RELATIONSHIP BETWEEN CORPORATE GOVERNANCE PRACTICES AND FINANCIAL PERFORMANCE OF REGULATORY STATE CORPORATIONS IN KENYA

BY

JACOB OLUOCH J. MINIGA

D61/64202/2011

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

NOVEMBER 2013

DECLARATION

This research project is my original work and has not been presented for award of a degree at any other university.

Signed: …………………………………… Date: …………………….

Jacob O. J. Miniga

D61/64202/2011

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

Signed: …………………………………. Date: ………………………

Zipporah Onsomu

Lecturer,

Department of Finance and Accounting,

School of Business, University of Nairobi.

The Research project is moderated by

Signed: ……………………………….. Date: ……………………...

Ondigo H. O.

Lecturer,

Department of Finance and Accounting,

School of Business, University of Nairobi.

Signed: ……………………………. Date: ………………………….

Dr Aduda Josiah O.

Chairman,

Department of Finance and Accounting,

School of Business, University of Nairobi.

DEDICATION

This study is dedicated to my loving wife Maria and my family for being supportive during the time of my studies.

AKNOWLEDGEMENT

This study has been accomplished through the encouragement, support and various contributions from a number of people of whom I am greatly indebted. It may not be possible to thank each of those who assisted in one way or the other in realizing this goal but there are a few individuals I wish to recognize. First is to The Almighty God for the many blessings without which I would not have made it. I can do all things through him who gives me strength.

Special thanks to my supervisor Ms Zipporah Onsomu who patiently guided me through my work. She put in extra hours to ensure that the deadlines were met and that a well researched paper was finalized. Most importantly I would like to acknowledge the support, assistance and prayers of my family during the study. I am most grateful to my loving wife Maria for the invaluable support and understanding she accorded me while studying. To my children Joshua, Gabriella and Obed for bearing with me during the long hours spent in the library, and my parents for the sacrifice they made to take me through school. I will forever be indebted.

I would also like to acknowledge the assistance of lecturers and my fellow students from the School of Business University of Nairobi, may you be blessed abundantly for your support.

TABLE OF CONTENTS

LIST OF ABBREVIATIONS

CAMEL	Capital adequacy, Asset quality, Management, Earnings and Liquidity
CEO	Chief Excecutive Officer
CMA	Capital Markets Authority
KCAA	Kenya Civil Aviation authority
KCC	Kenya Corporative Creameries
NSE	Nairobi Securities Exchange
OECD	Organization for Economic Co-operation and Development
PSCGT	Private Sector Corporate Governance Trust
ICPAK	Institute of Certified Public Accountants in Kenya
GSC	Guidelines on State Corporations
SCAC	State Corporations Advisory Committee

LIST OF TABLES

ABSTRACT

The aim of this research was to determine the relationship between corporate governance practices and financial performance in regulatory state corporations in Kenya. The corporate governance practices included board of directors' composition and size, independence of board committees, role of internal audit function, frequency of board meetings, CEO duality and board diversity. The researcher used a descriptive correlation research design to determine the relationship between corporate governance practices and financial performance. The sample comprised of 18 regulatory state corporations in Kenya. The data set comprised of both secondary and primary data. Primary data on corporate governance practices was collected through questionnaires while Secondary data was obtained from the financial reports filled at the auditor general's office. A multiple regression model of financial performance and corporate governance practices characteristics was applied to examine the relationship between the variables. The study established that financial performance of regulatory state corporations in Kenya is influenced by corporate governance practices. The findings concur with previous evidence from empirical studies on corporate governance, indicating that adoption of the various corporate governance practices by regulatory state corporations plays a part in the improvement of their financial performance.

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

Corporate governance is a phrase denoting, as the Cadbury Report (1992), says, ‘‘the system by which companies are directed and controlled.’’ It is concerned with structures and the allocation of responsibilities within companies. Knell (2006) defines corporate governance as a set of processes, customs, policies, laws and institutions affecting the way a corporation is directed, administered or controlled. The principal players in corporate governance includes the shareholders, management, the board of directors and other stakeholders including the employees, suppliers, customers, banks and other lenders, regulators, the environment and the community at large (Knell, 2006).

Jensen and Meckling (1976) argue that the divergence of interest between the principals (shareholders) and the agents (managers) leads to agency costs. Donaldson (2003) adds that effective monitoring devices, such as governance mechanisms, facilitate the alignment of interests between shareholders and managers. That alignment reduces the firm’s agency costs and consequently improves the firm’s performance. Agency theory underlying assumption is that managers (agents) may engage in self-interest decision and therefore shareholders (principals) enforce governance mechanisms to monitor agents’ decision-making processes and consequently improve their firms’ performance.

A well functioning corporate governance system helps a firm to attract investment, raise funds and strengthen the foundation for firm financial performance (Donaldson, 2003). Nevertheless, Davies and Schlitzer (2008) note that corporate governance practices are not uniform across nations. In fact, the Organisation for Economic Cooperation and Development (1998) acknowledges the lack of a single model of corporate governance practice that is applicable to all organizations even within one country. Consequently, every country adopts a unique set of corporate governance procedures that are based on factors such as the country’s legal and financial system, corporate ownership structures, culture and economic circumstances.

In Kenya, the Capital Markets Act Cap 485A (2002) stipulates the best practice guidelines for corporate governance in public companies based on recommendations and reports from the Organization for Economic Cooperation and Development (OECD**)**, the Commonwealth Association for Corporate Governance and the Private Sector Corporate Governance Trust, Kenya. The measures recommended include; the separation of CEO and Chairman position , board of directors of not more than 14 and not less than 5 members in number, board composition that include at least one third independent and non-executive directors of diverse skills and expertise with gender and racial balance being taken into consideration, establishment of an audit committee of at least three independent and non-executive directors who shall report to the board, establishment of an internal audit function which should be independent of the activities they audit and should be impartial and proficient in their operations, board to meet at least quarterly though the frequency can be increased as per the needs of the company and the meeting dates in a calendar year agreed in advance (CMA Act, 2002).

Performance in the public sector is measured by the economy, efficiency and the effectiveness of resource utilization to meet the set objectives. The surplus financial returns is remitted to the government through the treasury as dividends or where authorised, carried forward for expensing in the subsequent financial years (Bradbury, 1999). Controls must be applied to ensure that surpluses resulting from inefficiency and non effective utilization of resources are not declared and used as an indication for good financial performance (Bradbury, 1999).

1.1.1 Corporate Governance Practices

Cornelius and Kogut (2003) defines corporate governance practices as those rules that apply to specific financial markets and organizational forms and establish the rights of owners, and the information and mechanisms at their disposal, to control management and employees. These practices for the public firm include the determination of the board of directors and its powers and voting rules, protection of minority investors, the publication of audited accounts, covenants restricting managerial actions such as the sale of assets, and the distribution of profits.

1.1.2 Financial Performance

Financial performance is a measure of how well a firm can use assets from its primary mode of business to generate revenues. This term is also used as a general measure of a firms overall financial health over a given period of time, and can be used to compare similar firms across the same industry. Measuring performance using accounting ratios is common in the Corporate Governance literature Demaetz and Lehn, (1985); in particular, return on capital employed, return on assets, and return on equity. Similarly, economic value added can be 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 (Copeland et al, 1995). Other measures of financial performance in profit making organizations are Capital adequacy, Asset quality, Management, Earnings and Liquidity which are commonly known as CAMEL Model.

The absence of the profit measure in the public sector makes analysis and evaluation of performance more difficult than in profit oriented firms. In the public sector, the following are used to measure performance; Economy is to be measured by the relationship between resource inputs and its related costs, Efficiency is to be measured by the relationship between resource input and outputs, Effectiveness is to be measured by the extent that outputs accomplish set outcomes of a programme, the priority of the government and addresses the real needs of the economy (Bradbury, 1999). Return in State Corporation's case is to the government through treasury which is the investing arm of government and performance is measured by improved financial results, higher growth rate and dividend declaration in semi privatised corporations (Gitari, 2008).

1.1.3 Relationship between Corporate Governance Practices and Financial performance

Good corporate governance shields a firm from vulnerability to future financial distress (Bhagat and Black, 2002). The argument has been advanced time and time again that the governance structure of any corporate entity affects the firm's ability to respond to external factors that have some bearing on its financial performance (Donaldson, 2003).

In this regard, it has been noted that well governed firms largely perform better and that good corporate governance is of essence to firm's financial performance.

According to Donaldson, (2003), a well functioning corporate governance system helps a firm to attract investment, raise funds and strengthen the foundation for firm financial performance. He further posits that better corporate framework benefits firms through greater access to financing, lower cost of capital, better financial performance and more favourable treatment of all stakeholders. They argue that weak corporate governance does not only lead to poor firm financial performance and risky financing patterns, but are also conducive for macroeconomic crises like the 1997 East Asia crisis.

Research has shown that companies with higher corporate governance (based on developed indices) were performing better and had higher market value or Tobin's q. Moreover, a portfolio of companies with better corporate governance delivered a 2.1 per cent higher return as compared with companies of poor corporate governance. Additionally, research conducted on firm-level data of corporate governance ratings across 14 emerging markets reveals that better corporate governance is correlated with better operating performance and market valuation (Heracleouse, 2001).

1.1.4 Regulatory State Corporations

State corporations governance can broadly be defined as the systems and processes by which a government manages its affairs with the objective of maximizing the welfare of and resolving the conflicts of interest among the stakeholders (Bradbury, 1999). In developing countries, the state-owned enterprise sector is an integral part of socio - economic activity. Most state owned enterprises were established to fulfil the social objectives of the state rather than to maximise profits. However, rising stakeholder expectations have forced governments in many countries to reform the corporate governance systems of state-owned enterprises, with expectations of improving their operations to reduce deficits and to make them strategic tools in gaining national competitiveness (Dockey and Herbert, 2000).

State corporations in Kenya are formed by the government to meet both commercial and social goals. They exist for various reasons including: to correct market failures, to exploit social and political objectives, provide education, health, redistribute income or develop marginal areas. According to Guidelines on State Corporations from the Office of the President (2010), to date there are 178 operational state corporations in Kenya being classified into eight broad functional categories based on mandate and core functions. The eight categories are Financial; Commercial; Regulatory; Public Universities; Training and Research; Service; Regional Development Authorities; and, Tertiary Education. This study will concentrate on the state corporations which are Regulatory in nature and they are 18 in number (appendix1) GSC (2010).

1.2 Research Problem

Solomon et al (2003) emphasized the importance of good corporate governance and claim that corporate governance involves a set of relationships between a state owned enterprises' management, its board, its shareholders and other stakeholders, with increasingly acceptance of good corporate governance practices. In developing countries, the state-owned enterprise sector is an integral part of socio - economic activity. Most state owned enterprises were established to fulfil the social objectives of the state rather than to maximise profits. However, rising stakeholder expectations have forced governments in many countries to reform the corporate governance systems of state-owned enterprises, with expectations of improving their operations to reduce deficits and to make them strategic tools in gaining national competitiveness (Dockey and Herbert, 2000).

State corporations in Kenya have gone under a lot of reforms through government task forces and session papers to make them more efficient, effective in the performance of their mandate and to reduce the financial burden of the corporations on the public coffers. Regulatory State corporations are the major culprits on this as they heavily rely on government support for their survival. Their main source of revenue is the levy of license fees and other regulatory charges. A lot of effort has gone in trying to make these corporations not only self reliant but to make sure they can fund the government through the residual surplus after covering their costs of operations from the revenue they earn. Effective and functioning corporate governance is at the core in ensuring this is achieved as this would be to the benefit of the whole country as it moves towards the achievement of Vision 2030 (SCAC, 2010).

The association between quality of corporate governance and firms' profitability is quite major focus in corporate governance studies, but one cannot predict much on the direction as prior literatures show mixed results. Jensen and Meckling (1976) have proven that better-governed firms might have more efficient operations, resulting in a higher expected future cash-flow stream. Contrast results are seen in Gompers *et al.* (2003) who found no significant relationship between firms' governance and operating performance. A study by Becht et al, (2002) show that corporate governance practices positively influences the profitability of the organization while MacAvoy and Millstein (2003) found that board composition does not have any effect on financial performance. Locally, Kasoo (2008) concentrated only on the quoted firms in the NSE. The companies that are not quoted were left out though an inclusion would have provided a more conclusive result. More recently Areba (2011) used the case of commercial state corporations leaving out the regulatory and the non-commercial corporations. None of these studies have focused on the relationship between corporate governance practices and financial performance of regulatory state corporations in Kenya. The research question that the study would wish to answer is; is there a relationship between corporate governance practices and financial performance in regulatory state corporations?

1.3 Research Objective

The study seeks to determine the relationship between corporate governance practices and financial performance in regulatory state corporations in Kenya.

1.4 Value of the Study

The study will be useful in guiding the regulators of state corporations on the importance and the impact of the governance policies they make on the financial performance of state corporations.

The study will also assist the management of the respective regulatory state corporations evaluate their governance principles to identify which ones participate in the improvement of their financial performance and which ones needs to be changed or improved on. They will also be able to understand the relationship that may exist between their governance systems and financial performance.

The results of this study will also be invaluable to researchers and scholars as it will form a basis for further research. They will also use it as a basis for discussions on the corporate governance practices by regulatory state corporations and how these affect their financial performance.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter presents the available literature on corporate governance that has been reviewed for the study. Specific areas covered include the main corporate governance theories, empirical literature on the relationship between corporate governance practices and firm performance, empirical evidence on corporate governance practices and financial performance in Kenya and lastly a brief summary of the literature reviewed.

2.2 Theoretical Review

The main theories reviewed in this section include the agency theory, stakeholder's theory, stewardship theory, and the resource dependence theory.

2.2.1 The Agency Theory

Agency theory having its roots in economic theory was exposited by Alchian and Demsetz (1972) and further developed by Jensen and Meckling (1976). Agency theory is defined as the relationship between the principals, such as shareholders and agents such as the company executives and managers. In this theory, shareholders who are the owners or principals of the company, hires the agents to perform work. Principals delegate the running of business to the directors or managers, who are the shareholder's agents (Clarke, 2004). Much of agency theory, as related to corporations is set in the context of the separation of ownership and control as described in the work of Berle and Means (1932). In this context, the agents are the managers and the principals are the shareholders, and this is the most important commonly cited agency relationship in the corporate governance context. Indeed, Daily et al (2003) argued that two factors influence the prominence of agency theory. First, the theory is conceptually simple and reduces the corporation into two participants being the managers and the shareholders. Second, agency theory suggests that employees or managers in organizations can be self-interested.

Such a problem was first highlighted by Adam Smith in the 18th century and subsequently explored by Ross (1973) and the first detailed description of agency theory was presented by Jensen and Meckling (1976). They integrated elements from the theory of agency, the theory of property rights and the theory of finance to develop a theory of the ownership structure of the firm (agency theory).

2.2.2 Stewardship Theory

Stewardship theory has its roots from psychology and sociology and is defined by Davis, Schoorman and Donaldson (1997) as a person who protects and maximises shareholders wealth through firm performance, because by so doing, the steward's utility functions are maximised. In this perspective, stewards are company executives and managers working for the shareholders, protects and make profits for the shareholders. Unlike agency theory, stewardship theory stresses not on the perspective of individualism (Donaldson and Davis, 1991), but rather on the role of top management being as stewards, integrating their goals as part of the organization.

Although Agency Theory is the dominant perspective in corporate governance studies, it has been criticized in recent years because of its limited ability to explain sociological and psychological mechanisms inherent of the principal-agent interactions (Davis et al., 1997). For example, outside directors as emphasized by Agency Theory, with only legal power, may not possess sufficient expertise and seldom have close social ties with top managers. Stewardship theory is proposed as an alternative perspective to Agency Theory. Stewardship theorists assume that managers are good stewards of the firms. They are trustworthy and work diligently to attain high corporate profit and shareholders' returns (Donaldson and Davis 1994).

2.2.3 Stakeholder Theory

Stakeholder theory was embedded in the management discipline in the 1970's and gradually developed by Freeman (1984) incorporating corporate accountability to a broad range of stakeholders. Wheeler et al, (2002) argued that stakeholder theory was derived from a combination of the sociological and organizational disciplines. Indeed, stakeholder theory is less of a formal unified theory and more of a broad research tradition, incorporating philosophy, ethics, political theory, economics, law and organizational science.

Freeman (1999) defines a stakeholder as any group or individual who can affect or is affected by the achievement of the organization's objectives. Unlike agency theory in which the managers are working and serving the stakeholders, stakeholder theorists suggest that managers in organizations have a network of relationships to serve – this include the suppliers, employees and business partners. He further argued that this group of network is important other than owner-manager-employee relationship as in agency theory.

2.2.4 Resource Dependence Theory

Whilst the stakeholder theory focuses on relationships with many groups for individual benefits, resource dependence theory concentrates on the role of board of directors in providing access to resources needed by the firm. Hillman, Canella and Paetzold (2000) contend that resource dependence theory focuses on the role that directors play in providing or securing essential resources to an organization through their linkages to the external environment. Indeed, Johnson et al, (1996) concurs that resource dependency theorists provide focus on the appointment of representatives of independent organizations as a means for gaining access in resources critical to firm success. For example, outside directors who are partners to a law firm provide legal advice, either in board meetings or in private communication with the firm executives that may otherwise be more costly for the firm to secure.

2.3 Measures of Corporate Governance Practices

2.3.1 Board Size

There is a view that larger boards are better for corporate performance because they have a range of expertise to help make better decisions, and are harder for a powerful CEO to dominate. However, recent thinking has leaned towards smaller boards. Lipton and

Lorsch (1992) argue that large boards are less effective and are easier for the CEO to control. Smaller boards also reduce the possibility of free riding by, and increase the accountability of, individual directors. Empirical research supports this. For example, Yermack (1996) documents that for large U.S. industrial corporations, the market values firms with smaller boards more highly profitable. Eisenberg et al. (1998) also find negative correlation between board size and profitability when using sample of small and midsize Finnish firms, which suggests that board-size effects can exist even when there is less separation of ownership and control in these smaller firms.

2.3.2 Independence of Board Committees

Similarly, independence is also considered important for a board committee to be an effective monitor (Clark, 2004). Freeman (1999) report empirical evidence showing that the presence of monitoring committees (audit, nomination, and compensation committees) is positively related to factors associated with the benefits of monitoring. However, the presence of insiders in the compensation committees increases the probability of making decisions in favor of the CEO's interests (Freeman, 1999). Moreover, when the CEO sits on the nominating committee or when no nominating committee exists, firms appoint fewer independent outside directors and more gray outsiders with conflicts of interest (Shivdasani and Yermack, 1999). In addition, the stock market's reaction to appointments of independent outside directors is more positive when the director's selection process is viewed as relatively independent of CEO involvement (Shivdasani and Yermack, 1999).

2.3.3 Board Independence/ Outside Directors

Though the issue of whether directors should be employees of or affiliated with the firm (inside directors) or outsiders has been well researched, no clear conclusion is reached. On the one hand, inside directors are more familiar with the firm's activities and they can act as monitors to top management if they perceive the opportunity to advance into positions held by incompetent executives. On the other hand, outside directors may act as "professional referees" to ensure that competition among insiders stimulates actions consistent with shareholder value maximization (Fama, 1980).

2.3.4 Board Leadership and CEO-Chairperson Duality

Financial economists have paid considerable attention to the role of boards in monitoring managers and in removing non-performing CEOs. Jensen (1993) voices his concern that a lack of independent leadership makes it difficult for boards to respond to failure in top management team. Fama and Jensen (1983) also argue that concentration of decision management and decision control in one individual reduces board's effectiveness in monitoring top management.

Relating CEO duality more specifically to firm performance, researchers however find mixed evidence. Daily and Dalton (1992) find no relationship between CEO duality and performance in entrepreneurial firms. Brickley et al. (1997) also show that CEO duality is not associated with inferior performance. Rechner and Dalton (1991), however, report that a sample of Fortune 500 companies with CEO duality have stronger financial performance relative to other companies

2.3.5 Frequency of Board Meetings

Vafeas (1999) finds that the annual number of board meeting increases following share price declines and operating performance of firms improves following years of increased board meetings. Lipton and Lorsch (1992) find that the most widely shared problem directors face is lack of time to carry out their duties, and that board meeting time is an important resource in improving the effectiveness of a board. Yet, an opposing view is that board meetings are not necessarily useful because the limited time the outside directors spend together is not used for the meaningful exchange of ideas among themselves or with management (Jensen, 1993), a problem that is a by product of the fact that CEOs almost always set the agenda for board meetings.

2.3.6 Board Diversity

In very recent times, researchers began to look at how board diversity might enhance corporate governance and firm performance (Fields and Keys 2003). In probably the first research of its kind, Carter et al. (2003), in a study of Fortune1, 000 firms, find significant evidence of a positive relationship between board diversity, proxied by the percentage of women and/or minority races on boards of directors, and firm value, measured by Tobin's Q. Adams and Ferreira (2002), in using U.S. data, find that gender diversity of corporate boards provides directors with more pay-for-performance incentives and that the boards meet more frequently.

Notwithstanding above, empirical studies on the relationship between board diversity and firm performance remain sparse to date. One explanation is insufficient development of testable theory. Hermalin and Weisbach (2001) comment that board specific phenomena are not quite explained by principal-agent models and note that current theoretical framework including agency theory does not provide clear-cut prediction concerning the link between board diversity and firm value. On the other hand, firms have in recent years been increasingly pressured by institutional investors and shareholder activists to appoint directors with different backgrounds and expertise, under the assumption that greater diversity of the boards of directors should lead to less insider decision making processes and greater openness to change (Westphal and Milton 2000).

2.3.7 Internal Audit Function

Internal audit could add value by helping organisations achieve economy, efficiency and effectiveness through consulting management and employees and assisting in the management of risk (Spira and Page, 2003). Thus it is argued that IA plays a value adding role not only by helping conserve existing value through prevention of wastage of capital through fraud and inefficiency but also by improving operational processes.

2.4 Measures of Financial Performance in Non Profit Making Organisations

The absence of the profit measure in the public sector makes analysis and evaluation of performance more difficult than in profit oriented firms. In the public sector, the following are used to measure performance; Economy is to be measured by the relationship between resource inputs and its related costs, Efficiency is to be measured by the relationship between resource input and outputs, Effectiveness is to be measured by the extent that outputs accomplish set outcomes of a programme, the priority of the government and addresses the real needs of the economy (Bradbury, 1999).

Return in State Corporation's case is to the government through treasury which is the investing arm of government and performance is measured by improved financial results over time, higher growth rate and dividend declaration in semi privatised corporations (Gitari, 2008).

2.5 Empirical Review

Studies have been done on corporate governance practices and firm performance both local and international, however the results are mixed. Some examine only the impact of one governance mechanism on performance as Daily et al (2003) did, while others investigate the influence of several mechanisms together on performance.

A study by Rechner and Dalton (1991) on CEO duality found out that a sample of Fortune 500 companies with CEO duality have stronger financial performance relative to other companies. CMA guidelines regarding the separation of the role of the CEO and Chairman are therefore a sign of good governance; however, some previous empirical analyses do not support this. For example Brickly et al (1997) observe that costs of separation are larger than benefits for most large US firms. A study by Coles at al (2001) found no significant relationship between CEO duality and performance. It is suggested that higher proportion of non-executive directors in the board helps to reduce the agency costs. Hutchison and Gul (2003) support this view by showing that higher levels of non-executive directors on the board weaken the negative relationship between the firms' investment opportunities and firms' performance. However Coles et al. (2001) dispute this by stating that there is no significant relationship between non-executive directors' representation and performance.

Locally, findings from a study by Mululu (2005) established that boards increase the frequency of their meetings following poor performance and as a consequence of such increase, the performance of firms improve as captured by the increase in firm value. Langat (2006) developed a regression model to test the hypothesis that there is a positive relationship between firm's financial performance of preceding year and frequency of board meetings. The value of the firm was proxied by the Tobin's Q or Book-to-Market ratios. The findings indicated that the test statistics obtained led to acceptance of the null hypothesis that there is a positive relationship between firm performance of preceding year and frequency of board meetings.

Ngugi (2007) revealed that the size of the board and insider holding on one hand have association with performance but does not find any evidence that external board, individual holding and institutional holding have any influence on performance while governance structures (Number of directors, external board membership (non-executive directors)), individual and family holding, insider holding and institutional holding had a mix of the expected impact on firm performance. Kiamba (2008) sought to find out the effect of corporate governance on financial performance of local authorities in Kenya. The findings revealed that financial performances by local authorities in Kenya are influenced by their political compositions, the manner in which internal audits are conducted and managerial approaches by chief officers. However the findings by Matengo (2008) dispute this and points out that not all governance factors were important in influencing performance if analyzed individually.

2.6 Summary

Understanding the need for good corporate governance is the first step on the path to successful implementation of corporate governance mechanisms. There's need to understand the issues that each organization has and how good corporate governance mechanisms help achieve the maximum benefit. The effects of corporate governance on the firms' performance have been subject to numerous empirical studies in the literature review. Different studies highlighted have yielded mixed results. Nevertheless, the studies are characterized by a lack of standardization; they differ in terms of country focus, choice of governance mechanisms, data sources and the choice of the statistical methodology being applied.

Empirical studies in Kenya including Areba (2011) and Gitari (2008) have focused on corporate governance practices and financial performance of commercial state corporations and New KCC Ltd respectively. None of these studies had considered regulatory state corporations who perform the fundamental task of controlling many sectors of the economy yet greatly wanting on corporate governance principles. To fill the existing gaps, this study sought to establish the relationship between corporate governance practices and financial performance in regulatory state corporations.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This section looks at the research design, population of the study, data collection methods and data analysis techniques in the study.

3.2 Research Design

Descriptive correlation research design was adopted as it enabled the study to assess the existence of a relationship between corporate governance practices and financial performance in Regulatory State Corporations. The design involves a set of methods and procedures that describes the intended variables and how they relate to each other (Mugenda and Mugenda, 2003). Descriptive research is used to obtain information concerning the current status of a phenomenon to describe what exists with respect to variables or conditions in a situation

3.3 Population

The population for the study was the 18 regulatory state corporations in Kenya as at the year 2010 (appendix 2.) however, 12 of them responded giving a response rate of 67%.

3.4 Data Collection

The study used both primary and secondary data. Questionnaires were used in primary data collection from respondents who were the chief finance officers, corporation secretaries, internal auditors and the chief officers in charge of the corporate affairs in the corporations. Structured questions were used in primary data collection to gauge the level of compliance with the best practice governance mechanisms as stipulated by the CMA Act Cap 485A (2002). Secondary data for the financial performance of the state corporations for the past 5 years was obtained from the audited reports filed at the auditor generals' office. Average increase in surplus was used to gauge the corporations' performance over the 5 years period.

3.5 Data Analysis

The primary data collected through the questionnaires were analyzed using descriptive statistics including mean and standard deviations using SPSS version 17.5. Tables are used to present the data to enable ease of understanding and analysis. A multiple regression analysis was used to find out whether the independent variables predict the given dependent variable.

3.5.1 The Analytical Model

A multiple regression model of financial performance versus corporate governance practices was applied to examine the relationship between the variables. The study used the average increase in surplus for the previous 5 years as the measure of financial performance as was modeled by Areba, (2011). The model treated financial performance of the state corporations as the dependent variable while the independent variables are the board size, board composition, frequency of board meetings, CEO/Chairperson duality, board diversity, independence of committees and internal audit function. Equation (1) presents the algebraic expression of the analytical model to be applied;

AvSUPP = βo + β1bs +β2bc + β3fr + β4cd + β5bd + β6ic + β7ia + e'

Where: **AvSUPP** = Average increase in surplus of the previous 5 years.

βo = Constant of the model

β1 - β5 =Regression coefficients – define the amount by which y is changed for every unit change in predictor variables.

e' = The error term reflecting other factors that influence financial performance.

bs = Board size

bc = Board composition

fr = Frequency of board meetings

cd = CEO duality

bd = board diversity

ic = independence of board committees

ia = internal audit function

Board size was measured by the number of the board members sitting in a full board meeting, board composition the ratio of executive to non executive directors, frequency of board meetings- number of board meetings held in a financial year, CEO duality – split of CEO and chairperson roles, board diversity was derived from the directors ethnic, professional, gender and race differences, independence of board committees by number if independent directors in the committee and who they report to and internal audit by the independence of activities they audit , impartiality and proficiency.

3.5.2 Diagnostic Tests

a) F-Test

In order to test the overall significance of the regression model, F-test is used to estimate if all the individual coefficients together were statistically different from Zero at the 5% level of significance. The p-value was used in testing the null hypothesis that all of the model coefficients are equal to zero. The alternative hypothesis was that all of the model coefficients are not equal to zero.

b) T-Test

To establish the significance of individual variables in the model, T-Test was applied at 5% levels of confidence. Five percent level of significance is used as it is the most commonly used for business research studies. The 2-tailed p-values were used in testing whether the coefficients were significantly different from zero at the individual levels.

CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSIONS

4.1 Introduction

This chapter presents the data analysis and interpretation on the study to determine corporate governance practices and their effect on the financial performance of the regulatory state corporations in Kenya. The study had targeted 18 respondents out of which 12 filled and returned the questionnaires constituting 66% response rate. This response was in line with Mugenda (2003) recommendation of an acceptable response rate of more than 60% of the sample which is adequate to small population whereas a response rate of more than 40% is required for big population.

4.2 Data Analysis

The data was summarised and descriptive statistics of mean and standard deviation calculated for the respective variables. The resultant mean values of the independent variables were then regressed against the dependent variable. Data analysis was done through Statistical Package for Social Scientists (SPSS) Version 17. Percentages, means and standard deviations were used to display the results which were presented in tables as detailed below.

Table 1: Board Size

	Mean	Std Dev
Number of the members of the board of directors	10.75	3.108
Approximate attendance of board meetings when constituted	9.42	2.875

(Source, researcher)

The study sought to determine the number of the members of the board of directors and their average attendance of meetings. As per the responses, 8% has a board of less than 5 members, 16% of between 5 to 8 members, 25% of between 9 to 11 members, 41 % of between 12 to 14 members and only 8 % of above 15 members. CMA Act, (2002) recommends a board of not less than 5 and not more than 15 members. Only 8 % of the respondents have a board of less than 5 and another 8% with boards of more than 15 members giving a compliance rate of 84% with a mean of 10.75 and standard deviation of 3.108.

As per the findings, the average attendance of the meetings had a mean of 9.42 and a standard deviation of 2.875. 16% of the respondents reported an average attendance of below 5, 16% of between 5 to 8, 41% of between 9 to 11 and 25 % of between 12 to 14 members. The mean of 9.42 was above the recommendation of at least 5 members present to constitute a quorum.

Table 2: Board Composition

	Mean	Std Dev
Number of board members who are not independent	6.00	2.335
Number of board members who are completely independent	7.00	1.651

(Source, researcher)

75% of the respondents reported less than 5 board members who are not independent of the firm, 16% reported between 5 to 8 non independent directors and 8% reported between 12 to 14 members as not independent of the corporation with a mean of 6.00 and standard deviation of 2.335. 58% of the respondents reported 5 to 8 members as completely independent of the corporation with 16% reporting between 9 to 11 and 25% reporting less than 5 independent directors. The CMA Act (2002) recommends at least one third of the members to be independent. The mean for the completely independent directors is 7.00 with a standard deviation of 1.651 which is an indication of compliance to the guidelines.

Table 3: Frequency of Board Meetings

	Mean	Std Dev
Annual number of scheduled meetings	8.75	3.194
Average number of actual meetings	8.83	3.563

(Source, researcher)

The study sought to determine the frequency of scheduled meetings in a financial year and the average number of meetings that actually take place. 8% of the respondents corporations schedules less than 5 meetings in a calendar year, 58% plans for between 5 to 8 meetings, 8 % plans for between 9 to 11 meetings, 16% plans for between 12 to 14 meetings and 8 % plans for over 15 meeting in a calendar year all with a mean of 8.75 and a standard deviation of 3.194. Out of the scheduled meetings, 16% of the firms reported below 5 meetings actually taking place per annum, 50% reported between 5 to 8 meetings, 25% reported between 12 to 14 meetings and 8 % for 15 meetings and above with a mean of 8.83 and a standard deviation of 3.563. CMA Act (2002) recommends at least quarterly meetings per annum. Too many meetings can also be of detriment to the corporation as the cost of the meetings would be uneconomical. A mean of 8.75 in schedule and 8.83 in actual meetings is an indication compliance with recommended corporate governance practice.

Table 4: CEO – Chairperson Duality

	Mean	Std Dev
The organisation is governed by a separate chairman and CEO	1	0.00
Independence of the functions of the two officers	3.43	1.443

(Source, researcher)

On CEO- Chairperson Duality, 100% compliance was observed which indicates a 100% compliance level, however, the results for the independence of the two offices has a mean of 3.43 and a standard deviation of 1.4443 indicating there exists some levels of interference between the two offices amongst the corporations. Only 33% of the respondents rated the two offices as having independent functions.

Table 5: Board Diversity

	Mean	Std Dev
Gender composition of the board in terms of the number of ladies	.317	.171
Number of diverse professionals serving in the boars	7.33	3.284
Diversification in terms of races and tribes	4.50	0.905
Diverse nationalities	1.50	1.168

(Source, researcher)

CMA Act(2002) recommends selection of directors of diverse skills and expertise, with gender and racial balance.tha study found a gender mean of 31,7% female and 68.3% male which is just on the legal boundary of the requirements of the constitution. 33% of the corporations have below 5 diverse professions in their boards, 50% has between 5 to 8 and 16 % has higher than 12 with a mean of 7.33 and standard deviation of 3.284. 67% had between 3 to 5 different races and tribes, 25 % had greater than six different tribes while only 8 % had 2 and bellow with a mean of 4.50 and standard deviation of 0.905 which is very well balanced. 75% of the respondents reported 2 or less nationalities in their boards with 16% reporting between 3 to 5 nationalities and 8 % reporting 6 and above with a mean of 1.50 and standard deviation of 1.168. This is a fair attempt even though conceited efforts should be made to bring in more foreign expertise into the boards of the corporations.

Table 6: Independence of Committees of the board

	Mean	Std Dev
Number of audit committee members who are independent directors	2.33	1.614
Do the committees report directly to the board	0.83	0.389

(Source, researcher)

25 % of the corporations did not have any independent directors in their board committees while 25 % had 2 independent directors, 16% had 3 and 33% had greater than 3.

84% of the firms had their committees reporting direct to the full board while 16% were not aware or their committees do not report direct to the full board. The Act recommends at least 3 independent and non executive directors in each committee which then reports directly to the full board. The mean of 2.33 is below the recommendation while a ratio of 83% reporting direct to the board indicated compliance to the recommendations.

Table 7: Internal Audit Function

	Mean	Std Dev
Presence of an effective internal audit function	4.33	0.651
The head of the internal audit reports direct to the board	4.42	1.240
Head of internal audit has ready and regular access to the chairperson and boards audit committee	4.17	1.115
Internal audit staff are registered members of a professional body	4.00	1.279

(Source, researcher)

The study sought to test for the presence of an effective, independent, impartial and proficient internal audit function. The results found out that 42% of the respondents strongly agreed that their corporations had strong and effective internal audit function, while 50% agreed and 8 % were not sure with a resultant mean of 4.33 and standard deviation of 0.651. This is a 92% agreement which is a sign of compliance. 77% of the respondents strongly agreed that the head of internal audit reports to the board of directors as per the recommendation of the institute of internal auditors code of best practice. 8% agreed, 8% were not sure while the rest 8 % disagreed resulting into a mean of 4.42 and standard deviation of 1.240. To the question of whether the head of internal audit has ready and regular access to the chairperson of the internal audit committee and that of the overall chairperson, the results indicated a 58% strong agreement, 8% agreement, 25% being not sure and 8% disagreement with a mean of 4.17. Membership to a professional body by the internal audit staff resulted into a 42% strong agreement, 42% agreement, 8% disagreement and 8% strong disagreement with a mean of 4.00 and a standard deviation of 1.279.

4.3 Regression Analysis

In this study, a multiple regression analysis was conducted to test the influence among predictor variables. The study used the mean increase in surplus over 5 years' period as the dependent variable and corporate governance practices as independent variables. Corporate governance practices were quantified using Likert scale scores whose means were computed for each factor within the elements. The research used statistical package for social sciences (SPSS) to code, enter and compute the measurements of the multiple regressions. The regression equation below has established that all factors taken into account (Board size, Board composition, Frequency of board meetings, CEO duality, board diversity, independence of board committees and internal audit function) influenced the performance of the state corporations.

The regression model summary is summarised below:

Table 8: Regression model summary

R	R Square	Adjusted R Square	Std. Error of the Estimate
.895	**.800**	**.718**	**.59353**

(Source, researcher)

The adjusted R squared is known as coefficient of determination and it indicates the variation in dependent variable due to changes in independent variables, from the above table the adjusted R squared was 0.718 which showed that there was a 71.8% variation in performance of the corporations due to changes in Board size, Board composition, Frequency of board meetings, CEO duality, board diversity, independence of board committees and internal audit function

The ANOVA table (table 9) shows the significance of the model.

Table 9: ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	24.011	7	3.430	9.737	.001(a)
	Residual	5.989	17	.352		
	Total	30.00	24			

From the above table the p- value was 0.001 which means that the model was statistically significant thus rejecting the null hypothesis that all the coefficients of the model are equal to zero.

Table 10: Correlation Coefficients

Model		Un standardized coefficient		Standardized coefficient	t	Sig.
		B	Std Error	Beta		
1	Constant	.684	.1457		.470	.645
	Board Size	.341	.197	.248	1.732	.101
	Board comp.	.330	.225	.369	1.466	.161
	Meetings freq.	.306	.282	.310	1.088	.292
	CEO duality	.641	.289	331	2.218	.040
	Board div	.044	.172	.035	.256	.801
	Committee ind	.352	.209	.300	1.681	1.111
	Internal audit	.437	.249	.226	1.759	0.097

(Source, researcher)

From the above table of regression coefficient the established regression equation was;

AvSUPP = 0.684 + 0.341bs +0.33bc + 0.31fr + 0.641cd + 0.044bd + 0.352ic + 0.437ia where:

bs = Board size

bc = Board composition

fr = Frequency of board meetings

cd = CEO duality

bd = board diversity

ic = independence of board committees

ia = internal audit function

The t- statistics from the table indicates that only the CEO duality variable was statistically significantly different from zero as its p- value of 0.04 which is less than Alpha of 0.05 thus being the only significant variable. All the other independent variables p- values were greater than Alpha of 0.05 meaning they are all statistically not significantly different from zero thus not significant.

4.4 Discussions

From the above regression equation holding board size, board composition, frequency of meetings, CEO duality, board diversity independence of committees and internal audit performance would be 0.684 billion shillings. Unit increase towards the recommended board size would lead to increase in performance by factor of 0.34, unit increase in board composition towards the boards independence would lead to increase in performance by factor of 0.33, unit increase or decrease in frequency of the boards meetings per annum towards the ideal would also lead to increase in performance by factor of 0.31, unit increase in compliance to CEO duality and independence of the two would lead to decrease in performance by factor of 0.641, unit increase in committees independence would lead to increase in performance by factor of 0.352, and unit increase in internal audit establishment and independence would lead to increase in performance by factor of 0.437.

The whole model was significant at a significance level of 0.01 while the test for significance of the respective variables indicated only CEO duality is significant at a significance level of 0.040. The correlation coefficient of 89.5% indicates a strong positive correlation. Corporate governance practices account for 80% of the variance in financial performance as measured by mean increase in surplus. The adjusted R squared of 0.718 indicated that corporate governance practices accounted for 71.8% of the variance in the corporations’ performance as measured by the mean increase in surplus.

CHAPTER FIVE: SUMMARY, CONCLUTIONS AND RECOMMENDATIONS

5.1 Introduction

From the analysis and data collected, the following discussions, conclusions and recommendations were made. The responses were based on the objectives of the study. The researcher had intended to investigate the relationship between corporate governance practices of regulatory state corporations in Kenya and their financial performance.

5.2 Summary of Findings

The research found out that compliance to best practice recommendations by the government and other professional associations amongst the regulatory state corporations in Kenya is quite impressive as is attested to by the statistics analysed. 82% of the corporations analysed met the recommendation on board size which is not greater than 14 and not less than 5 members, this was an indication of compliance to the guidelines. The mean quorum at the meetings was 9.42 members which was almost equal to the mean of the size of the boards being 10.75; this is also an indication attendance of meetings as recommended.

CMA Act, (2002) recommends a board composition of at least one third independent and non executive directors of diverse skills and expertise with gender and racial balance. With a mean board size of 10.75, a third of the mean being 4, it shows that the mean for independence of the directors of 7 members is above the recommendation indicating good compliance level. Gender balance of 31% female to 69% male is just at the mark of the recommendation and compliance with the Kenyan constitution. More conceited effort should be made to increase the gender balance to bring in more variety within the boards. With a mean of 7.33 the diversity in expertise and professions in the boards is also very impressive, indicating a wealth of knowledge and skills which can result into good decision making thus good financial performance. The research also revealed that 49% of the corporations had at least 3 or higher number of independent directors in the boards oversight committees which is a good indication of good governance however, 51 % of the firms not being compliant is of great concern and effort should be made to increase the compliance level. 84% of the state corporations have their board committees report direct to the full board which is a very good compliance rate.

5.3 Conclusions

The adjusted R squared was 0.718 which tell us there was a 71.8% variation in performance of the corporations due to changes in Board size, Board composition, Frequency of board meetings, CEO duality, board diversity, independence of board committees and internal audit function. This answers to the objective of the study and confirms a strong relationship between corporate governance practices and financial performance in regulatory state corporations.

5.4 Recommendations

The study recommends among other things that the government ought to enforce the measures it has laid down on corporate governance to ensure public organizations are following them so that the recommended governance structures are followed. The concerned ministries should also be very keen in the supervisory role through the relevant committees to ensure that all regulations are enforced as required.

The study further recommends the increase of participation of the female gender on the boards to beyond the 31% which is just at the threshold of the constitutional requirement; good corporate governance principle recommends more balanced gender parity. Number of independent directors in board committees should also be maintained at above 3 as only about half of the corporations were in compliance. More international experts should be included in the boards to bring in diverse experiences and different ways of doing things and to improve on the racial diversity. This would bring an international positive outlook to the firm which can be of paramount importance when seeking international financial grants, debts and business partnerships.

5.5 Limitations of the study

The limitations of the study included limited access to information especially due to delay to release information from some of the corporations and the auditor generals' office, non-response from some of the targeted respondents, selection bias and analysis methodology.

Time constraint is also a limitation as deadlines has to be met yet the beaurocracy to be followed to get data from state corporations is too long. Suspicion by some of the corporations management insinuating that the research results would reveal their shortfalls had to be dispelled by writing further letters explaining the fact that the results would be an aggregation and individual corporations names would not be shown in the findings.

5.6 Suggestions for further Research

The study purports that good performance of public organizations is influenced in a way by corporate governance. However, the study does not openly rule out the fact that some other variables in the environment could be critical for public organizations performance. Hence, future research could usefully focus on corporate governance practices in other state corporations like the non – commercial state corporations comprising those that are educational, research institutes, and other institutions.

REFERENCES

Adams, R. B. & Ferreira, D. (2002). *Diversity and Incentives in Teams: Evidence from Corporate Boards*, Dissertation, University of Chicago.

Alchian, A. A. & Demsetz, H. (1972). 'Production, Information Costs, and Economic Organization', *The American Economic Review*, vol. 62, no. 5, pp. 777-795.

Areba, J. N. (2011). Relationship between corporate governance practices and financial performance of commercial state corporations in Kenya, Unpublished MBA project, School of business, University of Nairobi.

Becht, M., Bolton, P. & Rosell, A. (2002). *Corporate Governance and Control*, w9371, National Bureau of Economic Research, Cambridge.

Berle, A. A., & Means, G. C. (1932). *The Modern Corporation and Private Property*. New York.

Bhagat, S. & Black, B. (2002). The Non-correlation between Board Independence and Long-term Firm Performance. *Journal of Corporation Law* 27, 231-274.

Bradbury, M. E. (1999). Government ownership and financial performance in a competitive environment: Evidence from the corporatization of the New Zeal and Government Computing Services. *Asia Pacific Journal of Management*, Vol. 16, pp. 157-72.

Brickley, J. A., Coles, J. L. & Jarrell, G. (1997). Leadership structure: separating the CEO and chairman of the board. *Journal of Corporate Finance, 3,* 189–220.

Cadbury, A. (1992). *Report of the Committee on the Financial Aspects of Corporate Governance*. London: Professional Publishing Ltd.

Carter, D. A., Simkins, B. J. & Simpson, W. G. (2003). 'Corporate Governance, Board Diversity, and Firm Value', *The Financial Review*, vol. 38, no. 1, pp. 33-53.

Clark, T. (2004). "*Theories of Corporate Governance: The Philosophical Foundations of Corporate Governance*" London & New York: Routledge.

CMA Act Cap485A. (2002). Guidelines on corporate governance practice by public companies in Kenya. Gazette Notice no. 3362.

Coles, J. W., McWilliams, V. B. & Sen, N. (2001). An examination of the relationship of governance mechanisms to perform. *Journal of Management* 27: 23–50.

Copeland, T., Koller, T. & Murrin, J. (1995). *Measuring and managing the value of companies.* McKinsey and Company Inc - Wiley, New York

Daily, C. M., Dalton, D. R. & Canella, A. A. (2003). "Corporate Governance: Decades of Dialogue and Data". *Academy of Management Review*, Vol. 28, No. 3, pp. 371-382

Davies, M. & Schlitzer, B. (2008). The impracticability of an international "one size fits all" corporate governance code of best practice, *Managerial Auditing Journal*, 23(6), 532-544.

Davis, J. H., Schoorman, F. D., & Donaldson, L. (1997). Toward a stewardship theory of Management. *Academy of Management Review*, *22*, 20–47.

Demsetz, H. & Lehn, K. (1985). "The structure of corporate ownership: causes and Consequences", *Journal of Political Economy*, Vol. 93, pp. 1155-77.

Dockery, E. & Herbert, W. E. (2000). Corporate governance and enterprise restructuring in transition economies: evidence from privatized Polish companies, *Managerial Finance*, Vol. 26 No. 9, pp. 80-92

Donaldson, L. & Davis, J. H. (1994). 'Boards and Company Performance: Research Challenges the Conventional Wisdom', *Corporate Governance*, vol. 2, no. 3, pp. 151-160.

Donaldson, L. & Davis, J. (1991). "Stewardship Theory or Agency Theory: CEO

Governance and Shareholder Returns”. *Academy Of Management Review*, Vol. 20, No. 1, pp. 65

Donaldson, W. (2003). "Congressional testimony concerning the implementation of the Sarbanes-Oxley Act of 2002", available at: www.sec.gov/news/testimony/090903.

Eisenberg, T., Sundgren, S. & Wells, M. T. (1998). 'Larger board size and decreasing firm value in small firms', *Journal of Financial Economics*, vol. 48, no. 1, pp. 35-54.

Fama, E. F. (1980). “Agency Problems and the Theory of the Firm”. *Journal of Political Economy*, Vol. 88, pp. 288-307

Fama, E. F. & Jensen, M. C. (1983). 'Agency Problems and Residual Claims', *Journal of Law and Economics*, vol. XXVI, pp. 327-349.

Fields, M. A. & Keys, P. Y. (2003). 'The Emergence of Corporate Governance from Wall St. to Main St.: Outside Directors, Board Diversity, Earnings Management, and Managerial Incentives to Bear Risk', *The Financial Review*, vol. 38, no. 1, pp. 1-24.

Freeman, R. E. (1984). “*Strategic Management: A Stakeholder Approach*”. Pitman, London.

Freeman, R. E. (1999). “Response: Divergent Stakeholder Theory”. *Academy of Management Review*, Vol. 24, No. 2, pp. 233-236

Gompers, P., Ishii, J. L. & Metrick, A. (2003). ‘‘Corporate governance and equity prices’’, *Quarterly Journal of Economics*, Vol. 118 No. 2, pp. 107-55.

Gathura, A. N., (2007). Corporate governance structure and performance of manufacturing Firms listed in the Nairobi stock exchange. Unpublished MBA project. University of Nairobi.

Gitari, J. M. (2008). Corporate governance and the financial performance of state

Corporations: the case of new Kenya cooperative creameries (K.C.C). Unpublished MBA project. University of Nairobi. Kenya.

Heracleous, C.W. (2001). "Board leadership structure and CEO turnover", *Journal of Corporate Finance*, Vol. 8 No.1, pp.49-66.

Hermalin, B. E. & Weisbach, M. S. (2001). *Boards of Directors as an Endogenously Determined Institution: A Survey of the Economic Literature*, w8161, National Bureau of Economic Research, Cambridge.

Hillman, A. J., Canella, A. A. & Paetzold, R. L. (2000). "The Resource Dependency Role of Corporate Directors: Strategic Adaptation of Board Composition In Response To Environmental Change". *Journal of Management Studies*, Vol. 37, No. 2, pp. 235-255

Hutchison, M. & Gul, F. A., (2003). Investment opportunity set, corporate governance practices and firm performance .*Journal of corporate finance 182, 1-20*

Jensen, M. (1993). The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems. *Journal of Finance* 48, 831-880.

Jensen, M. (2001). Value Maximisation, Stakeholder Theory and the Corporate Objective Function. *European Financial Management* 7, 297-317.

Jensen, M. & Meckling, W. (1976). Theory of the Firm: Managerial Behaviour, Agency Costs, and Ownership Structure. *Journal of Financial Economics* 3, 305-360.

Johnson, J. L., Daily, C. M. & Ellstrand, A. E. (1996). "Boards of Directors: A Review of Research Agenda". *Journal of Management*, Vol. 22, No. 3, pp. 409-438

Kasoo, S. N. (2008). A survey of the impact of diversified boards on the value of firms Quoted in the NSE; Unpublished MBA project. University of Nairobi.

Kiamba, J. M. (2008), Effect of corporate governance on financial performance of local Authorities. Unpublished MBA project. University of Nairobi.

Knell, A. (2006**),** *Corporate Governance: How to Add Value to your Company*: A Practical Implementation Guide. Oxford: E/Sevier.

Langat, R. (2006). Corporate governance structures and performance of firms quoted in The Nairobi stock exchange. Unpublished MBA projects. University of Nairobi.

Lipton, M. & J. Lorsch (1992). A Modest Proposal for Improved Corporate Overnance. *Business Lawyer* 59, 59-77.

MacAvoy, P.W. & Millstein, I. S. (2003), The *Recurrent Crisis in Corporate Governance, Palgrave*, New York, NY.

Matengo, M. (2008). The relationship between corporate governance practices and performance, the case of banking industry in Kenya. Unpublished MBA thesis. University of Nairobi.

Mugenda, M. O. & Mugenda A. (2003). *Research Methods: Qualitative and Quantitative Approaches*, Acts Press, Nairobi.

Mululu, A. K. (2005). The relationship between board activity and firm performance of firms quoted at NSE. Unpublished MBA Project. University of Nairobi

Ngigi, K.B. (2007). Relationship between corporate governance structures and Performance of insurance companies in Kenya. Unpublished MBA Thesis. University of Nairobi.

Organisation for Economic Cooperation & Development, (1998). *Corporate Governance: Improving competitiveness and access to capital in global markets*, a report to the OECD by the Business Sector Advisory Group on Corporate Governance, Paris.

Private sector initiative report (1998). Principles for corporate governance in Kenya and a Sample code of best practice. Kenya. Private sector corporate governance trust.

Rechner, P. L. & Dalton, D. R. (1991). CEO duality and organizational performance: a Longitudinal analysis. *Strategic Management Journal, 12,* 155–160.

Ross, S.A. (1973). “The Economic Theory of Agency: The Principal’s Problem”. *The American Economic Review*, Vol. 63, No. 2, pp. 134-139.

Smith, A. (1776). *An Inquiry into the Nature and Causes of the Wealth of Nations*, The Clarendon Press, Oxford.

Spira, L.F. & Page, M. (2003), “Risk management: the reinvention of internal control and the changing role of internal audit”. *Accounting, Auditing and Accountability Journal*, Vol. 16 No. 4, pp. 640-61.

State Corporations Advisory Circular (2010). Office of the President, Government Printing Press, Nairobi.

Sundaram, A. K. & Yamach, C. (1999). “The Corporate Objective Revisited”, *Organization Science*, Vol. 15, No. 3, pp. 350-363

Solomon, J. & Solomon, A. (2004). *Corporate Governance and Accountability*, John Wiley, New York, NY.

Vafeas, N. (1999). Board meeting frequency and firm performance. *Journal of Financial Economics* 53: 113–143.

Westphal, J. D. & Milton, L. P. (2000). 'How Experience and Network Ties Affect the Influence of Demographic Minorities on Corporate Boards', *Administrative Science Quarterly,* vol. 45, no. 2, pp. 366-398.

Wheeler, D., Colbert, B. & Freeman, E. (2002). Focusing on Value: Reconciling Corporate Social Responsibility, Sustainability and a Stakeholder Approach in a Network World. *Journal of General Management*, 1-28.

Yermack, D. (1996). Higher Market Valuation for Firms with a Small Board of Directors. *Journal of Financial Economics* 40, 1 85-2 1 1.

APPENDICES

Appendix One: Questionnaire

Questionnaire for the study on corporate governance practices and financial performance of Regulatory State Corporations.

Dear respondent,

My name is Jacob Miniga, a MBA student from the University of Nairobi. My study requires that I undertake a field study within your organisation on the aforementioned subject. I kindly request your assistance in filling in this questionnaire to assist in the achievement of the study objective. Your frank & accurate response is key to attaining the objective of the study. The results will be used only for research purposes and responses treated with utmost confidence.

Thank you for your cooperation.

1) Name of the corporation……………………………………………
2) Your designation ……….………………………………………….
3) Duration of employment in the corporation …………………………..

GOVERNANCE PRACTICES STRUCTURED QUESTIONS

Board Size

1. Indicate by ticking in the appropriate bracket the range within which the number of the members of the board of directors of the organisation falls.

   Below 5 [ ] 5 to 8 [ ] 9 to 11 [ ] 12 to 14 [ ] 15 and above [ ]

2. Roughly what is the average attendance of the board meetings when constituted per sitting?

   Below 5 [ ] 5 to 8 [ ] 9 to 11 [ ] 12 to 14 [ ] 15 & above [ ]

Board Composition

3. How many of the board members are employees of the firm or affiliates of the firm, including those who are state employees in other governmental organisations.

   Below 5 [ ] 5 to 8 [ ] 9 to 11 [ ] 12 to 14 [ ] 15 & above [ ]

4. How many board members can you rate as completely independent of the organization or the state as a party to the organization?

   Below 5 [ ] 5 to 8 [ ] 9 to 11 [ ] 12 to 14 [ ] 15 & above [ ]

Frequency of Board Meetings

5. What is the annual number of scheduled board meetings?

   Below 5 [ ] 5 to 8 [ ] 9 to 11 [ ] 12 to 14 [ ] 15 & above [ ]

6. How many meetings take place averagely in a calendar year?

   Below 5 [ ] 5 to 8 [ ] 9 to 11 [ ] 12 to 14 [ ] 15 & above [ ]

CEO Chairperson Duality

7. Is the organisation governed by a separate chairman & CEO? Choose yes or no as appropriate. Yes [ ] No [ ]

8. On a scale of 1 to 5, rate the independence of the functions of the two officers in line with the organisations' structure? (Where 5 represents very independent).

   Not applicable [ ] 1 [ ] 2 [ ] 3[ ] 4[ ] 5[ ]

Board Diversity

9. What is the gender composition of the board? Male [ ] Female [ ]

10. How diversified is the board in terms of the number of professions serving in the board?

    Below 5 [ ] 5 to 8 [ ] 9 to 11 [ ] 12 to 14 [ ] 15 & above [ ]

11. How diversified is the board in terms of race/tribes & nationality?

    Races/tribes 1 to 2 [ ] 3 to 5 [ ] 6 & above [ ]

    Nationalities 1 to 2[ ] 3 to 5 [ ] 6 & above [ ]

Independence of Committees

12. How many of the audit committee members are independent directors? I.e. not employees of the authority or the Government.

    Non [ ] 1 [ ] 2 [ ] 3[ ] more than 3[ ]

13. Do the committee members report directly to the board?

    Yes [ ] No [ ] not applicable [ ]

Internal Audit Function

Specify the extent to which you agree (disagree) with various aspects of internal audit in regard to financial performance of your company where:

5 = Strongly agree 4 =Agree 3=Not sure 2= Disagree 1=Strongly disagree

14. The company has effective internal audit functions that have the respect and co-operation of both the board and management

    5 [ ] 4 [ ] 3 [ ] 2 [ ] 1 [ ]

15. In line with the Institute of internal Auditors code of practice, the head of internal audit report to the BOD, and have ready and regular access to the Chairman and the chairperson of the audit committee

    5 [ ] 4 [ ] 3 [ ] 2 [ ] 1 [ ]

16. All the professional staff from the internal audit department are members of any accountants' professional body? E.g. ICPAK

    5 [ ] 4 [ ] 3 [ ] 2 [ ] 1 [ ]

Appendix Two: List of Regulatory State Corporations in Kenya as at the Year 2010

REGULATORY STATE CORPORATION	PARENT MINISTRY
1. Capital Markets Authority	Finance
2. Catering Training & Tourism Dev. Levy Trustees	Tourism & Wildlife
3. Coffee Board of Kenya	Agriculture
4. Commission for Higher Education	Education, Science & Technology
5. Communications Commission of Kenya	Information & Communications
6. Council for Legal Education	Justice & Constitutional Affairs
7. Electricity Regulatory Board	Energy
8. Export Processing Zones Authority	Trade & Industry
9. Export Promotion Council	Trade & Industry
10. Horticultural Crops Development Authority	Agriculture
11. Investment Promotion Center	Trade & Industry
12. Kenya Civil Aviation Authority	Transport
13. Kenya Bureau of Standards	Trade & Industry
14. Kenya Dairy Board	Livestock & Fisheries Development
15. Kenya Industrial Property Institute	Trade & Industry
16. Kenya Plant Health Inspectorate Services	Agriculture
17. Kenya Sisal Board	Agriculture
18. Kenya Sugar Board	Agriculture

(State Corporations advisory Circular, 2010)

Appendix Three: Table of Aggregate surplus increase/decrease for the years 2008 to 2012

Year	Average Surplus	Average increase in surplus
2007	199956456	
2008	249500206	49543750
2009	298951503	49451297
2010	378924226	79972723
2011	543456455	164532229
2012	710664534	167208079
Mean	4.36E8	1.0214E8
Std Dev	1.89E8	5.94989E7

(Source, researcher)