THE EFFECT OF CORPORATE GOVERNANCE ON FINANCIAL PERFORMANCE OF COMPANIES LISTED AT NAIROBI SECURITY EXCHANGE

BY:

MWANGI MARY WANJIRU

REG NO: D63/79429/2012

A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENTS OF MASTER OF SCIENCE IN FINANCE, UNIVERSITY OF NAIROBI

OCTOBER 2013

DECLARATION

I declare that this research project is my originals work and my own effort and that it has not been submitted to other institution of higher learning for any academic purposes

Signature………………………..Date………………

Mwangi Mary Wanjiru
D63/79429/2012

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

Signature………………………..Date…………………

Mr. Herick Ondigo
Lecturer Department of Finance and Accounting
School of Business

ACKNOWLEDGEMENT

I am heartily thankful to my supervisor Mr Herrick Ondigo whose encouragement, guidance and support from the initial to the final level enabled me to develop an understanding of the subject. His insightful scholarship and meticulous accuracy were instrumental in shaping this work into its final form. My deepest gratitude to my dear husband Michael, my children Morris and Caleb for their continuous love and support every single minute.

This project would not have been possible without constant support from my employer, *Kenya Revenue Authority* in granting me a scholarship and study leave at the University of Nairobi.

Words are not enough to describe my indebtedness to my parents who sacrificed so much and has helped me become who I am now and placed me on the path where I am today. To all my classmates from whom I received valuable comments, I say thank you all and may God bless you mightily. Above all, I thank the almighty God for the gift of life, opportunity and ability granted for me to witness the successful completion of this research project.

DEDICATION

To my dear husband Michael Mwangi, my children Maurice and Caleb for their continued support and encouragement.

ABSTRACT

The main objective of this study was to investigate the effects of Corporate Governance on the financial performance of listed companies at (NSE) . Specifically, this study examined board size, board composition, CEO duality and leverage and how they affect the financial performance of listed Companies at (NSE). Firm performance was measured using Return on Assets (ROA) and Return on Equity (ROE). This study adopted a descriptive research design. The study population was all those Companies which were quoted on the Nairobi Securities Exchange as at December 2012.Secondary data were collected using documentary information from Company annual accounts for the period 2008 to 2012.

Both descriptive and inferential statistics were used. Data was analyzed using a multiple linear regression model. The study found that a strong relationship exist between the Corporate Governance practices under study and the firms' financial performance. There was a positive relationship between board composition and firm financial performance. However, the most critical aspect of board composition was the experience, skills and expertise of the board members as opposed to whether they were executive or non executive directors. Similarly, leverage was found to positively affect financial performance of insurance firms listed at the NSE. On CEO duality, the study found that separation of the role of CEO and Chair positively influenced the financial performance of listed firms.

.

TABLE OF CONTENTS

LIST OF ABBREVIATIONS

ANOVA	Analysis of Variance
EAC	East African Community
DC	Developing Countries
DPS	Dividend per Share
EPS	Earnings per Share
NSE	Nairobi Securities Exchange
LIQ	Liquidity
KIPPRA	Kenya Institute for Public Policy Research and Analysis
KNBS	Kenya National Bureau of Statistics
CMA	Capital Market Authority
OECD	Organization for Economic Co-operation and Development
ROA	Return on Asset
NED	Non Executive Director
PWC	Price Waterhouse Coopers
OLS	Ordinary Least Square
R&D	Research and Development
ROCE	Return on Capital Employed
USA	United States of America
WDI	World Development Indicator

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Corporate Governance is basically concerned with ways in which all parties interested in the well-being of the firm (the stakeholders) attempt to ensure that managers and other insiders are always taking appropriate measures or adopt mechanisms that safeguard the interests of the stakeholders. Such measures are necessitated because of the separation of ownership from management, an increasingly vital feature of the modern corporations. Corporate Governance is defined as the process and structure used to direct and manage business affairs of the Company towards enhancing prosperity and corporate accounting with the ultimate objective of realizing shareholder long term value while taking into account the interest of other stakeholders (CMA Act, 2002).

Corporate Governance is the system by which organizations are directed and controlled. It's a set of relationships between company directors, shareholders and other stakeholder's as it addresses the powers of directors and of controlling shareholders over minority interest, the rights of employees, rights of creditors and other stakeholders (Muriithi, 2009). Corporate Governance is also defined as an internal system encompassing policies, processes and people, which serve the needs of shareholders and other stakeholders, by directing and controlling management activities with good business savvy, objectivity, accountability and integrity (Mangunyi, 2011). Corporate governance has, in more recent years, become one of the most commonly used terms in the modern corporation.

The empirical research and literature has burgeoned and the field is highly interdisciplinary. Stakeholders in the corporate governance arena are many and wide-ranging and their participation in this field has spawned a rich and varied range of information resources pertaining to distinct disciplinary fields and practitioner interests. The corporate governance researcher thus needs to have an in-depth understanding of the diverse roles various stakeholders play and how they "fit" together in the complex arena of corporate governance as it exists today. Corporate governance has come to underpin systematically the work of many business academics and practitioners alike, and their information and research needs present challenges not only for them, but also for the information professionals who assist them. Governance refers to the manner in which power is exercised in the management of economic and social resources for sustainable human development initiative (McCord, 2002). According to McCord corporate governance refers to the manner in which the power of a corporation is exercised in the stewardship of the corporation total portfolio and resources with an objective of obtaining increasing stakeholders value with a satisfaction of other stakeholders within the context of individual organizations corporate mission and vision as spelt out in the strategic plan of an institution.

In today's world governance has assumed critical importance in the socio-economic and political systems. A typical firm is characterized by numerous owners having no management role, and with managers with no equity interest in the firm. Shareholders, or owners' equity, are generally large in number, and an average shareholder controls a minute proportion of the shares of the firm. This gives rise to the tendency for such a shareholder to take no interest in the monitoring of managers, who, left to themselves, may pursue interests different from those of the owners of equity. The compatibility of corporate governance practices with global standards has also become an important part of corporate success.

The practice of good corporate governance has therefore become a necessary prerequisite for any corporation to be manage effectively in the globalize market. The term “corporate governance” is relatively new terminology used in both public and academic debates, although the issues it addresses have been around for much longer. In the last two decades, however, corporate governance issues have become important not only in the academic literature, but also in public policy debates. During this period, corporate governance has been identified with takeovers, financial restructuring, and institutional investors' activism Ross, Shleifer and Vishny (1973) 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.

Corporate-governance mechanisms assure investors in corporations that they will receive adequate returns on their investments (Shleifer and Vishny, 1997). If these mechanisms did not exist or did not function properly, outside investors would not lend to firms or buy their equity securities. As thus, businesses would be forced to rely entirely on their own internally generated cash flows and accumulated financial resources to finance ongoing operations as well as profitable investment opportunities. Therefore the overall economic performance likely would suffer because many good business opportunities would be missed and financial distress at individual firms would spread quickly to other firms, employees, and consumers.

Few studies examined corporate governance in emerging markets. Researchers have studied the implications of the concentrated corporate ownership which is common in many emerging and developing markets, and conclude that the principal agency problem in large corporations around the world represented by the restricting expropriation of minority shareholders by the controlling shareholders.

1.1.1 Corporate Governance

Corporate Governance refers to the system by which corporations are directed and controlled. The governance structure specifies the distribution of rights and responsibilities among different participants in the corporation (such as the board of directors, managers, shareholders, creditors, auditors, regulators, and other stakeholders) and specifies the rules and procedures for making decisions in corporate affairs,Donalson(1991). Governance provides the structure through which corporations set and pursue their objectives, while reflecting the context of the social, regulatory and market environment. Governance is a mechanism for monitoring the actions, policies and decisions of corporations,Gomper(2003). Governance involves the alignment of interests among the stakeholders.

There has been renewed interest in the corporate governance practices of modern corporations, particularly in relation to accountability, since the high-profile collapses of a number of large corporations during 2001–2002, most of which involved accounting fraud. Corporate scandals of various forms have maintained public and political interest in the regulation of corporate governance. In the U.S., these include Enron Corporation and MCI Inc. (formerly WorldCom). Their demise is associated with the U.S. federal government passing the Sarbanes-Oxley Act in 2002, intending to restore public confidence in corporate governance. Comparable failures in

Australia (HIH, One.Tel) are associated with the eventual passage of the CLERP 9 reforms. Similar corporate failures in other countries stimulated increased regulatory interest (e.g., Parmalat in Italy).

Corporate governance is a set of rules that define the relationship between stakeholders, management, and board of directors of a company and influence how that company is operating. At its most basic level, corporate governance deals with issues that result from the separation of ownership and control. But corporate governance goes beyond simply establishing a clear relationship between shareholders and managers. The presence of strong governance standards provides better access to capital and aids economic growth. Corporate governance also has broader social and institutional dimensions. Properly designed rules of governance should focus on implementing the values of fairness, transparency, accountability, and responsibility to both shareholders and stakeholders

Good corporate governance ensures that the business environment is fair and transparent and that companies can be held accountable for their actions. Conversely, weak corporate governance leads to waste, mismanagement, and corruption. It is also important to remember that although corporate governance has emerged as a way to manage modern joint stock corporations it is equally significant in state-owned enterprises, cooperatives, and family businesses. Regardless of the type of venture, only good governance can deliver sustainable good business performance, Freeman (1984). Organizations with good corporate governance have the capacity to maintain high-quality services and to deliver improvement. Poor governance arrangements set the framework within which the organizational systems and processes fail to detect or anticipate serious service and financial failures. Baker (2007) Good governance in organizations, based on openness, clarity and honest accountability enhances public trust and civic engagement.

The corporate governance debate has largely centered on the powers of the Board of Directors vis-à-vis the discretion of top management in decision making processes. The traditional approach to corporate governance has typically ignored the unique influence that firm owners exert on the board, and by extension, the top management, to behave or make decisions in a particular way. Consequently, studies on corporate governance (Cubbin and Leech, 1982; Monks, 1998; Jensen, 2000; Shleifer, 2001; Frentrop, 2003; Donaldson, 2005; Huse, 2005) have not comprehensively identified and dealt with the complexities that are inherent in corporate governance processes. Perhaps, this is where the greatest problem of corporate governance lies. Owner preferences and investment choices are influenced by, among other factors, the extent to which they can take risks.

To the extent that owners have economic relations with the firm, their priority would be to protect their interests even though this may lead to low investment returns, and generally low profitability. In this regard, Thomsen and Pedersen (1997) argue that banks which play a dual role as lenders and owners would not favor high risk ventures with great potential for returns since such a policy is inimical to loan repayment. Government may also play the dual role of regulator and owner. For each of these owners Firm Ownership, Board, Managerial Discretion, and Performance: Empirical Evidence from Kenya 101 (stakeholders), preferences regarding company strategy will involve a tradeoff between the pursuit of shareholder value and other goals (Hill and Jones, 2005).This paper argues that the Board alone is not a panacea to all the governance problems afflicting the modern corporation.

To better appreciate the corporate governance issues, firms need to also take into consideration the risk-taking orientations of their shareholders as these have a direct bearing on the type of investment decisions that managers will prefer. Firm ownership structure is thus discussed in terms of the actual identities of the owners as well as percentages of shareholding by these shareholders (ownership concentration). In addition, managerial discretion is critical for innovation and creativity, which translate to firm performance. External governance factors also play a role in supporting good corporate governance. The external environment includes both the takeover mechanisms and the laws and regulations that enforce the rights of shareholders and other stakeholders, such as creditors, and a good external environment also includes appropriate oversight by government or other regulatory bodies like Central Banks and the Deferent Stock Exchange Markets.

The capital market infrastructure-depth and breadth-supports the ability of shareholders to hold management accountable; if a corporation is under-performing, investors may significantly discount the value of its shares, and in severe cases the corporation may be taken over and reorganized to produce acceptable returns for its owners. Accounting standards prescribe the presentation of financial information- in terms of timeliness and accuracy-that investors use to hold management and the board accountable, Novikova (2004).

1.1.2 Financial Performance

Financial performance is a subjective measure of the accountability of an entity for the results of its policies, operations and activities quantified for an identified period in financial terms. In the public sector the nature of financial performance is a function of what the public sector entity is held accountable for accomplishing in financial terms in the identified period Adams (2003). Multiple perspectives of financial performance considered together provide a comprehensive picture of a public sector entity's achievement in relation to the multiple accountabilities expected of it. A subjective measure of how well a firm can use assets from its primary mode of business and generate revenues. This term is also used as a general measure of a firm's overall financial health over a given period of time, and can be used to compare similar firms across the same industry or to compare industries or sectors in aggregation. There are many different ways to measure financial performance, but all measures should be taken in aggregation. Line items such as revenue from operations, operating income or cash flow from operations can be used, as well as total unit sales. Furthermore, the analyst or investor may wish to look deeper into financial statements and seek out margin growth rates or any declining debt.

The word 'Performance is derived from the word 'par four men', which means 'to do', 'to carry out' or 'to render'. It refers t he act of performing; execution, accomplishment, fulfillment, etc. In border sense, performance refers to the accomplishment of a given task measured against pre set standards of accuracy, completeness, cost, and speed. In other words, it refers to the degree to which an achievement is being or has been accomplished. In the words of Frich Kohlar(2008) "The performance is a general term applied to a part or to all the conducts of activities of an organization over a period of time often with reference to past or projected cost efficiency, management responsibility or accountability or the like. Thus, not just the presentation, but the quality of results achieved refers to the performance. Performance is used to indicate firm's success, conditions, and compliance.

1.1.3 Effect of Corporate Governance on Financial Performance

It is a fact that the objectives pursued by shareholders and corporate managers tend to be differing and contradictory with regards to their own interests. Consequently, this has nurtured the conception of a wide spectrum of approaches and processes ensuring that conflicting interest' spill-over are minimized. One of the compromises that have been given birth to address this divergence is corporate governance. At its very root, according to some researchers (Harris and Raviv, 2008, Larcker, Richardson and Tuna, 2007)the theoretical platform on which foundations of corporate governance is built is weak and as such finds itself deprived of any theoretical base. Tricker (2000) and Parum (2005) also have the same line of reasoning and conclude that studies carried out on corporate governance have not been consistent whether empirically, methodologically, or even theoretically.As such, a vast number of theoretical frameworks have seen the day, stemming from the fields of economics, finance, management or even sociology, so as to serve as a basis for researchers in their analysis of CG.

Though to some (for instance Stiles and Taylor 2002), these piecemeal attempts to understanding CG leave them skeptic about the actual function of the BOD in a company, others like Solomon and Solomon (2004) have adopted an optimistic position and consider that these differing frameworks share commonalities on a theoretical base. The well known and widely discussed theories are the Agency cost theory (interested readers are referred to Berle and Means, 1932; Jensen and Meckling 1976), the Stakeholder theory (see Freeman et al., 2004; Kiel and Nicholson, 2003b; John and Senbet 1998); the stewardship theory (Donaldson, 1990; Pfeffer, 1972) and the resource dependency (Ruigrok et al., 2006).

1.1.4 Nairobi Securities Exchange

The Capital Markets Authority (the Authority) has developed these guidelines for good corporate governance practices by public listed companies in Kenya in response to the growing importance of governance issues both in emerging and developing economies and for promoting growth in domestic and regional capital markets. It is also in recognition of the role of good governance in corporate performance, capital formation and maximization of shareholders value as well as protection of investors' rights. Corporate governance, for the purpose of these guidelines is defined as the process and structure used to direct and manage business affairs of the company towards enhancing prosperity and corporate accounting with the ultimate objective of realizing shareholders long-term value while taking into account the interest of other stakeholders. These guidelines have been developed taking into account the work which has been undertaken extensively by several jurisdictions through many task forces and committees including but not limited to the United Kingdom, Malaysia, South Africa, Organization for Economic Cooperation and Development (OECD) and the Commonwealth Association for Corporate Governance.

The Authority has also supported development of a code of best practice for corporate governance in Kenya issued by the Private Sector Corporate Governance Trust, Kenya, whose efforts have also been useful in the development of these guidelines and are supplementary there to. The objective of these guidelines is to strengthen corporate governance practices by public listed companies in Kenya and to promote the standards of self-regulation so as to bring the level of governance in line with international.

Good corporate governance practices must be nurtured and encouraged to evolve as a matter of best practice but certain aspects of operation in a body corporate must of necessity require minimum standards of good governance. In this regard the Authority expects the directors of every public listed company to undertake or commit themselves to adopt good corporate governance practices as part of their continuing listing obligations. It is important that the extent of compliance with these guidelines should form an essential part of disclosure obligations in the corporate annual reports. It is equally important the extent of non-compliance be also disclosed. Every public listed company shall disclose, on an annual basis, in its annual report, a statement of the directors as to whether the company is complying with these guidelines on corporate governance with effect from the financial year ending during 2002, as prescribed under the Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations, 2002. All issuers of fixed income securities or debt instruments through the capital markets such as bonds and commercial paper shall also comply with these guidelines. Where the company or Issuer is not fully compliant with these guidelines, the Issuer shall identify the reasons for non- compliance and indicate the steps being taken to become compliant.

1.2 Research Problem

Previous researchers have been only concentrating on Banking and other service industries thereby ignoring other sectors like automobile sectors which are still prone to Corporate Governance issues i.e. recent CMC Motors and performance of all sectors in Kenyan economy despite the fact that all sectors are important player in Kenya’s economy. Despite tight regulatory framework, Corporate Governance continues to weaken in Kenya (Mang’unyi, 2011). According to Muriithi, (2009), many companies have been characterized by scandals. Directors have acted illegally or in bad faith towards their shareholders. Indeed, the Insurance Regulatory Authority identified poor Corporate Governance in insurance Companies as one of the threats to achieving its strategic plan 2008-2012. This is worrying especially in the banking and insurance sector since the industry has witnessed in the past, the collapse of firms such as Kenya National Assurance Company, Euro Bank, Lake Star Assurance Company, Standard Assurance, Trade Bank, Stallion Insurance, Nyaga Stock Brokers and Blue Shield Insurance Company.

The study is trying to answer the following questions: What is the effect of corporate governance on performance indicator? Corporate Governance is important in all organizations regardless of their industry, size or level of growth.

The main Corporate Governance themes that are currently receiving attention are adequately separating management from the board to ensure that the board is directing and supervising management, including separating the chairperson and chief executive roles; ensuring that the board has an effective mix of independent and non-independent directors; and establishing the independence of the auditor and therefore the integrity of financial reporting, including establishing an audit committee of the board.

In Kenya, the studies done in financial services sector have focused on other companies other than insurance service providers in Kenya. For instance, Jebet (2001) conducted a study of Corporate Governance practices among the quoted companies in Kenya, Muriithi (2005) did a study on the relationship between Corporate Governance mechanisms and performance of firms quoted on the NSE, Manyuru (2005) researched on Corporate Governance and organizational performance the case of companies quoted at the NSE while Matengo (2008) did a study on the relationship between Corporate Governance practices and performance: the case of banking industries in Kenya.

Whereas there has been renewed inters in Corporate Governance, relevant data from empirical studies are still few. There are therefore limitations in the depth of our understanding of corporate governance issues. With such an environment in the background, together with the week judicial system, the interest of both minority shareholders and creditors could be compromised hence no research has been carried out on all sectors of the firms as the previous researchers has been only concentrating in financial and service sectors thereby ignoring other sectors like motor industries i.e.the resent CMC motors and Nyagah stock brokers.

1.3- Objectives the Study

To establish the effect of corporate governance on the financial performance of the companies listed at Nairobi Securities Exchange.

1.4 Value of the Study

This research aimed to investigate the relationship between corporate governance and the financial performance of firms listed at (NSE) in Kenya. The study would be invaluable to the various stakeholders in the Kenyan economy.

The treasury would identify how various aspects of corporate governance practices affect the operations of various firms in Kenya as well as determine the extent to which this and other factors affect operations of firms. They would also identify the impediments that face firms in approaching various corporate governance practices that affect their financial performance.

The policy makers would obtain knowledge of the various firm dynamics and the responses that are appropriate; they will therefore obtain guidance from this study in designing appropriate practices that would regulate the shareholders participation in affecting the financial performance of the firms in Kenya.

The study will enable the future researchers and academicians to identify gaps which have never been covered by the previous researchers.

CHAPTER TWO
LITERATURE REVIEW

2.1 Introduction

This chapter provides a discussion of the theoretical and the empirical literature explaining and related to this study. There are three theories that explain the impact of corporate governance financial performance of companies listed in (NSE). These theories are, Agency Theory, The Stewardship Theory and Stakeholders Theory. The empirical studies on the corporate governance in different countries show that there are positive effects of corporate governance on performance of the companies listed on (NSE). Neumann (2006) defines a theory as a system of interconnected ideas that condense and organize knowledge about the world.

2.2 Review of Theories

There are several theories on the effect of corporate governance on financial performance of the firms listed in Nairobi Security Exchange which include:

2.2.1 Agency Theory

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). Agency theory suggests that employees or managers in organizations can be self-interested. The agency theory shareholders expect the agents to act and make decisions in the principal's interest. On the contrary, the agent may not necessarily make decisions in the best interests of the principals (Padilla, 2000). The agent may be succumbed to self-interest, opportunistic behavior and falling short of congruence between the aspirations of the principal and the agent's pursuits. Even the understanding of risk defers in its approach. Although with such setbacks, agency theory was introduced basically as a separation of ownership and control (Bhimani, 2008). The agents are controlled by principal-made rules, with the aim of maximizing shareholders value. Hence, a more individualistic view is applied in this theory (Clarke, 2004).

Indeed, agency theory can be employed to explore the relationship between the ownership and management structure. However, where there is a separation, the agency model can be applied to align the goals of the management with that of the owners. The model of an employee portrayed in the agency theory is more of a self-interested, individualistic and are bounded rationality where rewards and punishments seem to take priority (Jensen & Meckling, 1976).

2.2.2 Stewardship Theory

A steward is defined by Davis, Schoorman & Donaldson (1997) as one who protects and maximizes shareholders wealth through firm performance, because by so doing, the steward's utility functions are maximized. In this perspective, stewards are company executives and managers working for the shareholders, protects and make profits for the shareholders. Stewardship theory stresses not on the perspective of individualism, but rather on the role of top management being as stewards, integrating their goals as part of the organization. The stewardship perspective suggests that stewards are satisfied and motivated when organizational success is attained.

It stresses on the position of employees or executives to act more autonomously so that the shareholders' returns are maximized. Indeed, this can minimize the costs aimed at monitoring and controlling behaviors (Daly et al., 2003). On the other end, Daly et al. (2003) argued that in order to protect their reputations as decision makers in organizations, executives and directors are inclined to operate the firm to maximize financial performance as well as shareholders' profits. In this sense, it is believed that the firm's performance can directly impact perceptions of their individual performance. Moreover, stewardship theory suggests unifying the role of the CEO and the chairman so as to reduce agency costs and to have greater role as stewards in the organization. It was evident that there would be better safeguarding of the interest of the shareholders.

2.2.3. Stakeholders Theory

Wheeler et al, (2002) argued that stakeholder theory was derived from a combination of the sociological and organizational disciplines. Stakeholder theory can be defined as any group or individual who can affect or is affected by the achievement of the organization's objectives. Stakeholder theorists suggest that managers in organizations have a network of relationships to serve – this include the suppliers, employees and business partners. And it was argued that this group of network is important other than owner-manager-employee relationship as in agency theory. On the other end, Sundaram & Inkpen (2004) contend that stakeholder theory attempts to address the group of stakeholders deserving and requiring management's attention.

2.3 Measuring Firm Performance

Firm performance is studied and measured by different researchers (Shah et al., 2011; Matolcsy & Wright, 2011;Yasser et al., 2011) using different measures. Matolcsy & Wright (2011) measured firm performance by ROA (Return on Assets= EBIT / Average total Assets – in book value -), ROE (Return on Equity=net profit / equity -in book value -), Change in market value of equity, Change in market value of equity, adjusted for dividends and risk). Yasser et al. (2011) used return on equity (ROE) and profit margin (PM) for the measurement of firm performance. Market based measures of companies' performance were done by Shah et al. (2011) by Market value of equity divided by book value of equity and Tobin's Q (market value of equity + book value of debt/total of assets - in book value -), whereas financial reporting perspective was measured by ROE and Return on investment (net result + interest) / (equity +total debt).

Bhagat & Black (1999) measured dependent variable firm performance by Tobin's Q, Return on assets (Operating income/Assets), Turnover ratio (Sales/Assets), Operating margin (Operating income/Sales), Sales per employee and also by Growth of Assets, Sales, Operating income, Employees and Cash flows. The study was focus on those measures that are strategically important for the success of the company. In that direction, the study would measure the financial performance of the companies by looking at profitability (Return On Assets, Return on Equity and Dividend Yield).

2.3.1 Board Composition and Firm Performance

Boards mostly compose of executive and non-executive directors. Executive directors refer to dependent directors and non-Executive directors to independent directors (Shah et al., 2011). At least one third of independent directors are preferred in board, for effective working of board and for unbiased monitoring. Dependent directors are also important because they have insider knowledge of the organization which is not available to outside directors, but they can misuse this knowledge by transferring wealth of other stockholders to themselves (Beasly, 1996).A board composed of members who are not executives of a company, nor shareholders, nor blood relatives or in law of the family (Gallo, 2005).

An independent board is generally composed of members who have no ties to the firm in any way, therefore there is no or minimum chance of having a conflict of interest because independent directors have no material interests in a ompany. Dalton,Daily, Ellstrand, & Johnson (1998) saw Jacobs (1985) stating that independent directors are important because inside or dependent directors may have no access to external information and resources that are enjoyed by the firm's outside or independent directors (e.g., CEOs of other firms, former governmental officials, investment bankers, Social worker or public figures, major suppliers).

2.3.2 Board Size and Firm Performance

Hermalin and Weisbach (2003) argued the possibility that larger boards can be less effective than small boards. When boards consist of too many members agency problems may increase, as some directors may tag along as free-riders. They argued that when a board becomes too big, it often moves into a more symbolic role, rather than fulfilling its intended function as part of the management. On the other hand, very small boards lack the advantage of having the spread of expert advice and opinion around the table that is found in larger boards. Furthermore, larger boards are more likely to be associated with an increase in board diversity in terms of experience, skills, gender and nationality (Dalton and Dalton, 2005). Expropriation of wealth by the CEO or inside directors is relatively easier with smaller boards since small boards are also associated with a smaller number of outside directors. The few directors in a small board are preoccupied with the decision making process, leaving less time for monitoring activities.

Vafeas (2000) reported that firms with the smallest boards (minimum of five board members) are better informed about the earnings of the firm and thus can be regarded as having better monitoring abilities. Echoing the above findings, Mak and Yuanto (2003) reported that listed firm valuations of Singaporean and Malaysian firms are highest when the board consists of five members. Bennedsen, Kongsted and Nielsen (2004), in their analysis of small and medium-sized closely held Danish corporations reported that board size has no effect on performance for a board size of below six members but found a significant negative relation between the two when the board size increases to seven members or more. Bhagat and Black (2002), found no solid evidence on the relationship between board size and performance.

In an attempt to compare the effects of board structure on firm performance between Japanese and Australian firms, Bonn, Yokishawa and Phan (2004) found that board size and performance (measured by market-to-book ratio and return on assets) was negatively correlated for Japanese firms but found no relationship between the two variables for its Australian counterpart. However, contrary to the Japanese firms the ratios of outside directors and female directors to total board numbers have a positive impact in the Australian sample (Bonn, 2004). Contrary to the above findings, a positive impact on performance was recorded with larger board size by Mak and Li (2001) and Adams and Mehran (2005); however, in examining 147 Singaporean firms from 1995 data, Mak and Li (2001) support the argument that board structure is endogenously determined when the results of their OLS indicate that board size, leadership structure and firm size have a positive impact on firm performance but their 2SLS regressions do not support this result.

Adams and Mehran (2005) found a positive relationship between board size and performance (measured by Tobin's Q) in the U.S banking industry. Adam and Mehrans results suggest that such performance relationship may be industry specific, indicating that larger boards works well for certain type of firms depending on their organizational structures. A meta-analysis based on 131 studies by Dalton and Dalton (2005) revealed that larger boards are correlated with higher firm performance.

2.5 Review of Empirical Studies

Beiner, Drobetz, Schmid and Zimmerman (2004) studied the Corporate Governance and firm valuation by using a broad Corporate Governance index and additional variables related to ownership structure, board characteristics, and leverage to provide a comprehensive description of firm-level Corporate Governance for a broad sample of

Swi. An increase in Corporate Governance index by one point caused an increase of the market capitalization by roughly 8.6%, on average, of a company's book asset value. Zheka (2007) studied the effect Corporate Governance on performance by constructing an overall index of Corporate Governance and shows that it predicts firm level productivity in Ukraine. The results imply that a one-point-increase in the index results in around 0.4%-1.9% increase in performance; and a worst to best change predicts a 40% increase in company's performance. Using data on companies in many African countries, including Ghana, South Africa,Nigeria and Kenya, Kyereboah-Coleman (2007) shows that better governance practices are associated with higher valuations and better operating performance.

Baker, Godridge, Gottesman and Morey (2007) using a unique dataset from Alliance Bernstein, an international asset management company, with monthly firm-level and country-level governance ratings for 22 emerging markets countries over a five year period, report a significantly positive relation between firm-level (and country-level) Corporate Governance ratings and market valuation, suggesting lower cost of equity for better governed firms.In Kenya, Wanjiku et al (2011) carried out a study to establish the Corporate Governance practices of firms and its relationship with the growth of Companies listed at the Nairobi Securities Exchange using a causal comparative research design. The study focused on corporate communication, leadership and technology application. The study found a positive linear dependence of growth and Corporate Governance. Ongore and K'Obonyo (2011) conducted a similar study in Kenya to examine the interrelations among ownership, board and manager characteristics and firm performance in a sample of 54 firms listed at the Nairobi Securities Exchange. The findings from this study show a positive relationship between managerial discretion and performance. However, the relationship between ownership concentration and government on firm performance was significantly negative.

Mang'unyi (2011) carried out a study to explore the ownership structure and Corporate Governance and its effects on performance of firms. His study focused on selected banks in Kenya. His study revealed that there was significant different between Corporate Governance and financial performance of banks. The study recommended that corporate entities should promote Corporate Governance to send positive signals to potential investors and those regulatory agencies including the government should promote and socialize Corporate Governance and its relationship to firm performance across firms. Miring'u and Muoria (2011) analyzed the effects of Corporate Governance on performance of commercial state corporations in Kenya. Using a descriptive study design, the study sampled 30 SCs out of 41 state corporations in Kenya and studied the relationship between financial performance, board composition and size. The study found a positive relationship between Return on Equity (ROE) and board compositions of all State Corporations.

The studies cited in the literature mostly concentrate on the developed countries whose strategic approach and Corporate Governance systems are not similar to that of Kenya. In Kenya, the studies done in financial services sector have focused on other companies especially financial sectors failing to cover all the firms listed in NSE other than insurance service providers in Kenya. For instance, Jebet (2001) conducted a study of Corporate Governance practices among the quoted companies in Kenya, Muriithi (2005) did a study on the relationship between Corporate Governance mechanisms and performance of firms quoted on the NSE, Manyuru (2005) researched on Corporate Governance and organizational performance the case of companies quoted at the NSE while Matengo (2008) did a study on the relationship between Corporate Governance practices and performance: the case of banking firms in Kenya. None of these studies have focused specifically on the relationship between Corporate Governance and financial performance of listed insurance Companies in Kenya. Many other researchers have examined the relationship between variety of governance mechanisms and firm performance. However, the results are mixed. Some researchers examine only one governance mechanism on performance while others investigate the influence of several mechanisms on performance.

2.6 Summary of Literature Review

The literature review has provided clear indication regarding the effects of corporate governance on the financial performance of firms listed in the theoretical literature and empirical literature have shown that corporate governance with indicators like ROE and profitability improved the financial performance of the firms listed in NSE. Examined the corporate governance mechanism driving firm's financial performance, appraise the corporate governance practices in the firms listed in (NSE) and also assess the effectiveness of corporate governance. The empirical result established statistical significant and if there is any negative or positive relationship between composition of the board, board size as well as CEO duality and financial performance. Even though empirical study shows a positive relationship between board size, composition and financial performance there was no empirical evidence on how other factors which are not captured in the model could influence financial performance of the firms.

CHAPTER THREE
RESEARCH METHODOLOGY

3.1 Introduction

In this chapter, the research methodology followed in the study is discussed. This includes the research design, sampling design, measuring instruments and data analyses.

3.2 Research Design

Kumar, (2005) defined a research design as a procedural plan that is adopted by the researcher to answer questions validly, objectively, accurately and economically. A research design helps a researcher to conceptualize an operational plan to undertake the various procedures and tasks required to complete the study and to ensure that these procedures are adequate to obtain valid, objective and accurate answers to the research questions.

This study will adopt a descriptive research design. According to Mugenda and Mugenda (2003), descriptive research is a process of collecting data in order to test hypotheses or to answer questions concerning the current status of the subjects in the study. A descriptive study determines and reports the way things are. The choice of the descriptive study design is based on the fact that the research is interested on the state of affairs already existing in the field and no variable will be manipulated. This study therefore will be able to generalize the findings to a larger population. The main focus of this study will be quantitative. However some qualitative approaches will be used in order to gain a better understanding and possibly enable a better and more insightful interpretation of the results from the quantitative study.

3.3 Population

A population refers to an entire group of individuals, events or objects having common observable characteristics (Mugenda and Mugenda, 2003). Target population is defined as a computed set of individuals, cases or objects with some common observable characteristics of a particular nature distinct from other population. According to Ngechu (2004), a population is a well-defined or set of people, services, elements, and events, group of things or households that are being investigated. The population was made up of all the 62 companies listed in the NSE as at 31st December 2012.

3.4 Sample

A sample is a small group obtained from accessible population, (Mugenda & Mugenda, 2003). Sampling is the procedure a researcher uses to gather people, places or things to study, (Kombo & Tromp, 2006). The purposive sampling was used to get appropriateness and required sample because it is a technique that allows a researcher to use cases that the required information with respect to the objective (Mugenda 2003).The sample of 40 listed companies was approriate.

3.5 Data Collection

Secondary data was collected from published annual reports and websites of the selected Companies. The secondary data provided a reliable source of the information needed by researcher to investigate the phenomenon and seek efficient ways for problem solving situations (Uma, 2003) Specifically the data was collected from the portion expounding on corporate information, statement of Corporate Governance as well as the directors' profile.

Data on financial performance was collected from final statements such as balance sheets, statements of cash flows, statements of changes in equity and statements of comprehensive incomes provided in the cash flows. Secondary data is easy to collect owing to the ease of availability. The period of study was from 2008to 2012 financial year.

3.5.1 Data Validity and Reliability

An instrument is considered reliable if the results of a study can be reproduced under a similar methodology (Joppe 2000). Reliability is therefore the extent to which measures yield consistent results (Zikmund 2000). To be considered reliable, the measuring instrument must be free of errors and the results or observations must be replicable or repeatable (Joppe, 2000). The consistency or reliability implied in the research instrument relates to three issues namely (1) the degree to which a measurement, given repeatedly, remains the same (2) stability of a measurement over time and (3) the similarity of measurements within a given time period (Kirk and Miller 1986). Reliability of a measuring instrument is established by determining the association between the scores obtained from different administrations of the instrument (Joppe, 2000). An instrument is considered reliable if the degree of association is high.

Validity of the measuring instrument determines whether the research truly measures that which it was intended to measure or how truthful the research results are (Joppe 2000, Jones 1993, Smit 1991). Validity thus involves ascertaining whether the means of measurement are accurate and whether they are actually capturing the variables, they were supposed to measure (Golafshani 20

3.6 Data Analysis

Both quantitative and qualitative analysis data was obtained from the study. For quantitative data, analyze it for and the statistical package for social science (SPSS – 12) was used to tabulate and analyze the data. Percentages, means and frequency distribution tables were used to describe the data. Percentages, means and frequency distribution tables were used to describe the sample. Relationships between the independent and dependent variables were established by means of regression analysis- test was used to test for any differences in the respondent's feelings towards the tax reforms.

3.6.1 Model Specification

Multiple regressions model was used. Hair, Black, Babin, Anderson and Tatham (2006: 209) claimed that s multiple regressions are the best method used to predict multivariate association as it eliminates automatically any independent. This study employed the following model;

$$Yit = \beta o + \beta 1BOS + \beta 2BODCOMP + \beta 3\ CEODUAL + \beta 4\ LEVERAGE + et$$

Where:

Yit represents firm performance variables which are: Return on Assets and Return on Equity for firms at time t.

BOS represents Board Size; the terms of measurement will be total number of directors on the board.

BODCOMP represents Board Composition; terms of measurement will be the ratio of outside directors to total number of directors.

CEODUAL represents CEO Duality, dummy variable 1 if CEO and Chairman are the same person; 0 if CEO and Chairman are different persons.

LEVERAGE represents Leverage as a Corporate Governance et, the error term which account for other possible factors that could influence Yit that are not captured in the model, ratio of total liabilities to total asset.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSIONS

4.1 Introduction

This chapter presents analysis and findings of the study as set out in the research methodology. The study findings are presented on the effects of corporate governance on the financial performance of the firms listed in Nairobi Security Exchange. The data was gathered exclusively from the questionnaire as the research instrument. The questionnaire was designed in line with the objectives of the study.

.

4.2 Descriptive Statistics

This section explains the characteristics of corporate governance factors that affects the financial performance of companies listed in (NSE). Some demographic variables including, duality of the CEO, size of the board of the directors, composition of the board of directors and leverage of the firm were tested using T-tests, ANOVA.

Table 4.2.1: Descriptive Data Analysis

	Year	Board Size	Board Composition	CEO Duality	Leverage	ROA	ROE
	2008	8	0.50	0	0.78	0.037	0.184
	2009	8	0.38	0	0.84	0.035	0.248
	2010	8	0.38	0	0.84	0.038	0.270
	2011	8	0.25	0	0.82	0.060	0.360
	2012	8	0.38	0	0.82	0.046	0.285
	2008	7	0.57	0	0.76	0.034	1.650
	2009	7	0.71	0	0.81	-0.016	-0.532
	2010	7	0.67	0	0.82	0.018	0.395
	2011	7	0.57	0	0.83	0.055	1.191
	2012	7	0.71	0	0.84	0.068	1.238

Source: Research Findings

Secondary data was collected from the firms' financial statements and report for the years between 2008 and 2012. The study collected data on Return On Assets which was measured as amount of net income returned as a percentage of total assets, Return On Equity which was measured as the amount of net income returned as a percentage of shareholder equity, the various independent variables were Board Size which was measured by the number of directors, Board Composition which was measured as the ratio of outside directors to total number of directors, CEO Duality which was measured as dummy variable 1 if CEO and Chairman are the same person; 0 if CEO and Chairman are different persons and Leverage which was measured as ratio of total liabilities to total assets. In order to test for multicollinearity the researcher conducted a Pearson Product Moment correlation.

Table 4.3: Regression Results and Analysis

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.969[a]	.939	.921	.01575

Source: Research Findings

Adjusted R squared is coefficient of determination which tells us the variation in the dependent variable due to changes in the independent variable. From the findings in the above table, the value of adjusted R squared was 0.921, an indication that there was variation of 92.1% on the financial performance (ROA) of companies due to changes in Board Size, Board Composition, CEO duality and Leverage at 95% confidence interval. This shows that 92.1% changes in financial performance of compnies could be accounted for by Board size, Board Composition, CEO duality and Leverage. R is the correlation coefficient which shows the relationship between the study variables. The findings show that there was a strong positive relationship between the study variables as shown by 0.969.

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.455	.231		1.973	.106
	Board Size	-.016	.009	-.444	-1.815	.009
	Board Composition	.182	.050	1.231	3.616	.036
	CEO Duality	.053	.017	1.075	3.159	.025
	Leverage	.204	.240	.230	.850	.028

Source: Research Findings

From the data in the above table the established regression equation was

$Y = 0.455 - 0.016 X_1 + 0.182 X_2 + 0.053 X_3 + 0.204 X_4$

4.4 Interpretation of the Findings

In summary, this study found that implementation of proper corporate governance is an important element in the financial performance from the regression equation it was revealed that Board Size, Board Composition, CEO duality and Leverage to a constant zero, financial performance of companies would stand at 1.573. A unit increase in Board Size would lead to decrease in financial performance of companies by a factor of 0.509, unit increase in Board Composition would lead to increase in financial performance of companies by a factor of 3.103, a unit increase in CEO duality would lead to increase in financial performance of companies by a factor of 1.483 and unit increase in Leverage would lead to increase in financial performance of companies by a factor of 1.317. At 5% level of significance and 95% level of confidence, Board Composition had a 0. 040 level of significance; Leverage showed a 0.032 level of significance, CEO duality had a 0.030 level of significance while Board Size showed 0.011 level of significance hence the most significant factor is Board Size. Overall Board Size had the greatest effect on the financial performance of companies, followed by CEO duality, then Leverage and Board Composition had the least effect to the financial performance of companies. All the variables were significant ($p<0.05$).

Corporate governance has positive relation with financial performance hence the introduction of various governance policies will improve the financial performance and performance efficiency. Many different claims by different authors explaining the impact of corporate governance on financial performance of firms listed at (NSE) have been explored and analyzed vis-à-vis the findings of the study. Competing explanations to the various arguments have also been shown .It was not, however possible to confirm the relationship between financial performance and some of the prepositions because of lack of relevant comparative data from other groupings of firms not listed at (NSE) Future work should attempt to explore the linkages between transparency, communication, and performance in more depth and by use of different techniques.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMENDATIONS

5.1 Introduction

The chapter provides the summary of the findings from chapter four, and it also gives the conclusions and recommendations of the study based on the objectives of the study. The objectives of this study were to investigate the effects of corporate governance and the financial performance of the firms listed in Nairobi Security exchange.

5.2 Summary

In summary the study found that the board size and composition affected the financial performance to a little extent. The number of non-executive directors affected the performance of the companies was a challenge the board faced to a great extent. From the study it was revealed that the number of non-executive directors affected the financial performance of the companies to a little extent.

The directors were involved in making the internal corporate governance mechanisms to a great extent. Reducing ownership concentration affected the financial performance of the companies to a great extent. It was established that the authority to determine the corporate governance are the lies with the shareholder and government corporate governance policy. However as financial performance is not an absolute, level of corporate governance will vary based on a variety of factors and the levels may change from year to year as the firm's operation environment changes. Managing the levels of financial performance are therefore key challenges the firms has to resolve. The study also found that other potential variables which are evidenced by other researchers in other study settings as significant factors affecting financial performance is turnover and implementation.

5.3 Conclusion

From the findings on the effects of Board Size on the financial performance of listed companies, the study found that various aspects of board size affect the financial performance of companies to a great extent. From the regression analysis, board size was found to negatively affect the financial performance of companies listed at the NSE. On the effects of board composition on the financial performance of listed firms, the study established that various aspects of composition of the board affect the financial performance to a great extent. The study thus concludes that composition of the board positively influence the financial performance of companies listed to a great extent.

From the findings on effects of CEO duality on the financial performance of listed firms, the study found that various aspect of CEO duality positively influenced the financial performance of firms listed to great extent. Thus the study concludes that separation of the role of CEO and Chair positively influenced the financial performance of firms listed to great extent. From the findings on effects of Leverage on the financial performance of listed firms, the study established that leverage of the firm positively influenced the financial performance of firms listed in the NSE. The study thus concludes that leverage of the firm positively influenced the financial performance of firms listed in the NSE.

5.4 Policy Recommendation

The study recommends that the board size and composition be considered since they affect the financial performance of the companies listed at (NSE). The number of non-executive directors needs to be selected well since they affect financial performance of the firms.

The board needs to comprise of well educated people since they are actively involved in shaping firms strategy. The study recommends that non-executive directors be trained on internal corporate governance mechanisms. Ownership concentration needs to be reduced to avoid few people controlling the financial performance of the organization.

Employees should be encouraged to be more active in financial management aspects of the business. Finally, the study recommends that financial monitoring should be done thoroughly by the board. A constitution which clearly indicates how to select and replace the CEO and directors need to be adopted. Companies should consider adopting conduct of regular Corporate Governance Audits and Evaluations. Good Corporate Governance has a positive economic impact on the institution in question as it saves the organization from various losses e.g. those occasioned by frauds, corruption and similar irregularities.

5.5 Limitations of the Study

Improved survey measures of financial performance of the listed firms and various potential financial performance determinants such as inflation, religion, marginal tax rates, market competition and culture could improve the reliability of the empirical results and further reduce the risk of measurement error. This study was unable to include those variables at the same time.

The types of approaches used in measuring corporate governance and financial performance(i.e. by using a survey instrument) might provide limited results, and different research designs (such as interviews or an experiment) could produce different results.

The researcher encountered various limitations that were likely to hinder access to information sought by the study. The researcher encountered problems of time as the research was being undertaken in a short period with limited time for doing a wider research.

5.6 Suggestions for Further Studies

The area of education related to corporate governance's knowledge and levels of financial performance offers opportunities for additional research. Instead of using a survey, other methods of data collection i.e. interviews may provide different results. It is expected that two-way communication via an interview could produce other meaningful results; however, non-anonymous methods such as interviews can be problematic in revealing the truth, especially when questioning respondents regarding governance matters, as failure to appropriately address the questions would harm or embarrass respondents

Further study should also be undertaken on corporate governance legislation reforms as an environmental base for strategic position taken to generate funds, and at the same time manipulate social as well as political demands of the nation.

Moreover, a study should also be carried out to establish the challenges listed companies face. The same study should be carried out in other sectors not listed in Nairobi Security Exchange for example banks and microfinance institutions to find if the same results will be obtained.

.

REFERENCES

Adams, R. B, & Mehran, H. (2005). *Corporate performance, board structure and its* determinants *in the banking industry, in EFA 2005 Moscow meetings.*

Alexander, J, Fennel, M., & Halpern, M. (1993): *Leadership Instability in Hospitals*: The influence of Board-CEO relations and Organizational growth and decline

Alexander, J, Fennel, M, & Halpern, M. (1993): *Leadership Instability in Hospitals*: The influence of Board-CEO relations and Organizational growth and decline.

Baker, E. Godridge. (2007*). Corporate Governance Ratings in Emerging Markets*: *Implications for Market Valuation, Internal Firm Performance, Dividend Payouts and Policy Paper presented at the International Research Conference on Corporate Governance*

Barako,D.G.(2006).*Factors influencing voluntary Corporate disclosure by Kenya*n Companies. Corporate Governance:

Brown, J.D. (2002). Statistics Corner. Questions and answers about language testing statistics: The Cronbach alpha reliability estimate. Available: Beiner, S., et al (2003). Is Board Size an Independent Corporate Governance Mechanism? Available:

Bhagat, S and B, Black (2002): *The non-correlation between board independence and long-term* firm performance. Journal of Corporation Law, 24(2), 231-274

Bhagat, S. and Bolton, B. (2008). Corporate Governance and Firm Performance. Journal of Corporate Finance.

Bourne, M., & Franco, M. (2003). *Corporate Management. Cranfield Centre for Business Performance.*

Cranfield, United Kingdom.Cadbury A. (2002): *Corporate Governance and Chairmanship, a personal view. Oxford, Oxford University Press.*

Capital Markets Authority (2002*). Guidelines on Corporate Governance in public listed Companies in Kenya.Kenya Gazette Notice No. 369, 122-128.Companies Act Chapter 486*, Laws of Kenya.Claessens, S., et al (2002). Disentangling the incentive and entrenchment effects of large shareholders. TheJournal of Finance, 57(6), 2741-2771

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

Cutting, B. & Kouzim, A. (2002*). The emerging patterns of power in Corporate Governance. Back to the futurein improving Corporate decision making. Journal of managerial psychology*, 15(5), 477- 507.

Cyert, R.M. and March, J.G. (1963): *A Behavior Theory of the Firm. New Jersey, Prentice Hall. Daily, C.M., et al. (2003) "Corporate Governance: Decades of Dialogue and Data" . Academy* of Management Review, 28(3), 371-382

Dalton, D. (2007): The fundamental agency problem and its mitigation. The Academy of Management Annals, 191, 1-64.Dalton, D., et al. (2009): Number of directors and

Donaldson, T. and Preston, L.E. (1995): *The Stakeholder Theory of the Corporation: Concepts , Evidence and Implications. Academy of Management Review, 20(1), 65-91*

Donaldson. L and Davis. J. (1991): Stewardship Theory or Agency Theory: CEO Governance and Shareholder Returns. Academy Of Management Review, 20(1), 1-64

Donaldson, W. (2003): *Congressional testimony concerning the implementation of the Sarbanes-Oxley Act of 2002. European Journal of Business and Management. 4(13)* Eisenhardt, K.M. (1989): Agency Theory. An Assessment and Review. Academy of Management Review, 14,57-74

Ekadah, J.W. and Mboya, J. (2011*). Effect of board gender diversity on the performance of Commercial Banksin Kenya. European Scientific Journal. 8, (7*)

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

Freeman, R.E. (1999): Response. Divergent Stakeholder Theory. Academy of Management Review, 24(2), 233- 236

Frost, C. A. (2002). *Stock exchange disclosure and market liquidity: An analysis of 50 international exchanges, Kuala Lumpur. A paper presented at the World Federation of Exchanges Forum on managing exchanges in emerging economies*.

Gliem, J.A. & Gliem R.R (2003). Calculating, interpreting and reporting Cronbach's alpha reliabilitycoefficient for Likert-type scales.

Gompers, P. A. (2003). Corporate Governance and equity prices. Quarterly Journal of Economics, 118(1), 107-55

Hair, J.F. (2010). Multivariate Data Analysis. (7th Ed.), Upper Saddle River, New Jersey. Prentice Hall.

Hermalin, B, and Werisbach, M.S. (2003). Endogenously chosen board of directors and their monitoring of theCEO. RAND Journal of economics, 88, 96-118.

Hillman, A.J.(2000): The Resource Dependency Role Of Corporate Directors: Strategic Adaptation of Board Composition in Response To Environmental Change. Journal of Management Studies.

Holmstrom, B. and Milgrom, P. (1994): The Firm as an Incentive System. The American Economic Review,84(4), 972-991

Huang, L.(2007). Does Corporate Governance and Ownership Structure Influence *Performance? Evidence from Taiwan Life Insurance Companies. Journal of Insurance Issues, 30(2), 123-151*

Johnson, J.L. (2006): Boards of Directors. A Review of Research Agenda. Journal of Management, 22(3),409-438

Jebet, C. (2001). A study of Corporate Governance: Case of quoted companies in Kenya. University of Nairobi Press.

Jensen, M.C., and Meckling, W.H. (1976). Theory of the firm, managerial behavior, agency costs and ownership structure. Journal of financial economics, 3, 305-360.

Kariuki, M. (2011). Relationship between Corporate Governance and Growth of Organizations: A survey of Companies listed in Nairobi Stock Exchange. Proceedings of Kabarak University First InternationalConference.

Kakabadse, N.K. & Kakabadse, A. (2003). *Polylogue as a platform for governance; Integrating people, theplanet, profit and posterity. Corporate Governance*.

Kang, J, & Shivdasani, A. (2005*). Firm performance, Corporate Governance and top Executive turnover in Japan*

Kline, R.B. (2011). Convergence of structural equation modeling and multilevel modeling.

Kothari, C. R. (2004). Research Methods: Methods & Techniques. New Delhi. AGE International.

Kumar, R. (2005). Research Methods: a step by step guide for beginners. New Delhi. SAGE Publishers.

Kyereboah-Coleman, A. (2007). *Corporate Governance and firm performance in Africa: A Dynamic Panel Data Analysis. A paper presented at the International Conference on Corporate Governance in EmergingMarkets. Sabanci University, Istanbul, Turkey, November, 2007*

Levin, R.I. and Rubin, D.S. (1998). Statistics for Management, (7th Ed.). Prentice Hall.

Limpaphayom, J, and Connelly, P. (2006). Board characteristics and firm performance:

Evidence from the life insurance industry in Thailand Chulalongkorn. Journal of Economics, 16(2), 101-124

Mak, T, and Li, Y. (2001): *Determinants of Corporate Ownership and Board Structure : Evidence from Singapore.*

Mak, Y. T, and Yvanto, K. (2003). *Size really matters: Further evidence on the negative relationship between board size and firm value.*

Matengo, M. (2008). The relationship between Corporate Governance practices and performance: The case of banking firms in Kenya, University of Nairobi.

Monks, R.A.G (2002). Redesigning Corporate Governance structures and systems for the 21st century, paperdelivered to the 5th international conference on Corporate Governance and direction at the Centre for Board Effectiveness, Henley Management College.

Monks, R.A.G and Minow, N. (2001). *Watching the Watchers: Corporate Governance for the 21st Century, (Rev. Ed.) Cambridge: Blackwell.*

Mulili, M.B. and Wong, P (2010). *Corporate Governance in Developing Countries. The Case for Kenya.International Journal of Business Administration. 2(1).Myers, S. (1997). Determinants of Corporate Borrowing. Journal of Financial Economics.*

Muriithi, P. (2009). Corporate Governance. KASNEB Newsline, January to March 2009.

Mugenda, O. M., & Mugenda, A. G. (2003). Research Methods: Quantitative and Qualitative Approaches.

McConnell, J., and Servaes, H. (2000). Additional evidence on equity ownership and corporate value. Journal of financial economics.

Miring'u, A. and Muoria, E. (2011*). An analysis of the effect of Corporate Governance on performance of Commercial State Corporations in Kenya. International Journal of Business and Public Management*

,

Mang'unyi, E. (2011). *Ownership structure and Corporate Governance and its effects on performance: A case of selected Banks in Kenya. International Journal of Business Administration.*

Najjar, N. (2012). *The impact of Corporate Governance on the insurance firm's performance in Bahrain.International Journal of Learning and Development*.

Naser, A. (2002). *Empirical evidence on the depth of corporate information disclosure in developing countries: The case of Kenya. International Journal of Commerce and Management*.

Neuman, W. L. (2006). Social Research Methods: Qualitative and Quantitative Approaches, (6th Ed.), Boston.

Ndung'u, N. (2012). *Developments in Kenya's Insurance industry. Remarks at the launch of ContinentalReinsurance brand and products, Nairobi*.

Ngechu, M. (2004). *Understanding the research process and methods: An introduction to Research Methods.*
Olajide, S. F. (2013*). C*

orporate Governance and Insurance Company Growth: Challenges and Opportunities.International Journal of Academic Research in Economics and Management Sciences.

Ongore, V. and K'Obonyo, P. (2011). Effects of selected Corporate Governance Characteristics on Firm Performance; Empirical Evidence from Kenya. International Journal of Economics and Financial.

Organization for Economic Cooperation and Development (2009). *The Corporate Governance lessons from the financial crisis. Financial market trends.*

Padilla, A. (2002): *Can Agency Theory Justify The Regulation Of Insider Trading. The Quarterly Journal ofAustrian Economics.*

Private Sector Corporate Governance Trust: *Principles for Corporate Government in Kenya and a sample code ofbest practice for Corporate Governance, November 1999.*

Ross, S.A. (1973): *The Economic Theory of Agency: The Principal's Problem. The American Economic Review.*

Sanda, A. (2005*). Corporate Governance Mechanisms and Firm Financial Performance in Nigeria. African Economic Research Consortium, Nairobi, March 2005*

Shleifer, A., and Vishny, R.W. (1997). *A survey of Corporate Governance. Journal of Finance.*
Sundaram, A.K. and Inkpen, A.C. (2004*): The Corporate Objective Revisited. Organization Science.*

Tornyeva, K and Wereko, T. (2012). Soft Governance and Firm Performance: *A Study of Ghanaian InsuranceFirms. European Journal of Business and Management.*

Tornyeva, K and Wereko, T. (2012*). Corporate Governance and Firm Performance: Evidence from the Insurance Sector of Ghana. European Journal of Business and Management*.

Uma, S. (2003). Research Methods for Business Students: A skill building approach, (4th Ed.) John Wiley & Sons.

Vafeas, N. (2000). Board *meeting frequency and firm performance. Journal of financial economics.*

Wang, J. L(2007). *The Impact of Corporate Governance Structure on the Efficiency Performance of Insurance Companies in Taiwan*.

Yermack, D. (1996). *Higher market valuation of companies with small boards. Journal of financial economics.*

Zheka, V. (2007). *Does Corporate Governance casually predict Firm Performance? Panel Data and Instrumental Variables Evidence*.

3

APPENDIX I

LIST OF COMPANIES LISTED IN NAIROBI SECURITY EXCHANGE AS AT 31ST DECEMBER, 2012

SECTOR

AGRICULTURE

1 EAAGADS LTD

2 KAKUZI LTD

3 KAPCHORUA TEA CO. LTD

4 THE LIMURU TEA CO LTD

5 REA VIPINGO PLANTATIONS LTD

6 SASINI LTD

7 WILLIAMSON TEA KENYA LTD

AUTOMOBILES &ACCESSORIES

8 CAR & GENERAL (K) LTD

9 CMC HOLDINGS LTD

10 MARSHALLS (E.A) LTD

11 SAMEER AFRICA LTD

BANKING

12 BARCLAYS BANK OF KENYA LTD

13 CFC STANBIC OF KENYA HOLDINGS LTD

14 DIAMOND TRUST BANK KENYA LTD

15 EQUITY BANK LTD

16 HOUSING FINANCE CO. KENYA LTD

17 I&M HOLDINGS LTD

18 KENYA COMMERCIAL BANK LTD

19 NATIONAL BANK OF KENYA LTD

20 NIC BANK LTD

21 STANDARD CHARTERED BANK KENYA LTD

22 THE CO-OPERATIVE BANK OF KENYA

COMMERCIAL AND SERVICES

23 EXPRESS KENYA LTD

24 HUTCHINGS BIEMER LTD

25 KENYA AIRWAYS LTD

26 LONGHORN KENYA LTD

27 NATION MEDIA GROUP LTD

28 SCANGROUP LTD

29 STANDARD GROUP LTD

30 TPS EASTERN AFRICA

31 UCHUMI SUPERMARKET LTD

CONSTRUCTION

32 ARM CEMENT LTD

33 BAMBURI CEMENT LTD

34 CROWN PAINTS KENYA LTD

35 E.A.CABLES LTD

36 E.A .PORTLAND CEMENT CO LTD

ENERGY& PETROLEUM

37 KENGEN CO LTD

38 KENOLKOBIL LTD

39 KENYA POWER & LIGHTING CO LTD

40 TOTAL KENYA LTD

41 UMEME LTD

INSURANCE

42 BRITISH –AMERICAN INVESTMENTS

43 CIC INSURANCE GROUP

44 JUBILEE HOLDINGS LTD

45 KENYA RE INSURANCE CORPORATION LTD

46 LIBERTY KENYA HOLDINGS LTD

47 PAN AFRICA INSURANCE HOLDINGS LTD

INVESTMENTS

48 CENTUM INVESTMENTS CO LTD

49 OLYMPIA CAPITAL HOLDINGS LTD

50 TRANS-CENTURY LTD

MANUFACTURING & ALLIED

51 A.BAUMAN & CO LTD

52 B.O.C KENYA LTD

53 BRITISH AMERICAN TOBACCO KENYA LTD

54 CARBACID INVESTMENTS LTD

55 EAST AFRICA BREWERIES LTD

56 EVEREADY EAST AFRICA LTD

57 KENYA ORCHARDS LTD

58 MUMIAS SUGAR CO LTD

59 UNGA GROUP LTD

TELECOMUNICATION & TECHNOLOGY

60 ACCESKENYA GROUP LTD

61 SAFARICOM LTD

GROWTH ENTERPRISE MARKET SEGMENT

62 HOME AFRICA LTD

Source: Capital Market Authority

APPENDIX II

LETTER OF INTRODUCTION

Mary Wanjiru Mwangi

P.O.Box 4319-00200,

Nairobi.

To: ____________________________

____

____

Dear Sir/Madam,

RE: INTRODUCTION LETTER FOR MARY WANJIRU MWEANGI

I'm an MBA student in the School of Business, University of Nairobi. In partial fulfillment of the requirements of the degree of Master Science in Finance (MSC), I'm conducting an academic research project titled the "**The Effect of Corporate Governance Financial Performance of Companies listed at Nairobi Security Exchange**".

Your participation in this exercise will be highly appreciated as an integral part of this study, hence the request for your assistance to fill out this questionnaire.

The results of this research are for educational purposes only and will be treated with utmost confidentiality.

Thank you in advance for your cooperation.

MWANGI MARY WANJIRU