CORPORATE GOVERNANCE AND THE FINANCIAL PERFORMANCE OF STATE CORPORATIONS: THE CASE OF NEW KENYA COOPERATIVE CREAMERIES (KCC)

BY

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DECLARATION

This Masters of Business Administration Project Proposal is my original work and has not been submitted for another Degree qualification of this nature or to any other University or Institution of learning.

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ABSTRACT

Good Corporate Governance is a major focus in the management of organizations and in particular where financial performance is of great concern. This is because owners of organizations want to get value from their investments; society wants service from state corporations.

This study narrowed down to Corporate Governance and the Financial Performance of the New Kenya Cooperative Creameries. It looked into the Board of Directors role in Governance of the state corporation who are also mandated to oversee the running of the corporation. The study sought to determine and asses the corporate governance systems and practices in place and the financial performance of the corporation.

The study established that the Board of New Kenya Cooperative Creameries adopted practices of good corporate governance which were reviewed and improved over time and had yielded improved financial performance. Some of the corporate governance principles that were identified include appointment and leadership of the Board, structure of the organization, purpose and values, balance of power in the Board, corporate communication, assessment of performance of the Board, responsibility to stakeholders and social and environment responsibility.

Though some practices of good corporate governance were found and have yielded improved financial performance, there is need for more structured mechanisms of handling various issues that arise. The relationship between the Board and the management needs to be continuously monitored to ensure that the corporation remains cordial to realize the mission and objectives set out.

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List of Abbreviations and Acronyms

GOK	Government of Kenya
New KCC	New Kenya Cooperative Creameries
KFA	Kenya Farmers Association
KMC	Kenya Meat Commission
KPTC	Kenya Posts & Telecommunications Corporation
NSE	Nairobi Stock Exchange

CHAPTER ONE

1.0 INTRODUCTION

1.1 Background of the Study

Governance is the manner in which power is exercised in the management of economic and social resources for sustainable human development. It is a vital ingredient in the maintenance of a dynamic balance between the need for order and equality in society, in the production and delivery of goods and services, accountability in the use of power, the protection of human rights and freedom, and the maintenance of an organized corporate framework within which each citizen can contribute fully towards funding innovative solutions to common problems.

Governance is concerned with the processes, systems, practices and procedures (formal and informal rules) that govern institutions. It also looks into the manner in which these rules and regulations are applied and followed. The study of governance also examines the relationships that these rules determine or create, and the nature of those relationships. Governance will therefore address the leadership role in institutional frameworks.

Therefore corporate governance refers to the manner in which the power of a corporation is exercised in the stewardship of the corporations' total portfolio of assets and resources with the objective of maintaining and increasing shareholders value and satisfaction of other stakeholders. This is done in the context of the corporate mission. Private Sector Corporate Governance, Trust, (March 1999)

It is also concerned with creating a balance between economic and social goals and between individual and communal goals. While creating the balance,

governance encourages the efficient use of resources, accountability in the use of power and stewardship and as far as possible to align the interests of individuals, corporations and society.

Good corporate governance seeks to promote responsive and accountable corporations, legitimate corporations that are managed with integrity, probity and transparency, recognition and protection of stake holder's rights. Good corporate governance will also ensure efficient, effective and sustainable corporations that contribute to the welfare of society by creating wealth employment and solutions to emerging challenges, an inclusive approach based on democratic ideals, legitimate representation and participation

Simply put, corporate governance refers to the establishment of an appropriate legal, economic and institutional environment that allows firms to thrive as institutions for advancing long term share holder value. Corporate governance will aslos foster maximum human centered development while remaining conscious of their other responsibilities to stakeholders, the environment and society in general.

1.2 State Corporation Governance

This can be 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. Dr. Jeffrey Carmichael (2003)

Broadly put governance in state corporations is the way the Government proposes to reconcile the conflicting interests of its various stakeholders and the structures it puts in place to ensure that these objectives are met which encompasses both policy and practice.

Agency costs are the major cause of conflict between stakeholders and corporations. These conflicts arise when the principal in any operation or transaction appoints an agent to look after their interest. To identify the principals and the agent, the ultimate principals are the public who benefit from good regulation and who suffer when the regulation fails short. The public will delegate their interests to the government as their agent; the government in turn will delegate the responsibility to regulatory authority where there may be multiple levels of delegation. This will create several levels of delegation between principal/agent delegations and therefore multiple levels at which governance issues may arise.

1.3 Financial Performance

Financial Performance is 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.

The main aim of financial management in state corporations is to manage the limited financial resources with the purpose of ensuring efficiency and economy in the delivery of outputs required to achieve desired outcomes (effectiveness), which will serve the needs of the community (appropriateness).

Financial management ranges from daily cash management through to the formulation of long term financial objectives, policies and strategies in support of the strategic and operational plans of the State Corporation. It also entails the planning and control of the capital expenditure, working capital management, interaction with Treasury, funding and performance decisions. It also entails supporting financial and management accounting functions, which are predominantly concerned with the collection, processing and provision of

financial information and the planning, operation and control of the supporting financial information systems.

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.

Most private institutions and state corporations have corporate governance mechanisms, processes and systems in place to ensure that governance practices are efficient and effective. There is transparency and accountability to the various stakeholders, the corporation complies with legal and regulatory requirements, there is disclosure of all pertinent information to stakeholders, there is effective monitoring and management of risk, innovation and change, the corporations remain relevant, legitimate and competitive, and the corporation remains viable, solvent and sustainable. N.K Chidambaran, Drius Palia, Yudan Zheng, (March 2007)

The absence of the profit measure in the public sector makes analysis and evaluation of management 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 quantity and quality of resources 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 and appropriateness is to be measured by the extent of outcomes of a programme are the priority of Government and addresses the real needs of the economy.

1.4 Measuring Performance in State Corporations

Performance is measured by using a wide range of statistical data to draw valid conclusions. The improved performance of state corporations is usually measured by improved financial results, higher growth rates and any other factors that indicate good performance. Measuring return unlike in private firms which is to share holders, return is to the Government through Treasury which is the investing arm of the Government. However the performance varies from industry to industry depending on the number of players in the industry, the political environment, economic environment and social environment. The government will in most cases come in to intervene where it envisages that state corporations may be experiencing threat of extinction due to unfair competition from the private sector. The government may take steps such us creating monopolies such us Kenya Power and Lighting co. Ltd (KPLC), Kenya Railways (KR) and Telkom. Creation of state monopolies has not improved performance as it is not done hand in hand with improved corporate governance. The institutions have sunk into deeper poor performance and subsequent winding up only to be revitalized later after an over haul of the governance systems in place (internal and external) and injection of huge capital investments. Sanjai Bhagat & Brian Bolton (May 2006)

1.5 Statement of the Problem

A country's capacity to achieve sustainable prosperity, that is progressive economic growth and social development over a prolonged period of time, depends on the decisions of allocation, utilization and investment of resources. Strategic decisions about the allocation and utilization of corporate resources are the foundations of investments in productive capacities that can make innovation and economic development possible. Private Sector Initiative for Corporate Governance (October 1999)

Lack of adequate corporate governance in state corporations has been evidenced by the collapse of several state corporations that were set up in the early 1970's. Some of the documented evidence just to mention a few include lack of review of Board performance, the Board never met frequently as required, the Board never got performance based contracts, misappropriation of state corporation assets, declining financial performance, late or lack of performance of statutory audits by the Auditor General office, lack of prosecution of fraud and misappropriating agents of the state corporations and unwillingness of the government to take action to curb the gross misappropriation of state assets. This slowly led to the deterioration of the financial performance, loss of market share, loss of public faith in the institution, loss of revenue to the exchequer and eventually the collapse of all corporate governance systems in place of such government institutions. Over time closure of branches, divisions was evidenced and eventually the collapse of the entire institution. Private Sector Initiative for Corporate Governance (October 1999)

Corporate Governance and Financial performance has some complexities which relate to the difficulty of measuring and therefore monitoring the principal and agent problem. Unlike the corporate sector, there is no simple measure such as profitability by which to measure the performance of the state corporations.

The problem in the public sector is often witnessed when the principal fails to specify with sufficient clarity what interests are to be pursued and how the agent is supposed to achieve them. This also applies to measuring the costs of poor state corporate governance. For example how would you measure the opportunity costs in terms of foregone production and human suffering?

Governments and their bureaucracies create temporary monopoly power. This creates an opportunity for corruption in the state corporations, which has been argued as one of the manifestation of poor state corporate governance.

The research question that arises in this study is, "Is there any relationship between Corporate Governance and the Financial Performance of State Corporations in Kenya?"

1.6 Objectives of the Study

1. To determine the relationship between corporate governance and the financial performance of state corporations

1.7 Importance of the Study

a) The management of State Corporation

The study assists management of the state corporations be able to identify the governance principles that have helped improve their financial performance and which ones require more attention and subsequent improvement. The board of directors will be able to understand what relationship exists between the governance systems in place and the influence they have with the financial performance.

b) Policy Makers and Regulators

The study acts as a guide to other state corporation board of directors who draw up strategies and policies in identifying which governance systems are most effective and applicable in their corporate states and how they would affect their financial performance. Regulators would be able to evaluate how effective and efficient the governance systems are.

c) Government

The failure or success of any state corporation means the government is not meeting the requirements of the public sector. This also translates to lack of employment, poor economic growth and inefficiencies. The government through parliament will be able to make decisions as to whether to continue investing in the state corporations or to close them down.

d) Future Researchers

Since the study limits itself to financial performance and corporate governance, it forms a basis for future researchers and scholars to explore other performance indicators other that financial performance.

In summary the study reveals important attributes of corporate governance that promote good financial performance in state corporations. Some of these attributes of corporate governance can be used by other state corporations as a reference point for improving their corporate governance and their ailing financial performance.

CHAPTER TWO

2.0 LITERARURE REVIEW

2.1 Theories Relevant to Corporate Governance

Studies undertaken on corporate governance in the United States as part of a background paper for the Organization for Economic Cooperation and Development (OECD) identified four models of corporate control: 1. The Simple Finance Model; 2. The Stewardship Model; 3. The Stakeholder Model; and 4. The Political Model. While the "Survey of Corporate Governance" by Shleifer & Vishny (1996) for the National Bureau of Economic Research was not restricted to the United States, its scope was limited to the finance model consistent with the specialized definition of corporate governance adopted by the authors quoted earlier. Three additional ways of analyzing corporate governance will be suggested in the next section. Hawley & Williams (1996:21)

Both surveys undertaken contain some unstated culturally determined boundary conditions and assume that the United States context provides a universal reference.

Some scholars state that stewardship theory, stakeholder theory and agency theory are all essentially ethnocentric. Although the underlying ideological paradigms are seldom articulated, the essential ideas are derived from Western thought, with its perceptions and expectations of the respective roles of individual, enterprise and the state and of the relationships between them. Tricker (1996:31)

The Hawley & Williams (1996:21) survey is implicitly limited to corporations which have their shares publicly traded and explicitly limited to United States based firms. Not being limited to either United States firms or the 'simple finance model' of Hawley & Williams (1996:21), Shleifer & Vishny (1996) consider additional

dimensions of the finance model. Consistent with their concern of how financiers 'assure themselves of getting a return on their investment' they also survey how corporate control is influenced by debt securities and bankers.

Implicit assumptions of both surveys seem to be that all publicly traded firms have: 1. rights of perpetual succession; 2. limited liability; 3. unitary boards; 4. management hierarchies without related party transactions, strategic alliances or networks as found in non Anglo firms; and 5. unambiguous boundaries.

a) The Simple Finance Model

'In the finance view, the central problem in corporate governance is to construct rules and incentives (that is, implicit or explicit 'contracts') to effectively align the behavior of managers (agents) with the desires of principals (owners)', However, the 'rules' and 'incentives' considered, are generally only those within the existing United States system of publicly traded firms with unitary boards. (Hawley & Williams (1996:21).

The rules and incentives in the finance model refer to those established by the firm rather than to the legal/political/regulatory system and culture of the host economy or the nature of the owners. The finance view represents a sub-section of the political model of corporate governance. The political model interacts with the 'cultural', 'power' and 'cybernetic' models.

The problem of agents being responsible to principles is that it compounds the agency costs. A basic assumption is that managers will act opportunistically to further their own interests before shareholders. Jensen and Meckling showed how investors in publicly traded corporations incur costs in monitoring and bonding managers in best serving shareholders. They defined agency costs as being the sum of the cost of: monitoring management (the agent); bonding the agent to the principal (stockholder/'residual claimant'); and residual losses. Their analysis showed amongst other things: why firms use a mixture of debt and equity; why it is rational for managers not to maximize the value of a firm; why it

is still possible to raise equity; why accounting reports are provided voluntarily and auditors employed by the company; and why monitoring by security analysts can be productive even if they do not increase portfolio returns to investors.

As a result, managers obtain the right to make decisions which are not defined or anticipated in the contract under which debt or equity finance is contributed This raises the 'principal's problem'

In many countries, the law may limit the ability of shareholders to become associated together to form a voting block to influence or change management unless they make a public offer to all shareholders. Insider trading laws may also inhibit or prohibit shareholders from obtaining the necessary information to monitor and supervise management.

b) The Stewardship Model

In the stewardship model, managers are good stewards of the corporations and diligently work to attain high levels of corporate profit and shareholders returns Both Lex Donaldson and Davis teach in business schools. Their arguments support the investment of business schools and their students in the development of management skills and knowledge. It also reinforces the social and professional kudos of being a manager. Donaldson & Davis (1994)

Managers are principally motivated by achievement and responsibility needs and given the needs of managers for responsible, self-directed work; organizations may be better served to free managers from subservience to non-executive director dominated boards. Most researches into boards have had as their prior belief the notion that independent boards are good and so eventually produce the expected findings. There are influential and powerful sources who recommend the need for independent non-executive directors.

However, supporting stewardship theory are the individuals who contribute their own money and other resources to non-profit organizations to become a director.

In commenting on stewardship theory, the logical extension is either towards an executive-dominated board or towards no board at all.

Boards can become redundant when there is a dominant active shareholder, especially when the major shareholder is a family or government. One could speculate that some boards are established from cultural habit, blind faith in their efficacy, or to make government or family firms look 'more business like'.

The value of external directors is not so much how they influence managers but how they influence constituencies of the firm. The more regulated an industry is then the more outsiders there are present on the board to reassure the regulators, bankers, and other interested groups.

One of the requirements of company law is that directors show a fiduciary duty towards the shareholders of the company. Inherent in the idea of directors having a fiduciary duty is that they can be trusted and will act as stewards over the resources of the company. Thus, the director's duties are based on stewardship theory. This duty is higher than that of an agent as the person must act as if he or she were the principal rather than a representative.

There is the Possibility that the assumption of opportunism is which the agency theory is based on, in that it can become a self-fulfilling prophecy whereby opportunistic behavior will increase with the sanctions and incentives imposed to curtail it, thus creating the need for even stronger and more elaborate sanctions and incentives. Likewise, stewardship theory could also become a self-filling. This would appear to be the situation in firms which have no independent directors. All board members are either executives or stake holders. Turnbull (1995).

The inclination of individuals to act as stewards or self-seeking agents may be contingent upon the institutional context. If this is the case, then both theories can be valid as indicated by the empirical evidence. Stewardship theory, like

agency theory, would then be seen as sub-set of political and other broader models of corporate governance.

c) The Stakeholder Model

In defining 'Stakeholder Theory' Clarkson (1994) states: '"The firm" is a system of stake holders operating within the larger system of the host society that provides the necessary legal and market infrastructure for the firm's activities. The purpose of the firm is to create wealth or value for its stake holders by converting their stakes into goods and services'. This view is supported in that the goal of directors and management should be maximizing total wealth creation by the firm. The key to achieving this is to enhance the voice of and provide ownership-like incentives to those participants in the firm who contribute or control critical, specialized inputs (firm specific human capital) and to align the interests of these critical stakeholders with the interests of outside, passive shareholders.

Consistent with these view policy makers, should encourage long-term employee ownership and encourage board representation by significant customers, suppliers, financial advisers, employees, and community representatives. Its also recommended that corporations seek long-term owners and give them a direct voice in governance (i.e. relationship investors) and to nominate significant owners, customers, suppliers, employees, and community representatives to the board of directors.

All these recommendations would help establish the sort of business alliances, trade related networks and strategic associations which are noted but had not evolved as much as it would be expected. Hill & Jones (1992)

d) The Political Model

The political model recognizes that the allocation of corporate power, privileges and profits between owners, managers and other stakeholders is determined by how governments favour their various constituencies. The ability of corporate

stakeholders to influence allocations between themselves at the micro level is subject to the macro framework, which is interactively subjected to the influence of the corporate sector.

The finance model's have nearly exclusive reliance on the market for corporate control, and are primarily the result of the political traditions of federalism/decentralization which dates back to the American Revolution. However, these traditions have been subject to substantial changes within time.

After the Revolution, there was concern that newly won political freedoms could be lost through foreigners gaining control of corporations. As a result, the lives of all corporate charters were limited to 50 years or less up until after the Civil War. Nor did these charters provide limited liability for the owners. Most states adopted a ten year sunset clause for bank charters and sometimes they were as short as three years. The early state legislators wrote charter laws and actual charters to limit corporate authority, and to ensure that when a corporation caused harm, they could revoke the charter. However, during the late 19th century, corporations subverted state governments whereby corporations bought and sold governments.

At the end of the 19th century, there was the introduction of cumulative voting to allow minority interests to elect directors. This initiative was subverted by competition between states to attract corporate registrations. This was described as the race to the bottom and explained how contemporary corporations were influencing the determination of accounting and legal doctrines and promoting a management friendly political/legal/regulatory environment.

At the federal level, laws to limit ownership of corporations and related party transactions between corporations were introduced. This forced both the pattern of ownership and control of firms and the pattern of trading relationships to diverge from the existing trading norms.

By focusing on the micro level of the political model, we can define the political model of governance as an approach in which active investors seek to change corporate policy by developing voting support from dispersed shareholders, rather than by simply purchasing voting power or control. This new form of governance based on politics rather than finance will provide a means of oversight that is both far more effective and far less expensive than the takeovers of the 1980's'. Hawley & Williams (1996:29)

To have an understanding of the political marketplace is essential to appreciate the role that capital-market mechanisms can and the role they play in corporate governance. :

The political model of corporate governance places severe limits on the traditional economic analysis of the corporate governance problem, and locates the performance-governance issue squarely in a broader political context. Ben-Porath (1978), Hollingsworth & Lindberg (1985)

2.2 Other ways of analyzing Corporate Governance

There are other models of corporate governance to consider based on culture, power and cybernetics. A synthesis of all models may be required if we are to efficiently develop, construct, test and implement new approaches.

a) Culture

From the culture model perspective, transactions are conducted on the basis of mutual trust and confidence sustained by stable, preferential, particularistic, mutually obligated, and legally non–enforceable relationships. They may be kept together by value consensus or resource dependency, that is, through 'culture' and 'community' - or through dominant units imposing dependence on others. Schmitter & Streeck (1994:6)

This definition was made in the context of transactions being governed by networks at the 'mesolevel (e.g., the intermediate location between the micro

level of the firm and the macro level of the whole economy) rather than of the firm However, it is also relevant within firms, and in this way it would subsume elements of the stewardship model.

There exists a type of dominant religion in a culture that can affect trust and hence the ability of strangers in large organizations to co-operate. In particular, they found that trust in large organizations increases as the proportion of the population involved in hierarchical religions, like Catholicism, decreases. While Japan showed an above average degree of trust is was not as high as Nordic countries and China. Some scholars have speculated that the Japanese commitment to employee participation and the forming of strategic alliances between firms arises from their embedded belief in the inter-dependency of their many Gods. It might be interesting to research if Christian economists and managers, or other types of monotheists, have an embedded belief in hierarchies rather than alliances and networks. Porta, Lopez-de-Silanes, Shleifer, & Vishny, (1997)

The importance of culture is evident from the social adaptability in the most critical condition in converting a firm owned by an entrepreneur to a co-operative

It is unlikely to undertake a conversion if the prospects of remobilizing managers and workers appear poor. In this regard, the Catholic influence from the founder, Father Arizmendi stated: 'A company cannot and must not lose any of its efficiency just because human values are considered more important than purely economic or material resources within the company; on the contrary such a consideration should help efficiency and quality'.

b) The Power Perspective of Corporate Governance

From this perspective, it is the ability of individuals or groups to take action which is the over-riding concern.

The explicit use of power seems to be a neglected topic. Even when shareholders, directors, management or any other stakeholder have the knowledge and will to act, this is of no avail unless they also possess the power to act.

The power of shareholders to act is part of the political model of corporate governance. There are various inhibitions on the power of shareholders to act arising from security laws, agenda setting by management at general meetings, proxy procedures, voting arrangements and the corporate by-laws.

The power of directors to control management is dependent upon there being a sufficient number of directors who also have the knowledge and will to act to form a board majority. Even if independent directors have the knowledge to act, they may not have the will and power to act because they are loyal or obligated to management and/or hold their board position at the grace and favour of management. Directors are unlikely to act against management unless they are supported by shareholders. However, many institutional shareholders lack the will to act. This was found to be a major problem for several firms in a report into their competitiveness by Regan (1993).

It was also noted that management controlled the information that does reach the board. The result can be a board knowing too little, too late and, even if it is willing to act to confront a growing problem or crisis, it is often unable to do so. An appropriate separation of powers to create checks and balances provides a way to increase the welfare of stakeholders. Roland & Tabillini (1996).

All suggestions for reform of corporate governance processes need to consider the power of agents to act, or be subject to a veto, when there is a compound board. This has always been an opposition view and there must be an opposition party and the prospect of insurgency. However, this does not consider the principle of a division of power in his political model of corporate governance, even though he participated as co-chair of the shareholders' committee

established this purpose. While the power model of the firm may be but a part of the political model, it should never be neglected because without the power to take corrective action, no action can take place.

For any action to be appropriate, the actors also need information which is accurate, timely, sufficient and yet manageable. Despite the feed back aspect it is from institutional investors who do not, cannot, and should not, have firm specific inside expert information. This leads us to consider the cybernetic approach to corporate governance.

c) Cybernetic Analysis

Cybernetic analysis in social institutions is concerned with their information and control architecture. As control is dependent upon power, a cybernetic investigation is dependent upon an analysis of power.

Cybernetics is based on the mathematics of information theory where the basic unit of analysis is described as a 'bit'. A bit can be thought of as a letter in a language with eight bits creating what can be considered to be word, described as 'byte'. The ability of computers to store, process or transmit information is measured in thousands or millions of bytes described respectively as kilobytes and megabytes.

Like computers, humans have physical limitations on their ability to receive, store, process and transmit information. It's recognized that for the efficient processing of information it is an important and related concept to transaction costs, but for the limited ability of human agents to receive, store, retrieve, and process data, interesting economic problems vanish. More observations show. that an individual has limited information processing capacity so they prefer slow rates of change, i.e. nearly stable systems. Wearing (1973)

Another reason for economizing information is to reduce the problem of bounded rationality which refers to human behavior that is *'intended'* rational but only

limitedly so. More observations indicate bounded rationality which involves neurophysiologic limits on the one hand and language limits on the other. It also notes that a change in organizational structure may be indicated when individuals are exposed to information overload.

To undertake tasks which exceed the capacity of one computer, two or more computers can be connected together in the same way humans solve more demanding tasks by working in teams, groups, alliances and networks. Cybernetics considerations cannot be ignored in understanding or designing teams, divisions, the need for one or more boards and their structure, or the architecture of external alliances with stakeholders.

The cybernetic perspective provides a basis for evaluating the integrity of corporate governance information and control systems from a number of aspects. Evaluating the integrity of information channels been investigated and reveal;ed that reliable information can be obtained from unreliable channels if they are used in parallel. In other words, boards need to obtain information from strategic stakeholders as well as from management to avoid bias, distortion or errors as discussed by Turnbull (1993a; 1997).

The cybernetic concept of 'feedback' is a condition precedent for self-regulation or self-governance. If a firm is not to affect adversely its stakeholders through its actions or inactions it will require governance processes which allow its stakeholders to participate in establishing performance standards. Such arrangements are commonly established in quality assurance programs. However, for stakeholders to have the will to act, they need a power base independent of management to protect them from being treated as whistle blowers. Donaldson & Preston (1995)

2.3 Corporate Governance in State Corporations in Kenya

Corporate Governance is concerned with the establishment of an appropriate legal, economic and institutional environment that would facilitate and allow business enterprises to grow, thrive and survive as institutions for maximizing shareholder value while being conscious and providing for the well being of all other stakeholders in the society.

Good State Corporation Governance and Financial Performance is important for reasons namely, the size of the gains on the offer are greater in the public sector and the improvements in state corporate governance are unlikely to occur unless similar public sector governance reforms are undertaken.

2.4 The Government Governance Concept

The difference between the private sector and the government sector is best illustrated by the published documents attracting public attention. Firms publish their financial statements on the basis of which profit is appropriated and the directors are held accountable by the stakeholders. Government publishes its budgets whereby the discussion focuses on policy proposals. In both the government and private sector there is a trend towards increasing transparency.

The objectives of government governance are to create safeguards for achieving policy objectives. The design and operation of the governance is important all levels, from government minister to implementing organizations. Central government is concerned with policy objectives set by parliament. The minister is responsible and also accountable for achieving the objectives. The essence of sound governance from the perspective of the ministerial responsibility is that there are enough safeguards enabling the minister to bear ministerial responsibility. These safeguards should exist within the policy area, which may

extend over an entire policy chain, through a well designed cycle of management, control, supervision and accountability process.

Government governance can be defined as safeguarding the interrelationship between management, control and supervision by government organizations and by organization set up by government authorities aimed at realizing policy objectives efficiently and objectively, as well as communicating openly thereon and providing an account thereof for the benefit of stakeholders.

Ministerial responsibility concerns both the nature of the relationship with the participants in a particular policy area and achieving policy objectives. That is why the minister should have a management vision on the policy areas he or she may be held accountable for clearly defined policy objectives (i.e. effectiveness) and clearly defined pre conditions (i.e. quality, efficiency, compliance with relevant laws and regulations, financial control). This whole package forms the starting point for governance structures.

The definition shows that government governance has four elements;

a) Management Element

The management element of the cycle deals with the question of how the management process and associated division of responsibilities has been structured with a view of achieving the policy objectives.

b) Control Element

The control element of the cycle deals with the issue whether the minister has sufficient assurance that the policy implementation will achieve the policy objectives set out.

c) Supervision Element

The purpose of supervision is to establish whether policy objectives are actually being achieved, providing if necessary, opportunities to make adjustments.

d) Accountability Element

Accountability deals with the question whether the way of providing an account of activities at all levels provide sufficient certified information on whether the objectives are being achieved, and on the way management and control take place.

The foremost element in government governance is management element which entails directing in the realization of the government goals through, structuring the organization and developing process. At the macro level management involves the process of the minister working towards the realization of policy objectives set by parliament through, among other things setting the organization structure and developing policy implementation process. Once a state corporation has been designed, systems of measures and procedures have to be implemented and maintained, providing assurance to the administration that the state corporation will remain on the right course for achieving the adopted policy objectives. This brings into play the role of supervision and control. The last element that comes into play is accountability to the stakeholders on the benefits therefore making the minister accountable to parliament for management, control and supervision. Netherlands Ministry of Finance (November 2000)

In Kenya there has been tremendous improvement in the performance of several state corporations. Some of the success factors can be attributed to various reasons ranging from improved economic environment, stable political governments, growth in markets and many more.

Other reasons that may exist that are not obvious to all are the existence of excellent stewardship shown by the Board of Directors appointed by the shareholders and stakeholders. This is also evident in both the private sector and in the public sector with regard to improved public service delivery, collection of income targets in such institutions such us Kenya Revenue Authority (KRA), improved Financial performance and sub sequent listing in the stock markets for example Kengen which has private ownership and state ownership component.

The Directors of institutions are appointed by the shareholders in the case of private companies, whereas in state corporations they are appointed by the President or the Minister in Charge of the Ministry. The mandates for both diversely appointed Boards is to foster prosperity of the institutions performance they head and report back to their appointees who could be shareholders in the case of private companies and the Parliament in the case of state corporations. In some cases the firms comprise of both private shareholders and the state as the main shareholders, therefore appointment of the Board will be done by the majority shareholding entity, the Government or the Private shareholders. Narjess Boubakri (December 2001)

We can therefore envisage there is a relationship between the performance of an institution and the stewardship that is in place and how it undertakes its responsibilities and activities to improve shareholders and stakeholders wealth.

Regulators and governance advocates argue that the stock price collapse was in large part to poor governance. If their contentions are valid, a market premium should exist for relatively well governed firms.

In several previous studies, several factors representing good governance (as expected) are related to good performance have seldom been studied before. The findings are very important to regulators, investors, academics and others who contend that good corporate governance is important for increasing investor

confidence and market liquidity (Donaldson, 2003). With several regulators such us the Nairobi Stock Exchange and Capital Markets Authority focusing on corporate governance and performance, there is a widely held view that better corporate governance is associated with better firm performance, but the evidence is tenuous (LeBlanc and Gillies 2003). Results from these studies add credence to the notion that most measures of good corporate governance are associated with good firm performance

One reasonable argument that is often made is that governance systems have a significant impact on performance of state corporations that experience large performance declines. If governance systems are important in determining state corporation performances, then any governance system is important in determining the state corporation's performance. Lawrence D Brown (December 2004)

After independence the Government of Kenya set up several State Corporations particularly in the early 70's. The growth of these corporations in terms of numbers and also in terms of responsibility was not accompanied by development of efficient management systems and structures to ensure that the public sector plays its role in an efficient and accountable manner. There has also not been uniform and co-ordinate procedures or systems for ensuring efficient management and accountability in the running of these corporations.

The Government, therefore, found itself responsible for managing a large number of state corporations, some of which did not significantly contribute to social economic development. Other corporations are ailing, unprofitable or moribund and hence are administratively and financially a burden to the Government. The overall performance of state corporations has left a lot to be desired. Majority of these corporations have failed to realize the objectives for which they were established. Thus, over the years, it is being perceived that government participation in commercial enterprises has been carried well beyond original

conceptions and has reached the point where it is felt such participation could be inhibiting rather than promoting development. For this reason the Government has taken positive steps by working out a programme for divesting some of its investments to Kenya investors.

Thus since independence, there has been a proliferation of state-owned enterprises covering all sectors of the economy; in agriculture, commerce, industry, tourism, housing, construction, insurance, banking, transportation and basic services.

Unlike the objectives pursued during the pre-independence period, state-owned enterprises were now expected to:- hold the assets in public trust pending the growth of an industrial entrepreneurial spirit and talent among Kenya nationals, Act as instruments of promoting social justice, regional balance and technology transfer, Act as means of control over the commanding heights of the economy and in the interest of national security,

In addition to the above objectives, the other reasons for establishing state-owned enterprises include the following: to establish national control over certain "strategic" economic sectors, particularly the infrastructure and those in essential services; to "Kenyanize" or "indigenize" management of the national economy; to create employment opportunities for Kenyans; to maximize foreign exchange earnings through indigenized enterprises; to provide incentives to create more rapid development of local enterprises. Private Sector Corporate Governance Trust (March 1999)

In order for state corporations and other institutions achieve their objectives and effectively discharge their responsibilities, corporations must have quality and effective leadership which is responsive, transparent and accountable and which has the focused intelligence to acquire and apply knowledge and know how for

the production and creation of wealth. Good corporate governance is thus the livelihood of a prospectus society. Karugor Gatamh (2004)

Corporate Governance mechanisms usually take two types, which are internal and external mechanisms. Internal mechanisms include the ownership structure and the organizational structure of the firm, while external mechanisms include the monitoring of capital markets and the legal and institutional system.

Shleifer and Vishny (1997) and Dyek (2000), among others, argue that corporate governance can explain the performance of state corporations in developed countries. In some state corporations the governance system is relatively efficient in that investors are confident to obtain returns on their investments and firms can raise the necessary funds to finance their investment projects. In contrast, the governance mechanism in developing countries is generally weak and the risk of expropriation of shareholders by managers or by block holders is considerable. This limits the financing opportunities for firms that need to invest or restructure especially state corporations. Narjess Boubakri (December 2001).

2.5 Corporate Governance & Financial Performance

In November 1998, a seminar of some of the leading organizations with interest in corporate governance and financial performance of corporations which included the Nairobi Stock Exchange (NSE), Capital Markets Authority (CMA), the Institute of Certified Public Accountants (ICPAK) and other consultancy agencies was held in Nairobi in March 1999 where the participants came up with developments that revealed that firms that had well established corporate governance systems in place exhibited good financial performance in terms of improved share prices. For the relationship between corporate governance and financial performance it was evident that the governance systems were reviewed regularly by the management of the corporation. The study was initially limited to the corporations quoted in the Nairobi Stock Exchange. The same methodology

was extended to state corporations and other corporate bodies. The same relationship was evidenced that where corporate governance systems existed and were reviewed regularly evidenced a relationship in the financial performance. Private Sector Corporate Governance Trust (March 1999)

The study revealed that share price decline in the Nairobi Stock Exchange was not to be used as the only indicator of weak governance systems. The decline in share price could be as a result of other several variables such as political stability, increasing inflation rates and other variables. The collapse of Uchumi Supermarkets ltd which was quoted in the Nairobi Stock Exchange was partly due to the poor corporate governance systems in place which was evidenced by the decline in share prices, in ability to meet maturing obligations and loss of the market share.

In the face of major scandals leading to the collapse of state corporations especially the state owned ones such as Kenya Cooperative Creameries (KCC), Kenya Farmers Association (KFA), Kenya Posts and Telecommunications (KPTC), Kenya Meat Commission (KMC) etc with disastrous social and economic consequences, it was inevitable that that the wider society, led by the media, would start to question how the corporations were managed.

The study revealed that more research was needed which included, but not limited to; the quality of governance at all levels which was increasingly seen as the most important factor for the improved financial performance..

There was greater expectation from society that corporate organizations, especially private ones, should take a more leading role in the debate and implementation of economic revival strategies through corporate governance

Effective state corporate management and decision making requires adequate internal financial reporting systems, which consist of timely and regular submission of comprehensive and candid reports on every significant matter of financial administration in a state corporation to all levels of decision makers. Prof. David Fourier (2004)

Shareholders of firms that were publicly listed in the Nairobi Stock Exchange (NSE) were demanding better disclosure and transparency of information from the appointed directors. Regulatory bodies such as Capital Markets Authority (CMA), Nairobi Stock Exchange (NSE) and Institute of Certified Public Accountants (ICPAK) were already hinting they required good corporate governance practices from the private and state corporations.

Good governance and financial performance requires that the State puts in place and maintains an enabling environment which efficient and well managed corporations can thrive. It is therefore expected that institutions will continue to play their part in encouraging dialogue and between the public and private sectors in promoting good public governance and an enabling business environment.

2.6 Principles of Good Corporate Governance

a) Appointments to the Board

It's the responsibility of the Government to elect competent directors and to ensure they govern the corporation in a manner consistent with their stewardship. Good corporate governance dictates that the Board of Directors governs corporations in ways that maximizes shareholders value and in the best interest of society, ensure that only competent and reliable persons, who can add value, shall be elected or appointed to the Board of Directors, also ensure that the Board is constantly held accountable and held responsible for the efficient and effective governance and financial performance of the corporation so as to achieve corporate objectives, prosperity and sustainability. The Minister in charge can also change the composition of the Board that does not perform to expectation or according to the mandate of the organization.

b) Leadership

Every corporation should be headed by an effective Board that should exercise leadership, enterprise, integrity and judgment in directing the corporation so as to achieve continuing prosperity and to act in the best interest of the corporation in a manner based on transparency, accountability and responsibility. Appointments on the Board should be through a managed and effective process to ensure that a balanced mix of proficient individuals is made and that each of those appointed is able to add value and bring independent judgment to bear on the decision making process.

c) Structure of the Organization

The Board also ensures that a proper management structure, systems are in place and make sure that the systems operate in a manner that maintains corporate integrity, reputation and responsibility.

d) Purpose and Values

It's the Board that determines the purpose and values of the State Corporation, determine the strategy to achieve that purpose and implement its values in order to ensure the corporation survives and thrives and that procedures and values that protect the assets and reputation of the corporation are put in place.

e) Compliance to laws and regulations

It also ensures that the corporate complies with all relevant laws, regulations, and governance practices, accounting and auditing standards. It also ensures that it communicates to all shareholders and stakeholders effectively.

f) Balance of Power

The Board also ensures that there is a balance of power to ensure it can exercise objective and independent judgment. It also reviews regularly the internal controls systems to ensure effectiveness of these systems of control so that its decision making capability and accuracy of its reporting financial results are maintained at the highest level at all times.

g) Corporate Communication

The Board should ensure that the corporation communicates with all its stakeholders' effectively.

h) Assessment of Performance of the Board of Directors

The Board should regularly asses its performance and effectiveness as a whole and that of individual members including the Chief Executive Officer. A summary of the major findings together with a statement confirming the Board has carried out a self assessment exercise should be made available to the annual general meeting.

i) Responsibility to Stakeholders

The Board should identify the corporate internal and external stakeholders; agree on a policy or policies determining how the corporate should relate to, and with them, in creating jobs and the sustainability of a sound financially Sound Corporation while ensuring that the rights of stakeholders are recognized, protected and respected.

j) Social and Environment Responsibility

The Board should recognize that it is in the enlightened self interest of the corporation to operate within the mandate entrusted to it by society and shoulder its social responsibility. For this reason a corporate that does not fulfill its social responsibility by short changing beneficiaries or customers, exploiting its labor, polluting the environment, neglecting the needs of the local community, evading taxation. Private Sector Initiative for Corporate Governance (2005)

Most firms that have adhered to the above principles have had successful growth and good financial performance over a period of time. They have constantly registered improved performance in financial performance and improved shareholders.

Corporate governance is therefore deemed necessary for some of the following reasons such as attract investors, both local and foreign, and assure them that their investments will be secure and efficiently managed, and in a transparent and accountable process, Create competitive and efficient companies and enterprises, Enhance the accountability and performance of those entrusted to manage corporations and Promote efficient and effective use of limited resources

Without efficient state corporations, the country will not create wealth or employment. Without investments, companies would stagnate and collapse. If businesses do not prosper, there will be no economic growth; no employment, no taxes paid and invariably the country will not develop.

Good Corporate Governance therefore becomes a pre requisite for good financial performance for firms both in the private sector and state corporations. The Commonwealth Association of Corporate Governance (2004)

2.7 State Corporations Control and Regulation

The Government controls and regulates the operations, management and overall performance of state corporations through a composite framework of agencies spread across the wide spectrum of Government. Some of these agencies are involved in formulation and development of policies others in supervising and enforcing compliance with the regulations and laid down procedures, while others are involved in the continuous monitoring of performance

State-owned enterprises are accountable to the state through the Government. The President, therefore, commands enormous authority in the governance of these corporations. The following are some of the powers vested with the President in the management of state corporations. They include Establishment of state corporations; assigning ministerial responsibility for a state corporation; appointment of chairpersons of Boards of state corporations; giving directions of

a general or specific nature to Boards of state corporations; revocation of the appointment of members of the Boards of state corporations and constitution of a new Board.

In addition to the executive authority vested with the President, the Office of the President is the umbrella body which formulates and issues general policy direction to state corporations through the respective parent ministries. The office also co-ordinates all matters relating to the management of state corporations between different corporations, different ministries and between corporations and the Government. The control and supervisory role of the office of the President has been transformed and strengthened since independence by the following critical developments which include The enactment of the State Corporations Act Cap.446 in 1986 and the establishment of the State Corporations Advisory Committee.

Treasury is the Government agency entrusted with the responsibility of making and overseeing Government investments in state corporations. It is the official Government shareholder in state corporations.

Treasury participation in the governance of state corporations is exercised through Participation in the Board of a state corporation, Approval of the annual estimates of the state corporation's revenue and expenditure as well as capital budgets and Prescribing conditions and guidelines for borrowing or investing money by a state corporation.

Most external borrowing by state corporations is guaranteed and regulated by the Treasury. Treasury is the investing arm of the Government.

2.8 New Kenya Cooperative Creameries

The study narrows down to New Kenya Cooperative Creameries (New KCC) one of the revitalized state corporations since 2003 and has registered improved financial performance over the years. The study examines the Board and the Senior Management who are responsible for implementing, monitoring and evaluating the Governance systems in place and the Financial performance..

New Kenya Co-operative Creameries Ltd (New KCC) was registered on the 25th of June 2003. Its predecessor, the Kenya Co-operative Creameries Ltd had operated in Kenya since 1925, which makes it the oldest dairy processor in the country. New Kenya Cooperative Creameries (New KCC) is a state corporation established under the Co-operative Societies Act Cap.490. New Kenya Co-operative Creameries Ltd (New KCC) is the largest business entity in the dairy industry in East Africa which is in food industry, processing and marketing milk and milk products.

The business process of Kenya Co-operative Creameries Ltd encompasses receiving of raw milk from farmers, processing it into various milk products and marketing and selling the products for the benefit of the company shareholders.

The product range encompasses a wide range of premium products such as fresh milk, cheese, long life milk both flavored and unflavored, fermented milk both flavored and unflavored, yoghurt, ghee and powdered milk both whole and skimmed variants. Further, there are other products under development in line with our marketing strategies.

In our case study of New Kenya Cooperative Creameries which showed symptoms of collapse in the late 1990's due to lack of corporate governance was evidenced by the loss of market share to private milk processing firms, reporting of financial losses in every year, disposal of its assets, closure of several

processing plants, loss of employment and lack of state audited reports with the State Auditor General.

Summary

Studies have shown there are some governance factors that have a positive and significant correlation with performance measures, making them the governance factors that are most closely linked to expected performance of state corporations. They include all directors attend at least 75% of board meetings or had a valid excuse for non – attendance (positive for all performance measures) and executives are subject to performance contracts reviewed regularly

Other studies have used both stock market based accounting measures of performance. The use of different performance measures allows us to draw up a more comprehensive assessment of the impact of corporate governance and the performance of revitalized state corporations. Sanjai Bhagat & Brian Bolton (May 2006).

Effective corporate governance in the State Corporate means that public officials must demonstrate compliance with the following characteristics, they must be composed of people with the knowledge, ability and commitment to fulfill their responsibilities, they understand their purpose and whose interests they represent, understand the objectives and strategies of their respective departments, understand what constitutes reasonable information for good state corporation governance and do everything possible to achieve it, once appropriately informed, they are prepared to ensure that the departments objectives are met and that operational performance is never less than satisfactory and finally they fulfill their accountability obligations to those whose interests they represent by regularly and adequately reporting on their department’s activities and effectiveness.

Financial reporting obligations support good governance through outwards and internal reporting. Outwards reporting is to the members of Parliament and all external stakeholders who included Ministers, Government officials, Electorate, Taxpayers and the General public.

CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Research Design

This chapter presents the research design and methodology to be used in the study. The study was conducted by way of a case study of a selected study unit. This involved selecting a unit that meets certain criteria and allows for in depth exploration of issues in a phenomenon.

The research used the scorecard methodology which enables the researcher to evaluate corporate governance principles and practices in a quick but systematic manner with a concise structure of the major criteria with relevant individual points. The respondent assessed the degree of fulfillment of each governance principle variable and awarded a score to the variable on a scale of 1 to 5, where 1 = Very Poor (20%), 2= Poor (40%), 3 = Fair (60%), 4 = Good (80%),
5 = Excellent (100%). The scorecard method calculated the average of the respondents to give a final rating.

3.2 The Case study

The case study in this research was New Kenya Cooperative Creameries (New KCC) which is one state owned corporation that has been revitalized since June 2003 and has shown improved performance in regaining its lost market share in the dairy products industry. Other state corporations that have been revitalized but have not been in operation for long to warrant inclusion in the study unit include Kenya Meat Commission (KMC). Kenya Meat Commission (KMC) was revitalized in 2006 by an Act of Parliament under the Ministry of Agriculture. The respondents in this case study in this research population will be the senior

The target population interviewed included the head of departments, supervisors in milk processing plants, depot managers and reports submitted to the Auditor General of Government of Kenya. Information maintained in the corporate records was also be used for the study.

3.3 Data Collection

The data was collected by use of the Score Card method where scores were assigned to various Governance variables. The score card method has been used in several studies in Germany to analyze the governance systems variables in place and their influence to the financial performance of the firms. Governance variables representing good governance that are most highly associated with financial performance that have been identified in several studies were used in the questionnaire.

Previous studies assisted determine where to look for such links. Data was collected from two sets of data, namely from questionnaires from respondents and data from financial statements. Data from respondents who included the senior depot managers was obtained by, both structured questions whereby the respondents scored their own response. The respondent's answers were rated on a scale of 1 to 5 with 1 = Very Poor (20%), 2= Poor (40%), 3 = Fair (60%),
4 = Good (80%), 5 = Excellent (100%). The respondent had room to provide their descriptive data on the issues questioned. This provided more clarity on the respondents answers. McCahery J.A and Vermeulen E.P.M (2008)

Quantitative variable indicators of financial performance were obtained from the financial results from the Auditor General for the achieved results. The financial performance was analyzed by trend analysis which was used to indicate in which direction the financial performance has been taking. The data used was collected over a period of five years in order to provide a good period for analysis.

3.4 Data Analysis

The calculation and weighting of the scorecard provided standard weightings but also allowed the reflection of individual weighting differences. These were used to determine the weights of the governance variables in place in New Kenya Cooperative Creameries.

3.5 Interpretation of Data Analysis

Calculation and weighting of the scores followed an easy path that gave standard weightings but also allowed the reflection of individual weighting differences. In order to allow an individual approach an individual weighting was assigned to every governance variable. This allowed the scorecard to reflect individual experiences and preferences, avoiding the usual ticking. The spread between the different weights assigned by respondents indicated the different attitudes respondents felt. The average of the weights from the respondents gave the final rating of the governance variable in the inclusions.

Graphs were used to depict the trend of the financial performance over time. The graphs depicted growth in profits in relation to the high average rating of the governance variables which indicated a strong relationship exists between corporate governance and financial performance of the state corporation.

3.6 Duration of Study

The period covered by the study was from January 2003 to December 2005 for the financial performance variables. This is the period in which Kenya Cooperative Creameries was revitalized to New Kenya Cooperative Creameries under new management. Data on the performance of the state corporation during these periods of study was readily available and the subjects to be interviewed

had institutional memory that I enhanced the quality, analysis and interpretation of the data gathered from the institution and other data banks.

CHAPTER FOUR

4.0 DATA ANALYSIS & FINDINGS

This chapter covers data analysis and interpretation of the findings. Data was summarized and presented in tables.

A total of thirty questionnaires were distributed to respondents selected randomly from the top management and middle management of the state corporation's offices which are distributed country wide. Twenty eight of the respondents were received which were completed, one response was incomplete and one questionnaire was not returned. The response was therefore rated as high at 93%. The table below summarizes the response.

Response Type	Number of Respondents	Percentage
Completed Questionnaires	28	93%
Incomplete Questionnaires	1	3.5%
Unreturned Questionnaires	1	3.5%
Total Questionnaires	**30**	**100%**

4.1 Description of Governance Systems in Place

a) Board Independence, Appointment, Mix of Skills, Board Meeting Attendance and Board Composition

The Board of Directors of New Kenya Cooperative Creameries was found to be constituted by a full membership Board of ten Director members at any one point as stipulated. When a post falls vacant, a new member is appointed. A list of potential Board of Directors members is presented to the Minister of

Cooperatives and Development who appoints the Board of Directors member after vetting the qualifications and experience of the potential candidate.

The Board of Directors is chaired by an independent Chairman who reports to the Minister of Cooperatives and Development. All the Board of Directors members were found to be having a fixed term of tenure in office which may be extended by a reappointment based on the individual performance. Performance contracts are issued to the individual Board of Directors members and to the Board of Directors as a team which are reviewed regularly. The Board of Directors independence in voting on major issues was evident.

The Board of Directors meets quarterly in a year as stipulated and an agenda is circulated well in advance to all members. The agenda includes management accounts, previous minutes of meetings and performance achievements of the Chief Executive. Minutes are documented and shared with the Minister of Cooperative and Development who attends at least the Annual General Meeting. Those who could not attend the meetings gave valid reasons for absenteeism,

The Board of Directors members are drawn from both the private and public sector that have immense experience and are well conversant with the dairy industry. The Board members skills were evidenced by the vast knowledge, professional qualifications and the other positions they hold in other Boards and management positions in both the private and public corporations.

These variables were all rated at 65% by the respondents who also felt there was room for improvement over time.

b) Leadership of the Board of Directors

The leadership of the Board of Directors was rated at 65% by the respondents who felt that the Board of Directors exercised skills such us entrepreneurship, transparency, accountable, responsibility, integrity and directing the State Corporation to achieving continued prosperity and to act in the best interest of stakeholders and the society. The selection of the Board of Directors is done in a manner that reflects an effective process to ensure that a balanced mix of proficiency is made in such a way that those appointed are able to add value and bring independent judgment to the decision making process.

c) Organizational Structure

The study revealed that the organizational structure in place ensures that the Governance systems in place operate in a manner that maintains corporate integrity, reputation and responsibility to both stakeholders and society. Respondents rate the existence and effectiveness of the structure to address the above attributes at 63%. However the respondents pointed out that the organizational structure was not reviewed regularly as expected to keep up with the internal and external environment changes in the State Corporation.

d) Purpose, Values and Strategy

It was found that the Board of Directors determines the purpose, values and strategy on how to achieve them. The values described in the charter are implemented in order to ensure that the state corporation thrives, survives and protects assets and reputation of the State Corporation. The respondents rated the relevance and the achievement of the values at 65%. They also indicated that the values needed to be reviewed after a set period to be in line with the changing strategies.

e) Compliance to Laws and Regulations

It was established that New Kenya Cooperative Creameries complies with laws and regulations as prescribed by the Cooperative Act that are in place. Respondents indicated that governance practices, accounting and auditing standards were not complied with fully in the past and hence contributed significantly to the poor performance of the State Corporation. As at now the corporation has recorded significant improvement in attempts to compliance with regulations and laws. Respondents felt that there was need for improvement in compliances and rated the current compliance to laws and regulations to 55%

f) Balance of Power

The balance of power among the Board of Directors members and the management of the state corporation was widely felt across the corporation. Respondents felt this was evidenced by the ability of the Board of Directors to make objective and independent judgment on decisions that affected the state corporation. Respondents rated the balance of power at 67%

g) Performance Review

The Board of Directors regularly reviewed its performance of each of its Board of Directors members and also as a team based on the performance objectives spelt out in the performance contracts. The review also included the Chief Executive Officer's performance. Performance is also measured against set targets derived from the Corporations budgets. Such targets include reduction in overall expenses measure against the turnover (sales), gross and net profit margins. These are spelt out in the annual plans and in the performance contracts of the Board of Directors. During reviews any major findings are summarized and reviewed in the subsequent meetings and are communicated to the Minister of Cooperatives and Development. Respondents felt there were

areas in the Board of Directors performance that required more attention and was rated performance review of the Board of Directors at 58%.

h) Responsibility to Stakeholders

The Board of Directors identified the internal and external stakeholders regularly; agreed on policies detailing how the corporate should relate with them. These policies were widely shared widely across the organizational hierarchy in designated communication channels. Respondents felt that relationship between internal and external stakeholders had improved significantly and was rated it at 68%.

i) Social and Environment Responsibility

The Board of Directors recognizes the role it has to play in the society in which it operates within the mandate entrusted to it by the society. The Board of Directors ensured that all its dairy product processing systems were environmental friendly as possible as they can be by ensuring emissions into the air are regulated and effluents into streams are also environmental non hazardous. In the case on Corporate Social Responsibility, this was been evidenced by the increased sponsorship of social events ranging from school drives, dairy farmers open days, sponsorship of athletics events and participation in agricultural shows annually. Respondents felt there was great improvement and rated participation in social events at 60%.

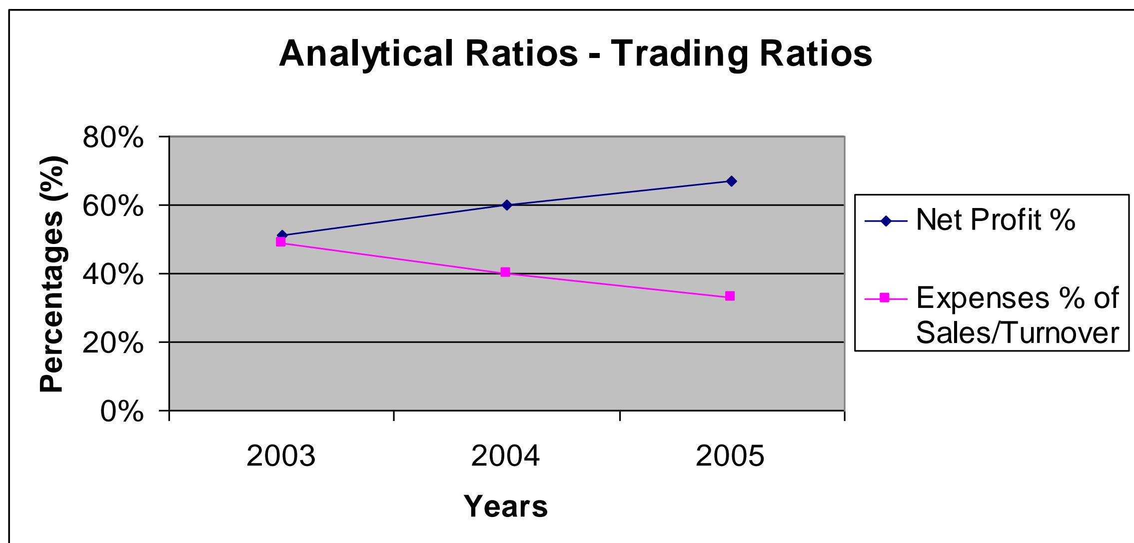
4.2 Financial Analysis Findings

Trend analysis was carried out to establish the financial performance of New Kenya Cooperative Creameries over the three years. The trend analysis enabled

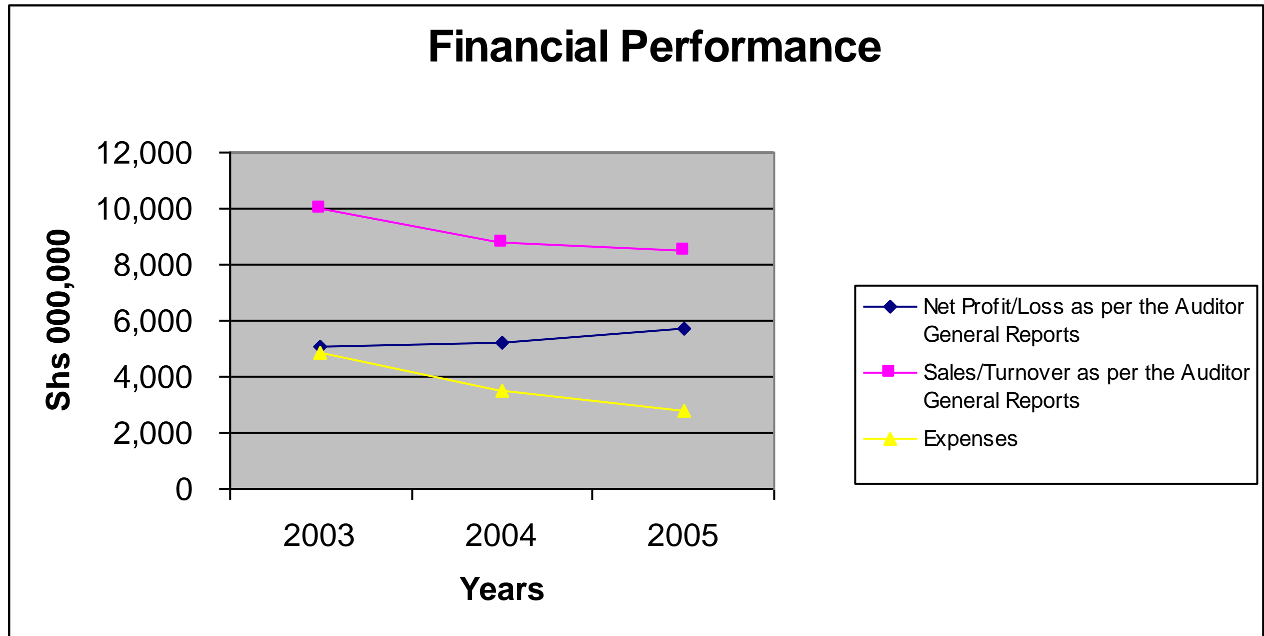
us establish whether there was an increase or decline in financial performance over period under study.

Data Description/Year	2003 *(Shs Million)*	2004 *(Shs Million)*	2005 *(Shs Million)*
Nett Profit/Loss as per the Auditor General Reports	5,105	5,235	5,700
Sales/Turnover as per the Auditor General Reports	9,987	8,754	8,508
Expenses	4,882	3,519	2,808
Analytical Ratios - Trading Ratios	**2003**	**2004**	**2005**
Nett Profit %	51%	60%	67%
Expenses % of Sales/Turnover	49%	40%	33%
Analytical Ratios - Balance Sheet Ratios			
Current Ratio	2.00	2.50	2.87
Liquidity (Acid Test) Ratio	1.50	1.70	1.90

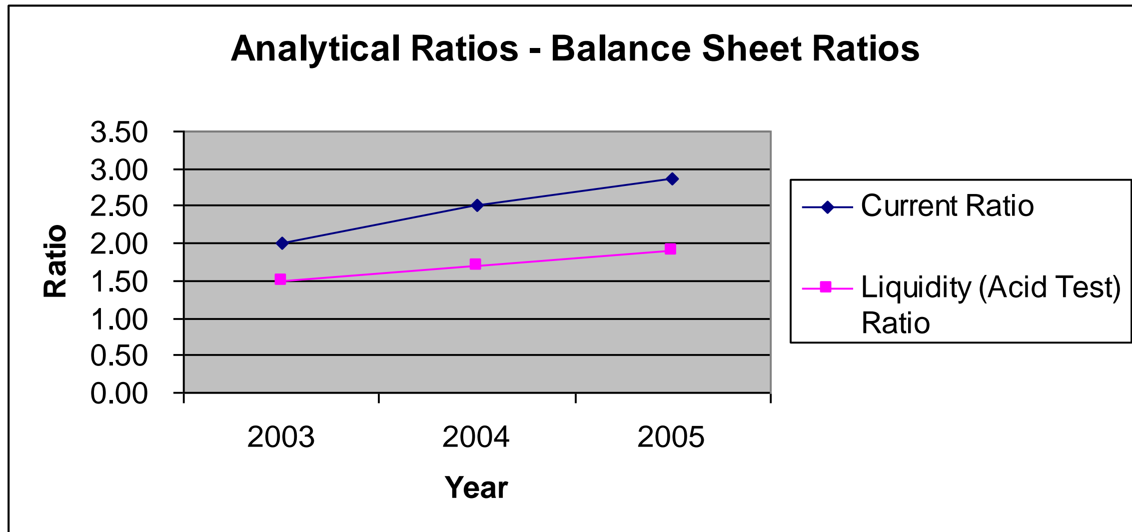
As shown in the graphs below, there has been improved financial performance over the period of study.



The analysis revealed that the Net profit increased as the expenses reduced. This was attributed to the fact that the Board of Directors reviewed performance of the state corporation and made adjustments to their annual plans in order to meet the set objectives in the performance contracts.



Further analysis revealed that there was an increase in the Net profits as running costs reduced significantly. This was also attributed to the fact that the Board of Directors met regularly to review the financial performance of the State Corporation and put in place measures to reduce the running expenses which led to an increase in Net profits. Sales were seen to be declining over time leading to loss of market share. This prompted the Board of Directors and management to review the existing sales and marketing strategies in line with the external environment.



The ratio between the current assets and current liabilities increased over the period which meant that the current liabilities reduced over time. Going further the analysis revealed that the liquidity test ratio also improved over time of study indicating that the liquidity of New Kenya Cooperative Creameries had improved allowing the State Corporation to meet its maturing obligations when they fell due.

CHAPTER FIVE

5.0 SUMMARY OF FINDINGS, LIMITATIONS, CONCLUSIONS , RECOMENDATIONS FOR FURTHER RESEARCH

This chapter provides the summary of the findings and conclusions of the study and makes recommendations emanating from the research findings covered in the previous chapters.

5.1 Summary of Findings

Good Corporate governance practices ensure that profitability and long term sustainability is achieved for any State Corporation. One of the key structures of corporate governance is the Board of Directors. The study sought to determine and asses the corporate governance practices of the Board of New Kenya Cooperative Creameries put in place and role they played in the financial performance.

The study revealed existence of governance systems which are reviewed regularly by the Board of members to ensure they achieve their set objectives in line with the financial performance of the state corporation. With reference to the graphs that depict the trend analysis indicate that there is a relationship between corporate governance structures and financial performance. The relationship was seen to very strong in that the governance structures positively influence the financial performance. Some governance structures influenced more the financial performance of the state corporation which included the review of performance of the Board of Directors and that of the state corporation. This in turn led to the review of various strategies and plans to ensure the objectives were met. Compliance with relevant laws and regulations was also seen as a great contributor to the positive relation in that compliance meant that stakeholders and the Government arms were well protected against abuse of power and

misappropriation of resources. Board of Director Mix brought about the various accumulated skills and knowledge in management that fostered the Board of Directors stewardship and leadership. The positive relationship showed that over time as the state corporation reviewed the corporate governance and reinforced them further would lead improved performance with time. The implementation of the governance system practices is a bit staggered hence lacking consistency was also evidence due to the size of the corporation. The performance review of the Board of Directors ensured that the performance reviews done would lead to adjustments in individual Board member work plans and the work plans of the Board of Directors in order to achieve the set goals over an agreed time frame.

Purpose, values and strategy have played a major role in guiding the Board of Directors in which direction to follow in stewardship and providing leadership. They have also defined the state corporation in the dairy industry making it stand out working towards its mission and vision.The organization structure gave guidance in development and implementation, monitoring of the governance structures so as to ensure that progressive monitoring, dissemination and reviews of the corporate governance structures is done systematically.

The study revealed that the key to improved financial performance lies with the development and implementation of the governance structures that are specific, monitoring and review of the structures regularly in order to make changes when necessary to be in line with the internal and external environment, reinforcement of the structures in place and the measuring the overall performance of the corporation against the set objectives, mission and vision over an agreed time frame.

5.2 Limitations of the Study

The study experienced some limitations such as time which was very limited to allow a deeper study into the governance structures in place. The fact that the intended mode of data collection was to furnish the respondents with the

questionnaire and get it back immediately was not possible therefore questionnaires were dropped and picked after a few days. This meant control over who filled the questionnaire could not be verified. Funds the scarcest resource in any research study was also a limiting factor. The limiting factors dictated the number of respondents, research methodology and the duration of the study.

5.3 Conclusions

From the study it is a clear that the Board of Directors of New Kenya Cooperative Creameries has adopted good corporate governance practices that have yielded improved financial performance over time. There is a also a strong relationship between Corporate Governance and Financial performance of state corporations which is positive, in that the better the governance structures in place the better the financial performance of the state corporation.

5.4 Recommendations

There is need for the Board to review the strategies in place to be able to keep up with the changing dairy industry. Since the linearization of the dairy industry in May 1992 dairy products processing and marketing has increased significantly with the licensing of 40 private and cooperative processors to process and market dairy products both locally and in export markets. Review of the strategies and policies in place must also be done in consultation with the farmers and with independent research organizations contracted to collect marketing intelligence. The review will also ensure that purposes and values are within the strategies in place. The review should be done at least once a year and progress reviewed quarterly.

The Board needs to enforce its compliance to Laws and Regulations that govern the dairy industry and the Ministry of Cooperative Development and Marketing

under which New Kenya Cooperative Creameries is governed. The Board and Management need to ensure that the state corporation's books of account are audited on time in order to provide accurate and timely status of the corporation financial health which in turn will assist the Board to make decisions that are accurate. This means that the terms of reference of the internal audit department need to be made clear in order to ensure that they perform their role effectively and efficiently. Periodic monitoring of the financial performance will also assist the Board make reviews on progress of the state corporation's financial performance.

A clear division and separation of duties by educating the Board of Directors and management on their respective roles is a major shortcoming. This will remove the tendency of management being suspicious of director's intentions and vice versa. This will also create awareness of where the Board needs management support and in what nature.

Performance of the Board of Directors needs to be improved and the review done more regularly taking into consideration past performance appraisals, signed performance contracts and the overall performance of the corporation. This will help make adjustments to performance indicators in light of the ever changing environment and where more effort and capacity building is required. Key performance indicators need to be spelt out clearly and measured over time for each Board member and the Board as a team.

The organization structure needs to be reviewed to ensure that certain bureaucracies that exist in the communication channels and the organization hierarchy are eliminated. The bureaucracies tend to make information sharing, decision making at middle level management and feed back channels very slow and makes information and decisions become obsolete when received or when decisions are made.

5.5 Suggestions for Further Research

Some of the areas that would be recommended for further research include the relationship between the governance structures and other variables which include share prices for quoted companies, the capital structure of corporations and market share for measuring corporate performance, how to compare the governance structures between various state corporations in the various industries and many more.

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APPENDIX

QUESTIONAIRE

Dear Respondent,

Kindly answer the questions below and submit the questionnaire. Print your comments in another sheet of paper if the space provided is not adequate and attach it to this questionnaire. All responses and comments will be treated in confidence.

Your answers for ratings for your answers are on a scale of 1 to 5.
1 = Very Poor (20%), 2= Poor (40%), 3 = Fair (60%), 4 = Good (80%),
5 = Excellent (100%)

Thank you for your Cooperation.

John Muriithi Gitari
Student of the University of Nairobi, School of Business

1) Position in the organization ………………………………
2) Duration of employment…

A. Governance Structures Questionnaire

	Question	Answer/Rating
1	Have all Board Members been appointed? How often is the Board supposed to meet as stipulated? Are Board Members Independent?	
2	How would you rate the Leadership of the Board on a scale of 1 to 5?	
3	How would you rate the organization structure in the manner that maintains corporate integrity, reputation and responsibility on a scale 0f 1 to 5? How often is the structure reviewed by the Board?	
4	How would you rate the purpose, values in achieving the strategy of the Corporate on a scale of 1 to 5? How often are the values and strategies reviewed by the Board?	
5	How would you rate the compliance with all relevant laws, regulations, and governance practices, accounting and auditing standards, and communicating the same to stakeholders on a scale of 1 to 5? Which laws, regulations if any that have not been complied with?	
6	How would you rate the balance of power to ensure it can exercise objective and independent judgment in making decisions and reporting to stakeholders on a scale of 1 to 5?	

	How often is the balance of power reviewed?	
7	Does the Board asses its performance and effectiveness as a whole and that of individual members including the Chief Executive Officer? How often is this done? How would you rate this on a scale of 1 to 5?	
8	Does the Board identify the corporate internal and external stakeholders; agree on a policy or policies determining how the corporate should relate to, and with them? How often are they reviewed? How would you rate this on a scale of 1 to 5?	
9	Does the Board recognize that it is in its enlightened self interest of the corporation to operate within the mandate entrusted to it by society and shoulder its social responsibility? How often does it review its social responsibility? How would you rate this on a scale of 1 to 5?	

B. Financial Performance Indicators

Data Description/Year	**2003** *(Shs Million)*	**2004** *(Shs Million)*	**2005** *(Shs Million)*
Nett Profit/Loss as per the Auditor General Reports			
Sales/Turnover as per the Auditor General Reports			
Expenses			
Analytical Ratios - Trading Ratios	**2003**	**2004**	**2005**
Nett Profit %			
Expenses % of Sales/Turnover			
Analytical Ratios - Balance Sheet Ratios			
Current Ratio			
Liquidity (Acid Test) Ratio			