THE EFFECT OF CORPORATE GOVERNANCE ON FINANCIAL PERFORMANCE OF INSURANCE COMPANIES IN KENYA.

ALBERT WANDERA MAKOKHA

A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENT FOR THE A WARD OF DEGREE OF MASTERS OF BUSINESS ADMINISTRATION, SCHOOL OF BUSINESS,

UNIVERSITY OF NAIROBI.

2014

DECLARATION

These research project is my original work and has not been presented for degree in any other university or any other award

Sign …….. Date……

ALBERT WANDERA MAKOKHA

D61/75741/2012

This research project has been submitted for examination with my approval as University Supervisor.

Sign …….. Date……

WINNIE NYAMUTE

Lecturer,

Department of Finance and Accounting

University of Nairobi.

ACKNOWLEDGEMENTS

Much gratitude goes to the researcher's supervisor, Ms. Winnie Nyamute for her tireless effort in guidance, advice, support and constructive criticism throughout the research project writing.

Special thanks also go to my wife Mrs. Charlotte Mwikhali for her support, advice and being there to type my work.

I would also like to extend my gratitude to the administration of the University of Nairobi through the university's library and the library staff that enabled me to access the various materials used in compiling this work. Special attribute goes to my class members and friends who through their persistence assistance and hard work saw the achievement of this study.

Last but not least, I would like to give my most special tributes to our almighty Lord for all His blessings.

DEDICATION

I dedicate this research project to my wife Charlotte, children Cheryl, Shantel and Bravin for their love, support, patience, encouragement and understanding. They gave me the will and determination to complete my masters.

ABSTRACT

Corporate governance affects the development and functioning of capital markets and exerts a strong influence on resource allocation. In an era of increasing capital mobility and globalization, it has also become an important framework condition affecting the industrial competitiveness and economies of member countries. Despite tight regulatory framework, Corporate Governance continues to weaken in Kenya. Many companies have been characterized by scandals. Directors have acted illegally or in bad faith towards their shareholders. Because Kenya offers great opportunity for investors, this makes it unique in the region and attractive for more investment flows. The purpose of this study is to determine the effect of corporate governance on financial performance of insurance companies in Kenya.

This study adopted a descriptive research design and all 49 insurance Companies registered in Kenya were investigated. Secondary data was used where both quantitative and qualitative data was analysed. Statistical Package for Social Sciences (SPSS) version 20.0 was used to analyse the data. Moreover, multiple linear regression analysis was used to determine the relationship among the variables. Further, normality of the variable was examined using the skewness and kurtosis.

The findings of the study show that corporate governance has influence on the financial performance of insurance companies in Kenya. Whereas financial performance of insurance companies in Kenya are significantly influenced by board composition (the ratio of outside directors to total number of directors) and leverage (ratio of total liability to total assets), the performance is not significantly influenced by board size and the number of members in the risk committee..

The study established that, generally, a weak, negative but statistically significant correlation between financial performance (ROA) of insurance companies in Kenya and corporate governance (board composition, board size, risk committee and leverage) as indicated by a small R Square of 0.33 , p values 0.001 and high F value of 5.408. The study findings shows governance mix influence on the financial performance of insurance companies in Kenya. Insurance companies should review their policies regarding Corporate governance particularly practices influencing board size and the number of members in the risk committee, majority of the members of a committee in insurance companies in Kenya be independent

TABLE OF CONTENTS

LIST OF TABLES

LIST OF ABBREVIATIONS

AC - Audit committee

AKI - Associate of Kenya insurer

BODCOMP - Board composition

BOU - Bank of Uganda

CEO – Chief executive officer

CMA - Capital Market Authority

EPS - Earnings per share

EVA - Economic value added

FOBM - Frequency of board meetings

IRA - Insurance Regulatory Authority

JSE - Johannesburg securities exchange

KR – Kunder Richardson

KPI – Key performance indicators

MVA - market value added

NSE - Nairobi Security Exchange

OECD – Organization for Economic co-operation Development

RC - Risk committee

RDT - Resource dependence theory

ROA-Return on Asset

ROCE - Return on capital employed

ROI- Return on investment

SEVA - standardized Economic value added

SMUA – Standard market value added

SPSS - Statistical Package for Social Sciences

TCE - Transaction cost Economies

URA - Uganda Revenue Authority

WACC - weighted average cost of capita

CHAPTER ONE

INTRODUCTION

1.1 Background to the Study

Corporate Governance has come to mean many things. Arya, Tandon, Vashisht (2003) defines corporate governance as the codes of practice by which a firm's management is held accountable to capital providers for the efficient use of assets. It exhibits how its mission, values and philosophy govern an organization. Jenifer (2002) defines Corporate Governance as a set of interlocking rules by which corporations, shareholders and management govern their behavior. In each country, this is a combination of a legal system that sets some common standards of governance and systems of behavior determined by firms themselves. Corporate Governance scandals and accounting failures such as Maxwell in the UK and Enron in the US have been dominating business debates during the last decade. Increasing and ethical problems are recognized as symptoms of failing Corporate Governance and systems of accountability and control in publicly quoted firms (Igor 2004).

In Kenya and the rest of the developing countries, the penetration of insurance services has always been limited. The insurance companies have not been able to penetrate all parts and reach all people. This problem is compounded by lack of enough skilled sales agents, lack of campaign activities by the government and negative publicity of insurance companies. Collapse of insurance companies such as United, INVESCO etc has dented the image of insurance industry in Kenya. Some of the cited reasons for insurance companies collapse include inadequate risk

management, unqualified personnel managing the firms and non-adherence to good corporate governance.

1.1.1 Corporate Governance

One view of corporate governance is that it is based on a series of underlying concepts (BPP, 2012)**.** Fairness; the director's deliberations and also the system and values that underlie the company must be balanced by taking into account everyone who has a legitimate interest in the company and respecting their rights and views. The views of minority shareholders and foreign shareholders should be considered when making decisions. Determination of pay structure in the organization should be fair to employees and directors but should also consider the shareholders in terms of availability of net profit for distribution.

Openness and transparency; transparency means corporate disclosures to stakeholders. The main reason why disclosures is so important relate to the agency problem, the potential conflict between owners and managers. Without effective disclosure the position could be unfairly weighed towards managers, since they have far more knowledge of the company's activities and financial situation than the owners/investors. Openness and transparency can be increased by increased reporting of financial activities and more voluntary disclosures in the financial statements.

The UK Cadbury report (2004) emphasizes that the board of directors are accountable to shareholders. Corporate accountability refers to whether an organization (and its directors) is answerable in some way for the consequences of their actions (BPP, 2007). However, Cadbury

stresses that making the accountability work is the responsibility of both the parties. Directors, as well have been seen to do so through the quality of information they provide whereas shareholders do so through their willingness to exercise their responsibility as owners, which means using the available mechanism to query and assess the actions of the board.

Integrity can be taken as meaning someone of high moral character who sticks to principles no matter the pressure to do otherwise. Straight forward dealing in relationships with different people constituencies who you meet is particularly important, trust is vital in relationships and belief in the integrity of those with whom you are dealing under in this. Integrity is an essential principle of the corporate governance relationship, particularly in relationship to representing shareholders' interests and exercising agency. The integrity of the financial statement will depend on the integrity of these preparing and presenting the financial statement.

Key issues in corporate governance have included the role of the board, the quality of financial reporting and auditing, directors' remuneration and risk management. Composition and balance of the board; a feature of many corporate governance scandals has been boards dominated by single senior executive with other board members merely acting as a rubber stamp. Sometimes the single individuals may bypass the board to act on their own interests. The board must also be balanced in terms of skills and talents from several specialisms relevant to the organization's situation and also in terms of age.

Director's remuneration and reward: Directors being paid excessive salaries and bonuses have been seen as one of the major corporate abuses for a large number of years. It is thus inevitable

that the corporate governance codes have targeted this issue. This has been cited as a resultant of Agency problem in many organizations. Director's rewarding themselves hefty salaries and bonuses means that little is available to re-invest or for distribution to the shareholders. The remuneration committee should be able to set remuneration packages for the directors and senior managers in the organization.

Responsibility of the board for risk management and internal control system: Boards that meet irregularly or fail to consider systematically the organization's activities and risks are clearly not fulfilling their responsibilities. Sometimes, the failure to carry out proper oversight is due to a lack of information being provided, which in turn may be due to inadequate systems being in place for measurement and reporting of risk. The composition of Risk committee should include people with knowledge of risks that are likely to face the organization. Suggestions and deliberation of risk committee and internal control function should be followed closely for compliance.

1.1.2 Financial Performance

Financial performance is a subjective measure of how 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 (Investopedia, 2014). Measures of financial performance includes key business statistics such as number of new orders, cash collection efficiency, and Return on Investment (ROI), Return on Asset (ROA) which measure a firm's performance in critical areas. Key performance indicators (KPIs) show

the progress (or lack of it) toward realizing the firm's objectives or strategic plans by monitoring activities which (if not properly performed) would likely cause severe losses or outright failure.

A company ought to be profitable and there are obvious checks on profitability such as whether the company has made a profit or loss on its ordinary activities and by how much this year's profit or loss is bigger or smaller than last year's profit or loss. Profitability measures include sales margin which is turnover less cost of sales, earnings per share EPS is defined as the profit attributed to each equity (ordinary) share as a convenient measure as it shows how well the shareholders are doing. EPS is widely used as a measure of a company's performance especially in comparing results over a period of several years. A company must be able to sustain its earnings in order to pay dividends and reinvest in the business so as to achieve future growth. Return on capital employed (ROCE) is another measure of profitability which states the profit as a percentage of the amount of capital employed.

Financial performance can be viewed from the perspective of its capital structure; the way in which an organization is financed which may include a combination of long-term capital (ordinary shares and reserves, preference shares, debentures, bank loans, convertible bond) and short term liabilities such as bank overdraft and trade payables. A high level of debt creates financial risk. Gearing measures the relationship between shareholders' capital plus reserves and debt (BPP, 2013). A stable organization should have a strong statement of financial position.

1.1.3 Corporate Governance and Financial Performance

Corporate governance affects the development and functioning of capital markets and exerts a

strong influence on resource allocation. In an era of increasing capital mobility and globalization, it has also become an important framework condition affecting the industrial competitiveness and economies of member countries. This paper set out to further develop our understanding of corporate governance and its effect on corporate performance and economic performance. Good corporate governance may improve organization capital structure by attraction of foreign investors.

(Wanyama and Olweny (2013) studies effect of corporate governance on financial performance of listed insurance firms in Kenya. Board size was found to negatively affect the financial performance of insurance companies listed at the Nairobi Security Exchange (NSE). There was a positive relationship between board composition and financial performance of insurance companies listed at the NSE. On CEO duality, the study found out that separation of role of CEO and chair positively influenced the financial performance of listed insurance firms. Robinah, (2012) investigated corporate governance and financial performance of public universities in Uganda. He found that board size had a negative effect on financial performance while policy and decision making had a significant positive relationship with board roles.

Nyamongo and Temesgen (2013) studied effect of corporate governance on performance of commercial banks in Kenya. They agree with Wanyama and Olweny (2013) that board size has a negative effect on the financial performance of organizations. Nyamongo and Temesgen found no evidence that CEO duality or otherwise has impact on performance of commercial banks in Kenya while Wanyama and Olweny (2013) argues that separation of CEO and chair positively influence financial performance of listed insurance firms. Brown and Caylor (2004) studied

corporate governance and firm's performance, they found that better governed firms are relatively more profitable, more valuable and pay more cash to their shareholders.

Najjar (2012) investigated the impact of corporate governance on the insurance Firm's performance in Bahrain. The research concluded that there is no statistically significant impact of corporate governance expressed by CEO status, ownership concentration, the number of employees, industry performance and number of shares traded on firm's performance in the Insurance industry expressed by the dependent variable – return on equity. On the other hand board size, number of block-holder have statistically significant impact on firm's performance in the insurance industry expressed by dependant variable – return on equity (ROE).

1.1.4 Insurance Industry in Kenya

The insurance industry in Kenya has for almost three decades seen a number of changes being introduced and adopted. It is however worrying to note that eight insurance firms have either collapsed or have been placed under statutory management (Wanyama, 2013). In response to this trend, the government of Kenya responded by establishing the Insurance Regulatory Authority (IRA) which is the prudential regulator of insurance industry in Kenya. IRA became autonomous in 2007 through the act of parliament. This act has defined how insurance companies should be set up, managed and controlled. However, just like other industries, regulation has not ensured the highest standard of governance. IRA is expected to improve regulation and stability of the industry. In 2011, the authority, in partnership with commissioner of police, created the insurance investigation unit to investigate insurance fraud. It also registered the first Islamic insurance firm First Takafu.

The insurance operates under an umbrella body, the associate of Kenya insurer (AKI) which was established in 1987. Its main objectives are to promote prudent business practices, create awareness among public and accelerate the growth of insurance business in Kenya. According to AKI, (2012), the world, Africa and Kenya insurance market wrote USD 4,612,514 billions, USD 71,891 billion and USD 108 billion respectively of Gross Direct Premiums in the year 2012. Kenya's insurance industry leads within East Africa Community and is a key player in the COMESA region. The industry employs over 10,000 people. Insurance penetration in Kenya is 3%, Ndung'u (2012) however product innovation in the industry particularly targeting lower market will enhance the level of financial inclusion among the population.

1.2 Research Problem

Incorporation may mean that the owners of the organization are not necessarily the managers and this may create agency issues which include managers acting for their own selfish interest at the expense of other stakeholders. Despite tight regulatory framework, Corporate Governance continues to weaken in Kenya (Mang'unyi, 2011). Many companies have been characterized by scandals. Directors have acted illegally or in bad faith towards their shareholders. Because Kenya offers great opportunity for investors, this makes it unique in the region and attractive for more investment flows. However, this increases the pressure on the firms to develop corporate governance and provide higher protection for the stakeholders generally. Whereas there has been renewed interest 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 weak judicial system, the

interest of both the minority shareholders and creditors could be compromised. Consequently, performance of such firms might be compromised.

Kenyans' uptake of insurance cover, both at corporate and personal level, remains predominantly in motor, fire industrial and personal accident (mainly group medical cover) classes. This illustrates a poor attitude towards personal insurance cover in general (Mbogo, 2010). Low insurance penetration is one of the challenges facing the insurance industry development in terms of market share, product diversification among other measures. Indeed, the Insurance Regulatory Authority identified poor Corporate Governance in insurance companies as one of the threats to achieving its strategic plan 2008-2012. Wanyama (2013) argues that this is a worrying trend especially since the industry has witnessed in the past, the collapse of firms such as Kenya National Assurance Company, United Insurance Company, Standard Assurance, Stallion Insurance, Invesco Assurance and Blue shield Insurance Company. Because Insurance sub-sector is crucial in the financial system of any country, there is need to strengthen corporate governance to improve on performance of the insurance companies.

Much of research has been done on the subject at global level and the result shown the relation of good corporate governance and superior financial performance. Najjar (2012) studied the impact of Corporate Governance on the insurance Firm's performance in Bahrain. Robinah (2013) studied Corporate governance and financial performance of public universities in Uganda. Wet (2012) investigated the relationship between executive remuneration of South African listed companies and economic value added (EVA) and market value added (MVA), as well as traditional performance measures such as return on assets (ROA) and return on equity (ROE).

They all concluded that with good corporate governance, superior financial performance can be achieved.

In Kenya, a number of researches have been done on corporate governance and financial performance in many industries other than Insurance industry. Nyamongo & Temesgen (2013), Ochieng (2011) says, large board size tends to impact performance negatively; the existence of independent board of directors tends to enhance the performance of the bank. Kiragu (2014) assessed challenges facing insurance companies in building competitive advantage in Kenya. He found that governance regulation is most significant unit of change. Wanyama (2013) studied effects of corporate governance on financial performance of listed insurance firms in Kenya.

Little research has been done on the corporate governance and performance of insurance companies in Kenya. A relevant issue for investigating therefore is what effect good corporate governance has on the performance of Insurance companies in Kenya?

1.3 Research Objective

To investigate the relationship between corporate governance on financial performance of insurance companies in Kenya

1.4 Value of the Study

Only few researches have been conducted on the effect of corporate governance on financial performance specifically on Insurance companies in Kenya. The study offers valuable knowledge to the stakeholders in the insurance sector on whether good corporate governance has a major role on financial performance of insurance company in Kenya and whether much focus should be directed to it.

The study will also influence the role the Kenya government play towards corporate governance practice in insurance company and any intervention, measures and strategies needed to be in place for continued growth. The focus will be on regulatory framework on areas that strengthen governance to ensure insurance companies are financially sound and can play a critical role in Kenya financial system as they gain competitive advantage.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

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). This chapter discusses the various theories relevant to corporate governance and reviews past studies on the subject and critically reviews relevant literature.

2.2 Theoretical Review

This study will be based on the following theories that the researcher deems necessary for the research. Neuman (2006) defines a theory as a system of interconnected ideas that condense and organize knowledge about the world. The agency and the stakeholder theory are the main theories underlying the concept of Corporate Governance. However, other theories are also discussed.

2.2.1 Agency Theory

Jensen and Meckling (1976) says Agency theory identifies the agency relationship where one party (the principal) delegate work to another party (the agent). In the context of a corporation, the owners are the principal and directors are the agents. The work of Fama, Jensen, (1983) are important. The agency relationship can have a number of disadvantages relating to the

opportunities or self-interest of the agent. For example, agent may not act in the best interest of the principal, or the agent may act only partly in the best interest of the principal. Much of agency theory as related to corporations is set in the context of separation of ownership and control as described in the work of (Besle Means, 1932). In this context, the agents are the managers and the principals are the shareholders, and this is the most commonly cited agency relationship in the corporate governance context.

2.2.2 Resource Dependence Theory

RTD is the study of how the external resources of organizations affect the behavior of the organization. The procurement of external resources is an important tenet of both the strategic and tactical management of any organization. RTD has implications regarding the optimal structure of organizations, recruitment of board members and employees, production strategies, contract structure, external organizational links and many other aspects of organizational strategy (Pfeffer & Salancit, 1978). Johnson et al (1996) concurs that resource dependence theory focuses on appointment of representative of independent organizations as a means for gaining access in resources critical to firm success. Millan (2013) says directors are able to connect the company to the resources needed to achieve corporate objectives. Davis, Cobb, (2009) argues that there are three core ideas of the theory: social context matter, organizations have strategies to enhance their autonomy and pursue interests and power (not just rationality or efficiency) is important for understanding internal and external actions of organizations. The emphasis on power, and a careful articulation of the explicit repertoires of tactics available to organizations, is a hallmark of resource dependence theory that distinguishes it from other approaches, such as transaction cost economics.

2.2.3 Transaction Cost Economies

Commons (1931) introduced the idea that transactions form the basis of an economic thinking. He said that these individual actions are really trans-actions instead of either individual behavior or the exchange of commodities. According to Williamson (1981) the determinants of transaction costs are frequency, specificity, uncertainty, limited rationality and opportunistic behavior. Mallin (2013) TCE views the firm as a governance structure whereas agency theory views the firm as a nexus of contract. Essentially, the latter means that there is a connected group of series of contracts amongst the various players arising because it is seemingly impossible to have a contract that perfectly aligns the interest of principal and agent in a corporate control situation. There are a number of costs to writing a contract between principal and agent, which include the cost of thinking about and providing for all the different eventualities that may occur during the course of the contract, the cost of negotiating with others and the cost of writing the contract in an appropriate way so that it is for example legally enforceable.

2.2.4 Stakeholders Theory

Freeman (1984) identifies and models the groups which are stakeholders of a corporation, and both describes and recommends methods by which management can give due regard to the interests of those groups. Mallin (2013), stakeholder theory takes account of a wider group of constituents rather than focusing on shareholders. A consequence of focusing on shareholders is that the maintenance or enhancement of shareholders' value is paramount, whereas when a wider stakeholder group such as employees, providers of credit, customers, suppliers, government and local community is taken into account, the overriding focus on the shareholder value becomes

less self-evident. In the traditional view of the firm, the shareholder view, the shareholders or stockholders are the owners of the company, and the firm has a binding fiduciary duty to put their needs first, to increase value for them. Stakeholder theory argues that there are other parties involved, including employees, customers, suppliers, financiers, communities, governmental bodies, political groups, trade associations, and trade unions.

While ethical codes have the potential to constrain how performance is pursued, arguably the most direct contribution of stakeholder ideas to company performance is to be found in Kaplan, Norton's (1992) ideas about the balanced scorecard and the revolution in performance measurement that this has encouraged. Kaplan and Norton acknowledge the power of measurement on performance as well as the potential distortions on the operational effectiveness that can arise from purely financial accounting measures like earnings per share or return on investment. Jensen (2001) states that traditional stakeholders theory argues that the management of a firm should take account of the interests of all stakeholders in a firm but, because the theories refuse to say how trade-offs against the interests of each of these stakeholders groups might be made, there are no defined measurable objectives and this leaves managers unaccountable for their actions.

2.3 Determinant of Financial Performance

2.3.1 Corporate Governance

Corporate governance is very often found in studies oriented toward the organizational performance. Drobetz et al. (2004) also identified a positive impact of corporate governance on the performance of German firms. Ochieng (2011) concluded that corporate governance practices (director's effectiveness, management effectiveness, shareholder' protection, disclosure

and transparency) have a positive relationship with bank performance. One of the most important and often cited studies belongs to (Gompers, Ishi & Metrick 2003). This study has demonstrated the existence of a positive relationship between the quality of corporate governance and the firm performance.

2.3.2 Organization Strategy

Prescott, (1986) examined the relationship between an organization's strategy and its performance. According to this study, business strategy significantly influenced performance, external environment having the role to mitigate the effect of strategy on performance. One of the most significant studies belongs to (Porter 1980). In this study the author compared two groups of strategies (strategies aimed at reducing costs and differentiation strategies). The objective of cost strategies is gaining competitive advantage through a reduction in cost below the level of competitors. The objective of differentiation strategies is gaining competitive advantage by concentrating all departments of an organization to differentiate their products from those of competitors on one or more dimensions.

2.3.3 Innovation and Development

Innovation and development is a factor that may determine firm's performance. Kotler (2003) studied the relationship between innovation and performance, offering example of Song, a leader in innovation that has significantly increased market share by means of numerous new products to client. According to this study, firm's innovation capacity was the critical factor in explaining performance differences between firms. The extent to which new products are introduced, and

the extent to which products and production processes are improved determine the performance of an organization.

2.3.4 Leadership

Weiner & Mahoney (1981) studied the leadership in 193 manufacturing companies. According to this study, managerial practices have a significant impact on two organization performance components: profitability and share price. Other studies have suggested that leadership is a key element that ensures the connection between the success factors of an organization. The leadership of an organization should be able to provide clear strategy and direction.

2.4 Empirical Studies

Kiel & Garim (2003) conducted a study on board composition and corporate governance. They examined the relationship between board demographics and corporate performance in 348 of Australia's largest publicly listed companies and describe the attributes of these firms and their boards. They found that, board size is positively correlated with firm value. They also found a positive relationship between the proportion of the inside directors and the market based measure of the firm performance. This confirms the stakeholder theory that extends the definition of stakeholders to include even employees.

Rogers (2006) examined the relationship between the core principles of corporate governance and financial performance in commercial banks in Uganda. A range of data collection tools and data analysis techniques were used. This study was conducted as a cross sectional and correlation investigation. Given that the key focus was investigate the relationship between corporate governance and financial performance, the target population included depositors (account

holders) in Bank R (6,228 elements), Bank Y (527,681 Elements), Bank Z (14,357 elements) and Bank M (344,005 elements). Other stakeholders considered include 16 BOU officials in charge of financial institutions, and 16 URA officials. The findings indicate that corporate governance predicts 34.5% of the variable in the general financial performance of commercial banks in Uganda. However, the significant contributors to financial performance include openness and reliability.

Ochieng (2011) examined the relationship between corporate governance practices and performance of commercial banks in Kenya. The population of study was the 45 banks licensed by central bank of Kenya as at the end of 2010. The study adopted a census study approach because of small population and the banks are easily accessible. Two methods of data analysis were employed, the description analysis which provides some average of relevant variables and regression analysis to establish the relationship between the corporate governance variable (independent variable) and firms performance (dependant variable) over the period of study. The research concluded that corporate governance practices (director's effectiveness, management effectiveness, shareholders' protection, disclosure and transparency) have a positive relationship with bank performance.

Wet (2012) studied the relationship between executive remuneration of south African listed companies and economic value added (EVA) and market value added (MVA) , as well as traditional performance measures such as return on assets (ROA) and return on equity (ROE). The research method entailed using data obtained from the financial data provider McGregor BFA and applying regression analysis to test the hypothesis as stated. The companies selected

for the study were all listed on the Johannesburg securities exchange (JSE) South Africa and the period covered was a five year period from 2006 to 2010. The dependant variable, total directors' remuneration (TDR) includes basic salary and bonus, as well as other remuneration such as shared based payment and options. The five independent variable believed to influence directors' remuneration are ROA (after tax percentage), ROE (after tax percentage), standardized EVA (SEVA), standardized MUA (SMUA) and weighted average cost of capital (WACC). The finding indicated that there is indeed a significant relationship between executive remuneration and EVA and MUA but the correlation is better between executive remuneration and ROA and ROE.

Robinah (2013) examined the relationship between corporate governance and financial performance of public universities in Uganda. A cross sectional and correlation study was conducted in four public universities in Uganda. Statistical package for social scientists (SISS) was used and spearman correlation coefficient and multiple regression analysis to determine the magnitude of the relationship and prediction of financial performance respectively were applied. The findings revealed that corporate governance variables namely; board size had a negative effect on financial performance while policy and decision making had a significant positive relationship with financial performance. Corporate governance had a significant positive relationship with board effectiveness and contingency had a significant positive relationship with board roles and effectiveness.

Nyamongo and Temesgen (2013) investigated the effect of corporate governance on the performance of commercial banks in Kenya; they studied 37 commercial banks in Kenya over a

period 2005-2009. They used two measures of performance i.e. return on assets (ROA) and return on equity (ROE) and the dependant variables and three measures of governance namely the board size, independent directors and CEO duality as the key independent variables. The study followed a panel econometrics technique to investigate the relationship between governance variable and bank performance. The main findings were, a large board size tends to impact negatively, the existence of independent board of directors tend to enhance the performance of the banks and there is no evidence that CEO duality or otherwise has impact on the performance of commercial banks in Kenya.

Amba (2014) studied the impact of corporate governance variable on firm's financial performance. Influence of corporate governance variable CEO duality, chairman of audit committee, proportion of non-executive directors, concentrated ownership structure, institutional investors, gearing ratio on firm financial performance and return on assets as researched using firms traded in Buhrain house, New York. Statistical technique multiple regression analysis had been employed to test the financial performance measured by return on assets and corporate governance variable. The research finds that corporate governance variable do influence firm's performance CEO duality, proportion of non-executive directors and leverage has negative influence and board member as chair of audit committee proportion of institutional ownership has positive influence on firm's financial performance.

2.5 Summary of Literature Review

Corporate Governance is important in all organizations regardless of their industry, size or level of growth. Good Corporate Governance has a positive economic impact on the Institution in question as it saves the organization from various losses such as those occasioned by frauds,

corruption and similar irregularities. 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; establishing the independence of the auditor and therefore the integrity of financial reporting, including establishing an audit committee of the board.

The studies cited in the literature review 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 other than insurance service providers in Kenya. For instance Nyamongo, Temesgen (2013) focused on the effect of governance on performance of commercial banks in Kenya. On the other hand Matengo (2008) did study on the relationship between Corporate Governance practices and performance: the case of banking industries 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

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This section provides information on the type of research design that as used for the study. It gives the population and sample for the study. Furthermore it discusses the data collection, analysis and presentation techniques used in study.

3.2 Research Design

Research design is the arrangement of conditions for collection and analysis of data in a manner that aimed to combine relevance to the research purpose with economy in procedure (Kothari, 2004). A research design helps a researcher to conceptualize an operational plan to undertake the various procedures and tasks required to complete the study and ensure that these procedures are adequate to obtain valid, objective and accurate answers to the research questions.

This study adopted a descriptive research design. According to Copper, Schindler (2003) a descriptive study is concerned with finding out the what, where and how of a phenomena. Descriptive research design was chosen because it enabled the study to generalise the findings to a larger population. Chandran (2004) says descriptive studies portray an accurate profile of persons, events or situations, describing the existing conditions and attitudes through observation and interpretation techniques. The choice of the descriptive study design is based on the fact that the research was interested on the state of affairs already existing in the field and no variable will be manipulated.

3.3 Population

Mugenda, Mugenda (2003) define population as the entire group of individual's, events or objects having a common observable characteristic. According to Mugenda, Mugenda, (2003), target population is that population the study studies, and whose findings are used to generalize the entire population. For this study, the population consisted of all 49 insurance Companies registered under the Insurance Act Chapter 487 Laws of Kenya as per list available on the Insurance Regulatory Authority (IRA) website (Appendix 1). This study used a census method which was adapted due the small population.

3.4 Data Collection

Different sources were used to collect data for the study. Several academic journals and articles were read to have better understanding of this topic. The previous academic studies were downloaded online from various websites. Real time numerical data about the insurance sector and companies were gathered from NSE and the published annual reports of each insurance company which are submitted on their official website. Data (board size, board composition, leverage, return on Assets) were extracted from financial statement such as statement of financial position, statement of cash flows, statements of changes in equity and statements of comprehensive income.

3.5 Data Analysis

According to Orodho (2003), a pilot test helps to test the reliability and validity of data collection instruments. Validity refers to the extent to which an instrument measures what is supposed to measure data need only to be reliable but also true and accurate. If a measurement is valid, it is also reliable (Joppe 2000). A pilot test was conducted on one of the companies to field test the

reliability and the validity of the data to be collected. Cronbach's coefficient Alpha was computed to determine how items correlate among themselves. Cronbach's Alpha is a general form of the Kunder-Richandson (K-R) 20 formula. The use of the K-R 20 formula reduces the time required to compute a reliability coefficient in other methods (Mugenda & Mugenda, 2003). A high coefficient implies that items correlate highly among themselves i.e there is homogeneity of data.

The study generated both qualitative and quantitative data. Descriptive statistics data analysis method was applied to analyze quantitative data. Data obtained was processed through editing and coding and then entered into computer for analysis using descriptive statistics with the help of Statistical Package for Social Sciences (SPSS) which offered extensive data handling capabilities and numerous statistical analysis procedures that analyze small to very large data statistics. Descriptive statistics helped to compute measures of central tendencies and measures of variability. Below are a description of the key characteristics and terms of measurement for each variable. This study focused on Corporate Governance characteristics namely board composition, board size, Risk committee and leverage and how they affect performance. Dependent and independent variables were grouped into component; namely, independent variable which consists of board composition, board size, Risk committee, leverage and dependent variables which consists of performance indicators namely return on Assets.

3.5.1 Regression Analysis

Multiple regression analysis is a statistical method utilized to determine the relationship between one dependant variable and one or more independent variable. This study employed a multiple

linear regression analysis using Return on Asset (ROA) as proxy for the firm's financial performance as dependent variables and independent variables comprising of of board composition, board size, Risk committee, leverage as control variable.

3.5.2 Normality Test

Normality of the variable was examined using the skewness and kurtosis. According to Kline (2011), the invariant normality of variables can be assumed if the skewness statistics is within the interval (-3.0, 3.0) and kurtosis statistic lying in the interval (-10.0, 10.0)

3.5.3 Multiple Regression Models

This study employed the following model

$Y_{it} = \beta_o + \beta_1 \text{BODCOMP} + \beta 2 \text{ BS} + \beta 3 \text{ RC} + \beta 4 \text{ LEVERAGE} + et$

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

BODCOMP represent Board composition

BS represents board size

RC represents risk committee

LEVERAGE represents leverage

et the error term which account for other possible factors that could influence Yit that are captured in the model.

Based on the fact that different financial performance proxies were employed, the above model was therefore modified as below to determine the relationship between firm performance and corporate governance of insurance firms in Kenya.

Equation 3.1

ROAit = f (BODCOMP t, BS t, RC t, LEVERAGE t)..... (1)

ROAit = β0 + β1 BODCOMP t + β2BS t + β3 RC t + β4 LEVERAGE t + et.....(2)

ROA represent firm performance variable which is return on assets for insurance firms at time t.

The terms of measurement (appendix 2) were useful in computing the descriptive statistics of the variables of the study which show the mean, median, standard deviation, minimum and maximum.

3.5.4 Test of Significance

The test of significance helps us to decide whether we can reject the null hypothesis, (Mugenda Mugenda 2003). An independent variable is said to be a significant predictor of the dependent variable if the absolute t-value of the regression coefficient associated with that independent variable is greater than the absolute critical t-value. Regression analysis also yields an F-statistics and its probability level. The F-statistics tells the researcher whether one or more of the independent variables significantly predicts the dependent variable at the selected probability level. The researcher examined the t-values for each independent variable and their probability

levels to determine which of the independent variables are significant predictors of the dependent variable.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter presents the study findings whose main objective was investigate the effect of corporate governance on financial performance of insurance companies in Kenya. Specifically, the study investigated how performance (Return on Assets) is influenced by Board composition, Board size, Risk committee and leverage. The study collected data on the return on assets, the ratio of outside directors to total number of directors (board composition), board size, number of members of risk committee, ratio of total liability to total assets (leverage) as shown in appendix i.

4.2 Data Reliability

Cronbach's alpha was used to measure internal consistency of the data collected. The Cronbach's alpha (α) generated from SPSS was 0.802 as shown in table 4.2 which indicated a good internal consistency of the data. According to Cronbach (1951), an alpha (α) in the range $0.7 \leq \alpha < 0.9$ indicates good internal consistency.

Table 4.2: Data Reliability

Cronbach's Alpha	N of Items
.802	5

Case Processing Summary

		N	%
Cases	Valid	49	100.0
	Excluded	0	.0
	Total	49	100.0

4.3 Normality Test

The study examined normality of the variable using the skewness and kurtosis. Table 4.3 shows the result of normality test as generated by SPSS.

Table 4.3: Normality Test

	N	Skewness			Kurtosis		
	Statistic	Statistic	Std. Error	Skewness	Statistic	Std. Error	Kurtosis
BODCOMP	49	-.367	.340	-0.00108	.274	.668	0.00041
BS	49	.790	.340	0.00232	.011	.668	1.65E-05
RC	49	.812	.340	0.00239	1.814	.668	0.002716
LEVERAGE	49	-.219	.340	-0.00064	-.096	.668	-0.00014
ROA	49	.208	.340	0.00061	-1.153	.668	-0.00173
Valid N (listwise)	49						

The study findings show that all the variables had skewness and kurtosis values less than 1. The invariant normality of variables can be assumed if the skewness statistics is within the interval (-3.0, 3.0) and kurtosis statistic lying in the interval (-10.0, 10.0) (Kline, 2011). Therefore the data used in the study had normal distribution.

4.4 Descriptive Statistics

The study examined the mean and standard deviation of the study variables. Table shows the findings of the study.

Table 4.4: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
BODCOMP	49	.25	11.00	6.1194	2.47453
BS	49	6.00	12.00	8.1020	1.64880
RC	49	2.00	6.00	3.7143	.84163
LEVERAGE	49	.36	.93	.6763	.13500
ROA	49	.07	.64	.3411	.17186
Valid N (listwise)	49				

The descriptive statistic in table 4.4 shows that the average Return on Assets (Amount of net income as a percentage of total assets/Earnings before tax divided by total assets of the Company) was 0.34 and standard deviation of 0.17 for the 49 insurance companies in Kenya.

The average ratio of outside directors to total number of directors (BODCOMP) is 6.11 and a standard deviation of 2.47. The highest and the lowest ratio of outside directors to total number of directors was 11.0 and 0.25 respectively. The average board size (BS) was 8.1 members with the highest and the least board sized at 12 and 6 members respectively. The average number of members of Risk Committee (RC) was 3.71 (standard deviation of 0.84) and the average ratio of total liability to total assets ((LEVERAGE) was 0.67 (standard deviation of 0.13).

4.5 Correlation Analysis

Table 4.5 presents the Pearson Product correlation coefficients of different variables in the study.

Table 4. 5: Pearson Product Correlation Coefficients (r)

	ROA	BODCOM	BS	RC	LEVERAGE
ROA	1				
BODCOM	-0.446	1			
BS	-0.233	0.104	1		
RC	-0.031	0.031	0.036	1	
LEVERAGE	-0.300	0.126	0.042	0.102	1

Two variables are said to be correlated if their coefficient of correlations is greater than 0.5. In a situation whereby two independent variables are correlated, one of the variables must be dropped from the analysis. As shown in table 4.5, none of the independent variables (board composition, board size, risk committee and leverage) had coefficient of correlation between themselves more than 0.5 hence all of them were included in the regression model. The matrix also shows weak and negative correlation between the dependent (ROA) and the independent variables (board composition (r=-0.446), board size (r=-0.233), risk committee (r=-0.031) and leverage (r= 0.300) as indicated by coefficients of correlations less than 0.5 and negative in nature.

4.6 Regression Analysis

Regression analysis was used to determine the effect of corporate governance on financial performance of insurance companies in Kenya. The following regression model was adopted for the study:

$ROA_{it} = \beta 0 + \beta 1\ BODCOMP\ t + \beta 2 BS\ t + \beta 3\ RC\ t + \beta 4\ LEVERAGE\ t + et$

Where: ROA- Return On Assets

$\beta 0$ – constant

B_1–β_4 are regression coefficients

BODCOMP - Board Composition

BS - Board Size

RC - Risk Committee

LEVERAGE - Leverage

Table 4.6: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.574[a]	.330	.269	.14698

a. Predictors: (Constant), LEVERAGE, BODCOMP, RC, BS

The model summary (Table 4.6) indicated that there was a weak positive relationship (R= 0.33) between the dependent and the independent variables. The value of R Square was 0.33 indicating that 33 % of the changes in ROA could be explained by the dependent variables for the study (board composition, board size, risk committee and leverage).

Table 4.1: Analysis of Variance (ANOVA)

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.467	4	.117	5.408	.001[b]
	Residual	.950	44	.022		
	Total	1.418	48			

a. Dependent Variable: ROA

b. Predictors: (Constant), LEVERAGE, BODCOMP, RC, BS

The Analysis of Variance (ANOVA) reveal that composite effect of the four variables (board composition, board size, risk committee and leverage) on financial performance (ROA) of insurance companies in Kenya is statistically significant as indicated by the low p values (0.001) i.e. less than 0.05 and high F value (5.408).

Table 4.2: Regression Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.963	.205		4.707	.000
	BODCOMP	-.030	.011	-.436	-2.795	.008
	BS	-.008	.017	-.080	-.485	.630
	RC	-.011	.026	-.053	-.418	.678
	LEVERAGE	-.486	.168	-.382	-2.901	.006

The regression model becomes:

ROAit = 0.963 - 0.030 BODCOMP t - 0.008BS t -.011 RC t - 0.486LEVERAGE t + et

From the regression analysis in Table 4.8 Constant = 0.963, shows that if all the independent variables (board composition, board size, risk committee and leverage) are all rated as zero, the financial performance (ROA) of insurance companies in Kenya would rate at 0.903.

The level of confidence for the analysis was set at 95%. Therefore, the P- value less than 0.05 imply that the independent variable is significant. The regression results show that financial performance (ROA) of insurance companies in Kenya is significantly influenced by board composition (p=0.008) and leverage (p=0.006).

However, the regression analysis shows that there is no significant relationship between financial performance (ROA) of insurance companies in Kenya and board size (p=0.63). Similarly, no significant relationship exist between financial performance (ROA) of insurance companies in Kenya and risk committee (p=0.678).

The nature of regression coefficients shows the type of relationship between the variables. Negative regression coefficients shows that an inverse relationship exist between independent and dependent variables. The independent variables in the regression model with positive coefficient have a direct relationship with the dependent variable. All the independent variables had negative regression coefficients. Therefore, increase in board composition, board size, risk committee and leverage lead to a decrease in financial performance (ROA) of insurance companies in Kenya.

4.7 Summary and Interpretation of Findings

The study established that, generally, a weak, negative but statistically significant correlation between financial performance (ROA) of insurance companies in Kenya and corporate governance (board composition, board size, risk committee and leverage) as indicated by a small R Square of 0.33 , p values 0.001 and high F value of 5.408. The study findings shows governance mix influence on the financial performance of insurance companies in Kenya. Whereas financial performance of insurance companies in Kenya are significantly influenced by board composition (the ratio of outside directors to total number of directors) and leverage (ratio of total liability to total assets), the performance is not significantly influenced by board size and the number of members of members in the risk committee.

The findings of the study are in agreement with the postulations that individual governance practices are examined, however, such as insider equity ownership (Dalton et al., 2003) or executive incentive compensation (Tosi et al., 2000), the link to performance returns becomes less evident. On the other hand corporate governance advocates and reformers claim that good governance policies are essential for high performance. Gompers et al., (2003) observe that if companies with good governance are rewarded by better stock performance. Companies whose cost of capital is lower will be motivated to make governance improvements.

Good corporate governance shields a firm from vulnerability to future financial distress (Bhagat, 2002). The argument has been advanced repeatedly that the governance structure of any corporate entity affects the firm's ability to respond to external factors that have some bearing on its financial performance. In this regard, it has been noted that well governed firms largely perform better and that good corporate governance is of essence to firm’s financial performance.

According to Demsetz and Villalonga, (2002), a well-functioning corporate governance system helps a firm to attract investment, raise funds and strengthen the foundation for firm financial performance.

It is believed that good governance generates investor goodwill and confidence. Again, poorly governed firms are expected to be less profitable. Claessens (2002) states that better corporate framework benefits firms through greater access to financing, lower cost of capital, better financial performance and more favorable treatment of all stakeholders. They argue that weak corporate governance does not only lead to poor firm financial performance and risky financing patterns, but are also conducive for macroeconomic crises like the 1997 East Asia crisis. Other researchers contend that good corporate governance is important for increasing investor confidence and market liquidity (Donaldson, 2003). Among the many claimants on firm's cash flows, equity shareholders have always claimed a special attention may be because of the residual nature of their claims. Parker (2007) paradigm of the separation of ownership and management's control explained that the agency problem occurs when the principal (shareholders) lack the necessary power/information to monitor and control the agent (manager) and when the compensation of the principal and the agent is not aligned.

In addition, Williams (2000), Drobetz et al. (2003) and Gemmill and Thomas (2004) concluded in their respective studies that there is a positive relationship between good corporate governance practices and firm value. A widely accepted statement is that good corporate governance results in a lower cost of capital. One explanation is that good corporate governance will lead to lower firm risk and subsequently to a lower cost of capital. The correlation of the governance index with performance could be explained in several different ways. One explanation, suggested by the results of other studies, is that inefficient governance directly causes additional agency costs.

If the market estimates these additional costs, then stock returns will drop (Faccio and Lasfer, 2000). An alternative explanation is that good governance is a signal or symptom of lower agency costs – a signal not properly incorporated in market prices (Baysinger and Butler, 1990). Each of these explanations has different economic implications for the source of agency problems and different policy implications for the regulation of governance. It would be interesting to see whether higher corporate valuations are associated with better-governed US companies, measured by our measure of corporate governance index (Baysinger and Hoskinsson, 1990).

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

The chapter presents summary of the study findings, conclusion and recommendations. The study investigated the effect of corporate governance on financial performance of insurance companies in Kenya. Specifically, the study investigated how performance (Return on Assets) is influenced by board composition, board size, risk committee and leverages.

5.2 Summary of Findings and Discussions

This section presents the summary of the study findings in line with the objective of the study. The reliability test indicated that study established a good internal consistency of the data (Cronbach's alpha $\alpha = 0.802$). The normality test revealed that the data used in the study had normal distribution (all the variables had skewness and kurtosis values less than 1).

The descriptive statistic indicated that the average Return on Assets (Amount of net income as a percentage of total assets/Earnings before tax divided by total assets of the Company) was 0.34 for the 49 insurance companies in Kenya. The average ratio of outside directors to total number of directors (BODCOMP) is 6.11 while the average board size (BS) was 8.1 members. The average number of members of Risk Committee (RC) was 3.71 and the average ratio of total liability to total assets (leverage) was 0.67.

In regard to inferential statistics, the correlation analysis indicated a weak and negative correlation between the dependent (ROA) and the independent variables (board composition (r=-

0.446), board size (r=-0.233), risk committee (r=-0.031) and leverage (r= 0.300) (the coefficients of correlations were less than 0.5 and negative in nature). Similarly, a small R Square of 0.33 indicate a weak relationship between the variables as 33 % of the changes in ROA could be explained by the dependent variables for the study (board composition, board size, risk committee and leverage).

However, the Analysis of Variance (ANOVA) reveal that composite effect of the four variables (board composition, board size, risk committee and leverage) on financial performance (ROA) of insurance companies in Kenya is statistically significant as indicated by the low p values (0.001) i.e. less than 0.05 and high F value (5.408). The significance was further explained by result of regression analysis which indicated that financial performance (ROA) of insurance companies in Kenya is significantly influenced by board composition (p=0.008) and leverage (p=0.006). On the other hand there is no significant relationship between financial performance (ROA) of insurance companies in Kenya and board size (p=0.63) and risk committee (p=0.678).

The negative nature of correlation was further supported by the results of regression analysis which revealed that an inverse relationship exist between independent and dependent variables. All the independent variables had negative regression coefficients. Therefore, increase in board composition, board size, risk committee and leverage lead to a decrease in financial performance (ROA) of insurance companies in Kenya.

5.3 Conclusions

The study concludes that corporate governance has mixed results on its influence on the financial performance of insurance companies in Kenya. Whereas financial performance of insurance companies in Kenya are significantly influenced by board composition (the ratio of outside

directors to total number of directors) and leverage (ratio of total liability to total assets), the performance is not significantly influenced by board size and the number of members of members in the risk committee.

Corporate governance metrics (board composition, board size, risk committee and leverages) among insurance companies in Kenya are inversely related to financial performance. Therefore increase in board composition, board size, risk committee and leverage lead to a decrease in financial performance (ROA) of insurance companies in Kenya. The study concludes that insurance companies in Kenya are yet to restructure corporate governance functions to maximize financial performance and gain competitive advantage in the market place.

5.4 Limitations of the Study

The study was limited by the fact that the performance is influenced by other economic variables such as the inflation rate, the interest rate, the level of the stock market and the exchange rate. Therefore, the analysis of the relationship between corporate governance on financial performance of insurance companies in Kenya is more comprehensive when the mediation effects of other variables affecting corporate governance and financial performance are included in the study.

The study was also limited to secondary data. The findings may be more comprehensive if primary data is collected to complement the secondary data. This would ensure a more comprehensive evaluation of the relationship between corporate governance on financial performance of insurance companies in Kenya.

The time available to conduct the research was limiting. The findings could have been more comprehensive if time was enough to collect primary data through interviews, questionnaires etc.

5.5 Recommendations

5.5.1 Policy Recommendations

The study recommends that insurance companies should review their policies regarding Corporate governance particularly practices influencing board size and the ratio of non Executive directors to Executive directors, number of members in the risk committee. Therefore, insurance companies need to consider board size and the number of members of members during policy formulation in order to improve performance.

The study recommends that majority of the members of a committee in insurance companies in Kenya be independent. The study established that the large committees have negative influence on the performance. A board committee should be set up with the sole purpose of facilitating the transaction of business by the board of directors and must not cause significant information required by all members of the board of directors only to be communicated to the board committee, or that the processing required in the board of directors be limited or omitted.

The study recommends a continuous monitoring and evaluation of the performance of the boards governing insurance companies in Kenya. Insurance companies should establish an evaluation procedure where contributions and results of the board of directors and the individual members, as well as collaboration with the executive board are annually evaluated. Significant changes deriving from the evaluation should be included in the management commentary or on the company's website.

5.5.2 Suggestion for further Study

The study suggests further research on key success factors that would maximize the contribution of corporate governance to financial performance of insurance companies in Kenya. The study would reveal the strengths, challenges and measure to solve the challenges that hider corporate governance from improving financial performance of insurance companies in Kenya.

The further study should be conducted using both primary and secondary data. This would ensure a more comprehensive evaluation of the relationship between corporate governance on financial performance of insurance companies in Kenya.

Enough time should be dedicated to the research because of various factors that should be investigated to ascertain effect on financial performance.

REFERENCES

Amba, S.M. (2014). Corporate governance and firms' financial performance, *journal of academic and business ethics unpublished*. Bahrain: New York Institute of Technology.

Association of Kenya Insurers (2012). *Insurance Industry Annual Report 2012*, Nairobi. Kenya.

Basel Committee (2006). "*Enhancing Corporate Governance for Banking Organization*" February, Bank for International Settlements, Basel.

Berle & Means (1932). *The Modern Corporation and Private Property*. New York: Macmillan.

BPP (2012). *Performance Management*. London: BPP Leaving Media.

Cadbury, A. (1992). *Report of the committee on the Financial Aspects of Corporate Governance*. London: Gee & Co. Ltd.

Chandaran, E. (2004). *Research methods: A qualitative approach*. Nairobi: Dayster University.

Cooper, D. & Schindler, P. (2003). *Business Research Methods.* (8th ed.). New Delhi: Tata McGraw Hill.

Davis and Cobb (2009). Resource Dependence Theory: Past and Future, Ross School of Business, University of Michigan Retrieved on 15/07/2014 from http://webuser.bus.umich.edu/gfdavis/Papers/davis_cobb_09_RSO.pdf

Donaldons, L. & Davis, J. H. (1991). 'Stewardship theory or agency theory: CEO governance and shareholders return' Australian *Journal of Management,* Vol. 16 No. 1, PP 49-64.

Drobetz, W. Schillhofer, A. Zimmermann, H. (2004). Corporate Governance and Expected stock Returns: Evidence from Germany'' *European Financial management,*

Fama & Jensen (1983). Separation of Ownership and Control, *Journal of law and economics* Vol. 88

Freeman, R. E. (1984). Strategic management: A stakeholder approach. Boston: Pitman.

Fmbutu, june (2012). Reasons for the Increasing Importance of Corporate Governance and Benefits of Good Corporate Governance retrieved on 11/06/2014 http://www.studymode.com/essays/Reasons-For-The-Increasing-Importance-Of-1023578.html

Gompers, P., Ishii, J., Metrick, A. (2003), Corporate Governance and equity prices, Quarterly Journal of Economics, 118, pp 107-155

Jensen, M.C & Meckling, W. (1976). "Theory of the Firm, managerial behavior, agency costs and capital structure," Journal of financial economics, Vol. 3 305-60.

Joppe, P. (2000). *Research Methodology*. (3rd ed.). London: Pearson publishers.

Kiel C. & Gavin N. J (2003). Board Composition and Corporate Governance Performance, how the Australian experience informs contrasting theories of corporate governance.

Kings report (2002) The King's report on corporate governance, south Africa retrived on 20/7/14 from Wikipedia.org/wiki/kingreportoncorporategovernance.

Kombo, K, D. & Tromp, A.L.D. (2006). *Proposal and thesis writing: An introduction*, Nairobi: Pauline Publications Africa.

Kothari, C. R. (2004). *Research Methodology: Methods and techniques.* (2nd ed.) New Delhi: New Age International.

Kotler, P. (2003). *Marketing management*, upper Saddle River (NJ): Pearson Education.

Lawrence D. B & Marcush G. (2004). *corporate governance and firm performance*, fox school of business, Temple University USA Available at SSRN. http/ssrn.com/abstract=586423

Mallin, C.A. (2013). *Corporate Governance*, (4th ed), United Kingdom: Oxford University Press.

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. 2(3).

Matam R. (2006). Corporate governance and financial performance of selected commercial banks in Uganda. Kampala: Makerere University Business School.

Mbogo, S. (2010). Insurance Companies Seek New Strategies to attract customers. Business daily, March 10.

Mugenda, O., & Mugenda A. G. (2003). *Research methods: Quantitative and qualitative approaches*. Nairobi, Kenya: Acts Press.

Najjar, N. (2012). The impact of corporate governance on the insurance firms in Bahrain. *International journal for learning and Development*(2).

Ndung'u, N. (2012). Developments in Kenya's Insurance industry. *Remarks at the launch of Continental Reinsurance brand and products, Nairobi. July 2012* Retrieved 21/07/2014 from http://www.bis.org/review/r120723f.pdf

Neuman, W.L. (2006). *Social research methods: Qualitative and Quantitative Approach*, (6th Ed.), Boston.

Nyamongo E.M & Temesgen. K. (2012). The effect of governance of performance of commercial Banks in Kenya: *a panel study: corporate governance* vol. 13 No. 3 236.

Ochieng, S. O. (2011). The relationship between corporate governance practices and performance of commercial banks in Kenya Retrived from http://evepository.uonbi.ac.ke:8080/handle/123456789/6137.

OECD (2004). OECD Principles of Corporate Governance, Paris.

Orodho, J. (1978). *Essentials of educational and social sciences research methods: Qualitative and Quantitative Approaches*. Nairobi: Acts Press.

Pfeffer, J. and Salancit G.R. (1978). The external control of organization: A resource dependence perspective.New York,NY: Harper and Row.

Porter, M.E. (1980).*Competitive Strategy*. New York: Free press.

PP Arya, BB. Tandon, AK Vashisht (2003). *Corporate Governance*. Chandigarh: University Business School, Panjab University.

Prerre-yves Gomez (2009). Economic Performance, corporate governance and the fragmentation of ownership, Cambridge University Press.

Prescott, J. (1986). "Environment as moderators of the relationship between strategy and performance" *Academy of management Journal*, 29, pp 329-346.

Sarbanes-oxley Act (2002), US Legislature, Washington, DC.

Scott M. & Koch, T.W, (2006). *Management of Banking* (6thed), Columbia: University of South Carolina.

Tura, H.A (2012). Overview of corporate governance in Ethiopia *Mizan Law review vol.* 6 No. 1 53.

Uma, S. (2003). *Research Methods for Business students: A skill building approach*, (4th ed.) john wiley & Sons.

Wanyama D. W & Olweny T (2013). Effects of Corporate governance on financial performance of listed insurance firms in Kenya, *public policy and administration research* Vol. 3 retrieved on 20/7/14 from www.slideshare.net/Alexanderpecker/effects

Weiner, N., Mahoney, T. (1981). “A model of corporate performance as a function of environmental, organization, and leadership influences” *Academy of management Journal*, 24, pp. 14-26

Wet J.H (2012) Executive Compensation and the EVA & MUA Performance of South Africa listed companies, *Southern Africa’s Business Review* L6 No. 3 16.

Williamsons, O. E. (1981). The ecomonics of organization: The transaction cost approach, The ammerican Journal of sociology, 87(3), pp. 548-77

APPENDICES

Appendix I: Licensed Insurance Companies in Kenya for the Year 2013

	Board composition	Board size	Risk committee	lever age	Return on Assets
1. AAR Insurance Kenya Limited	7:1	8	3	0.58	0.61
2. Africa Merchant Assurance Company Limited	5:1	6	4	0.78	0.37
3. AIG Kenya Insurance Company Limited	7:1	8	3	0.63	0.164
4. APA Insurance Limited	3:4	7	4	0.71	0.38
5. APA Life Assurance Limited	7:1	8	3	0.83	0.077
6. British American Insurance Company	10:1	11	2	0.63	0.164
7. Cannon Assurance Company Limited	5:1	6	4	0.78	0.37
8. CFC Life Assurance Limited	7:1	8	4	0.9	0.07
9. CIC General Insurance Limited	4:3	7	4	0.73	0.61
10. CIC Life Assurance Limited	4:3	7	3	0.58	0.53
11. Continental Reinsurance Limited	7:2	9	6	0.42	0.5
12. Corporate Insurance Company	7:1	8	3	0.58	0.53
13. Directline Assurance Company Limited	5:1	6	4	0.78	0.37

14. East Africa Reinsurance Company	10:1	11	6	0.357	0.22
15. Fidelity Shield Insurance Company	7:1	8	3	0.58	0.61
16. First Assurance Company	5:1	6	4	0.78	0.37
17. GA Life Assurance Limited	6:1	7	4	0.78	0.2
18. GA Insurance Limited	6:1	7	4	0.78	0.2
19. Gateway Insurance Company Ltd	7:1	8	2	0.66	0.23
20. Geminia Insurance Company	7:2	9	4	0.62	0.32
21. ICEA LION General Insurance Company	8:1	9	5	0.74	0.26
22. ICEA LION Life Assurance Company	7:1	8	3	0.83	0.58
23. Intra Africa Insurance Company Ltd	4:3	7	4	0.73	0.61
24. Invesco Assurance Company Limited	4:3	7	4	0.73	0.64
25. Kenindia Assurance Company Limited	9:1	10	4	0.93	0.067
26. Kenya Orient Insurance Limited	5:1	6	3	0.71	0.58
27. Kenya Reinsurance Corporation Limited	10:1	11	6	0.36	0.3
28. Madison Insurance Company	6:1	7	4	0.72	0.2

Limited					
29. Mayfair Insurance Company Limited	6:1	7	4	0.62	0.24
30. Mercantile Insurance Company Limited	5:1	6	3	0.62	0.179
31. Metropolitan Life Insurance Company	8:1	9	4	0.92	0.1
32. Occidental Corpany Limited	7:1	8	3	0.61	0.43
33. Old Mutual Life Assurance Company Limited	8:1	9	4	0.92	0.1
34. Pacis Insurance Company Limited	9:2	11	3	0.58	0.387
35. Pan Africa Life Assurance Limited	8:1	9	4	0.8	0.2
36. Phoenix of East Africa Insurance Company Limited	6:1	7	3	0.63	0.164
37. Pioneer Assurance Company Limited	7:1	8	4	0.77	0.48
38. Real Insurance Company Limited	7:1	8	4	0.77	0.48
39. Resolution Insurance Company Limited	7:1	8	4	0.58	0.61
40. Takaful Insurance of Africa Limited	7:1	8	3	0.52	0.49

41. Tausi Insurance Company Limited	6:1	7	4	0.62	0.24
42. The Heritage Insurance Company	6:2	8	4	0.77	0.28
43. The Jubilee Insurance Company Limited	8:1	9	3	0.8	0.16
44. The Kenya Alliance Insurance Company	9:2	11	3	0.58	0.38
45. The Monarch Insurance Company	5:1	6	3	0.61	0.41
46. Trident Insurance Company Limited	7:1	8	4	0.52	0.49
47. UAP Life Assurance Company Limited	11:1	12	4	0.54	0.27
48. UAP Insurance Company	11:1	12	4	0.54	0.27
49. Xplico Insurance Company Limited	5:1	6	3	0.58	0.22

(Source: IRA website)

Appendix 2: Summary for terms of measurement

Variables	**Terms of measurement**
Board composition (BODCOMP)	Ratio of outside directors to total number of directors
Board size (BS)	Board size
Risk committee (RC)	Number of members of Risk committee
leverage (LEVERAGE)	Ratio of total liability to total assets
Return on Assets (ROA)	Amount of net income as a percentage of total assets/Earnings before tax divided by total assets of the Company

(Source: Wanyama and Olweny, 2013)