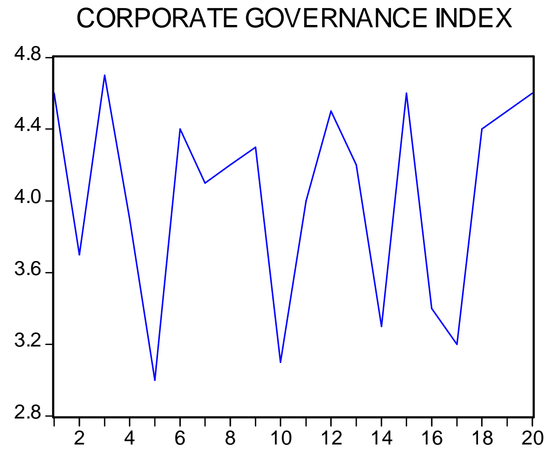
SOURCE:Author (2010)

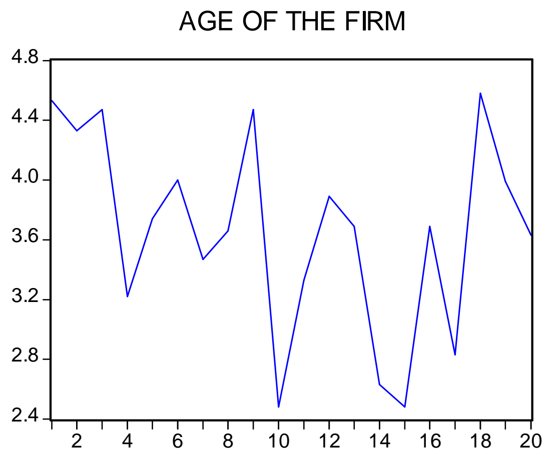
GRAPH 3-ANALYSIS OF THE VARIABLES











SOURCE: Author (2010)

APPENDIX 3: CALCULATION OF PREDICTOR VARIABLES OF THE MODEL FOR 20 SELECTED KENYA FIRMS FOR 2009

FIRMS	Tobin Q	CG-INDEX	SALES/ REVENUE	AGE OF THE FIRM	DEBT/ EQUITY
Barclays Bank of Kenya Ltd	0.87	4.6	10.04	4.53	5.82
E.A Portland Cement Co. Ltd.	0.14	3.7	8.99	4.33	0.97
E.A. Breweries Ltd.	0.52	4.7	10.45	4.47	0.74
Equity Bank Ltd.	0.91	3.9	9.59	3.22	3.4
Eveready East Africa Ltd	0.81	3.0	7.41	3.74	1.53
Kengen Ltd.	0.51	4.4	9.48	4.00	0.72
Kenya Airways Ltd	0.80	4.1	11.18	3.47	3.36
Kenya Commercial Bank Ltd.	0.93	4.2	9.99	3.66	7.55
Kenya Power & Lighting Co. Ltd	0.64	4.3	11.09	4.47	1.63
Kenya Re-Insurance Ltd.	0.49	3.1	8.44	2.48	1.53
Mumias Sugar Company Ltd.	0.57	4.0	9.38	3.33	1.97
Nation Media Group Ltd.	0.35	4.5	9.01	3.89	0.41
National Bank of Kenya Ltd.	0.98	4.2	8.63	3.69	5.5
Rea Vipingo Ltd.	0.58	3.3	7.13	2.63	0.45
Safaricom Ltd.	0.48	4.6	11.16	2.48	0.79
Sameer Africa Ltd.	0.70	3.4	8.10	3.69	0.32
Sasini Tea & Coffee Ltd.	0.33	3.2	7.69	2.83	0.45
Standard Chartered Bank Ltd.	0.92	4.4	7.93	4.58	7.89
Total Kenya Ltd.	0.93	4.5	10.39	3.99	2.52
TPS (Serena) Ltd.	0.71	4.6	8.31	3.63	0.48

Source: Author (2010)

APPENDIX 4: SELECTED LISTED FIRMS

KENYA FIRMS

Barclays Bank of Kenya Ltd.
E.A Portland Cement Co. Ltd.
E.A. Breweries Ltd.
Equity Bank Ltd.
Eveready East Africa Ltd
Kengen Ltd.
Kenya Airways Ltd.
Kenya Commercial Bank Ltd.
Kenya Power & Lighting Co. Ltd.
Kenya Re-Insurance Ltd.
Mumias Sugar Company Ltd.
Nation Media Group Ltd.
National Bank of Kenya Ltd.
Rea Vipingo Ltd.
Safaricom Ltd.
Sameer Africa Ltd.
Sasini Tea & Coffee Ltd.
Standard Chartered Bank Ltd.
Total Kenya Ltd.
TPS (Serena) Ltd

Source: NSE