EFFECT OF CORPORATE GOVERNANCE ON SHARE RETURN OF COMPANIES LISTED IN NAIROBI SECURITIES EXCHANGE

PRESENTED BY

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DECLARATION

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

Signature……………………..Date………………

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

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DEDICATION

To my dear wife Elizabeth Wanjiru , my child Gabriel Wachira for their continued support and encouragement.

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ABSTRACT

The main objective of this study was to investigate the effects of Corporate Governance on the share returns of listed companies at (NSE). Specifically, this study examined board composition being the ratio of non executive directors, presence of audit committee, CEO duality and how they affect the share returns of listed Companies at (NSE). Firm performance was measured using Earning per Share (EPS) and Dividend Yield (DY).

Secondary data were collected using documentary information from Company annual accounts for the period 2010 to 2013. Both descriptive and inferential statistics were used. Data was analyzed using a multiple linear regression model descriptive statistics included mean and standard deviation. Data was also presented by use of tables. Regression analysis was also used to show the sensitivity of share return to various independent variables.

The population involved in this study was all the 61 companies listed at Nairobi Securities Exchange. A sample ratio of 0.32 was used to obtain sample representation of the entire population. Statistical Package for Social Scientists (SPSS) was used and Spearman Correlation Coefficient and Multiple Regression Analysis to determine the magnitude of the relationship and prediction of share returns respectively were applied. A unit increase in independent director Board Size would lead to increase in share return of companies by a factor of 7.22, unit increase in Audit committee would lead to increase in Share return of companies by a factor of 0.716, a unit increase in EPS would lead to increase in share return of companies by a factor of 1.213 and unit increase in Dividend Yield would lead to increase in return on share by a factor of 1.762. Following the study findings it was possible to conclude that all the five variables the independent variables had an effect on a company's share return. The independent directors monitor and control activities of the executive while the audit committee ensures that the executive B.O.D makes decision based on current financial information. The post of the CEO should be fulltime and should have no duality. Regression results indicated that there was a positive and significant relationship between independent directors, Audit committee and CEO's dual role as a company's chairman on share return. The study recommended that the firm should have non executive directors who constitute at least one third of the board, an Audit committee and separation of CEO and chairman of the board.

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LIST OF ABBREVIATIONS

CMA: Capital Market Authority

DPS: Dividend per Share

DY: Dividend Yield

EBIT: Earnings before Interest and Tax

EPS: Earnings per Share

NSE: Nairobi Securities Exchange

ROA: Return on Asset

ROCE: Return on Capital Employed

ROE: Return on Equity

SPSS: Statistical Package for Social Science

CHAPTER ONE

INTRODUCTION

1.1 Background to the study

This study investigates the relationship between the corporate governance structure and share performance of 55 companies listed on the Nairobi Securities Exchange (NSE). Governance is concerned with structures and processes for decision making, accountability, control and behaviour at the top of organizations. Corporate governance is a concept that involves practices that entail the organization of management and control of companies. Corporate governance is the means by which an organisation is directed and controlled. In broad terms, corporate governance refers to the processes by which organizations are directed, controlled and held accountable.

1.1.1 Corporate Governance

Since 2001, Enron Xerox, WorldCom had been caught of getting involved in accounting scandals, which leads to the credibility of corporate financial reports under suspicion, furthermore, shocking investors' confidence. Consequently, corporate governance mechanism has been a crucial issue discussed again. Sarbanes-Oxley Act was enacted in 2002 to enhance corporate government mechanism which is viewed as the priority of financial revolution, in the expectation that governance mechanism may be reinforced, public confidence retrieved, accuracy and reliability of financial information assured.

The relevance of corporate governance remains fairly established following the collapse of several organizations. It is recognized to play an important role in the management of organizations in both developing and developed countries. Indeed, the significance of corporate governance has increased with the separation of control from ownership in companies that are publicly held due to the conflict of interest that may arise between agents and principals (Clarke, 2007).

Therefore, corporate governance is intended at safeguarding the interests of the principals from agents. Nonetheless, strong corporate governance does not only establish and maintain good corporate culture that inspires the management to make decisions that maximize the wealth of shareholders but it also ensures efficient management of a firm's resources (Wambua, 2010).

Adams &Mehran, (2003) define corporate governance as "the mechanism through which stakeholders (shareholders, creditors, employees, clients, suppliers, the government and

the society, in general) monitor the management and insiders to safeguard their own interests." Morin and Jarrel (2001) define it as follows: "It is a framework through which monitors and safeguards the concerned actors in the market (managers, staff, clients, shareholders, suppliers and the board of administration." It is management through which the company is guided and monitored for the purpose of striking a balance between its interests, on the one hand, and the interests of other related parties such as investors, lenders, suppliers and clients in addition to the environment and society."

1.1.2   Share returns

This term is also used as a general measure of a firm's overall financial health over a given period of time, and can be used to compare similar firms across the same industry or to compare industries or sectors in aggregation. There are many different ways to measure share return 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.

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

value of debt/total of assets - in book value -), whereas financial reporting perspective was measured by ROE and Return on investment (net result + interest) / (equity +total debt).

1.1.3 Corporate Governance and Share returns Performance of Listed Companies

In spite of the generally accepted notion that effective corporate governance enhances firms'

Share performance, other studies have reported negative relationship between corporate governance and firm performance (Bathala and Rao, 1995) or have not found any relationship (Singh and Davidson, 2003; Young, 2003). Several explanations have been given to account for these apparent inconsistencies. Some have argued that the problem lies in the use of either publicly available data or survey data as these sources are generally restricted in scope. It has also been pointed out that the nature of performance measures (i.e. restrictive use of accounting based measures such as return on assets (ROA), return on equity (ROE), return on capital employed (ROCE) or restrictive use of Market based measures (such as market value of equities) could also contribute to this inconsistency (Gani and Jermias, 2006).

Performance refers to the accomplishment of a given task measured against pre set standards of accuracy, completeness, cost, and speed. In other words, it refers to the degree to which an achievement is being or has been accomplished. In the words of Frich Kohlar(2008) "The performance is a general term applied to a part or to all the conducts of activities of an organization over a period of time often with reference to past or projected cost efficiency, management responsibility or accountability or the like.

1.1.4 Firms listed at Nairobi Securities Exchange

The Nairobi Securities Exchange (NSE) was founded in 1954 and is Kenya's only stock exchange. It has traditionally been a mutual organization owned by its member brokers, but is now in the final phases of demutualization. The NSE has recently played relatively little role in the oversight of listed companies and brokers.

Exchange comprises approximately 55 listed companies with a daily trading volume of over United States Dollar (USD) 5 million and a total market capitalization of approximately USD 15 billion. Aside from equities, Government and corporate bonds are also traded on the Nairobi

Stock Exchange. Automated bond trading started in November 2009 with the KES 25 billion KenGen bond. Average bond daily trading is USD 60m. Trading hours are from 09:00 to 15:00. Delivery and settlement is done scrip less via an electronic Central Depository System (CDS) which was installed in 2005. Settlement is currently T+4, but moving to T+3, on a delivery-vs.-payment basis. The daily price movement for any security in a single trading session shall not be more than 10% except during major corporate announcements.

The Nairobi Stock Exchange in 2006 introduced an Automated Trading System (ATS) which ensures that orders are matched automatically and are executed on a first come/first serve basis. The ATS has now been linked to the Central Bank of Kenya and the CDS thereby allowing electronic trading of Government bonds. Short selling and same day turn-around trades are not permitted. Aggregate foreign ownership limit of NSE listed companies is 75%. Almost all NSE listed companies are open to additional foreign investment, including multinational subsidiaries

1.2 Research problem

Strong corporate governance is important especially with the current global financial crisis in order to ensure good financial management and to deal with uncertainties that characterize future business occurrences. Efficient financial management is a vital aspect of creating competitive advantage and it requires a firm to make good decisions regarding long-term and short-term capital and to maintain solvency and liquidity.

Corporate governance has received much attention in the accounting literature, with studies focusing on the impact of corporate governance and the share returns of the firm. Brown and Caylor (2004) provide insights to relationships between good corporate governance and corporate performance. Research indicates that companies with better corporate governance guarantee, the payback to the shareholder and limit the risk of the investment.

The association between quality of corporate governance and firms' profitability is quite major focus in corporate governance studies, but one cannot predict much on the direction as prior literatures show mixed results. Jensen and Meckling (1976) have proven that better-governed firms might have more efficient operations, resulting in a higher expected future cash-flow

stream. Klapper and Love (2003) that use return on assets as measure for performance found evidence that firms with better governance have higher operating performance.

Contrast results are seen in Gompers et al. (2003) who found no significant relationship between firms governance and operating performance. Eisenberg et al. (1998) also find negative correlation between board size and profitability when using sample of small and midsize Finnish firms. Mak and Yuanto (2003) re-echo the above findings in firms listed in Singapore and Malaysia when they found that firm valuation is highest when a board has five directors, a number considered relatively small in those markets. According to Cho and Kim (2003), company would enhance their corporate governance when the company's performance is poor because changes in corporate governance structure are expected to bring out positive result on their performance.

The need to optimize shareholders wealth requires corporate governance mechanisms to focus on enhancing the economic efficiency of a firm. Miringu and Muoria (2011) emphasize that the governance structure of any firm affects its ability to deal with external factors and it has an impact on its share returns, Uwuigbe, Olubukunola Ranti (2013) observed that most companies in Nigeria adopt corporate governance without really knowing the resultant effect on share return. However, well governed firms have been noted to record better performance hence good corporate governance is core in enhancing shareholders value.

In this regard, Achchuthan and Kajananthan (2013) argue that corporate governance practices are strategies which are formulated in order to meet the short, medium and long term objectives of a firm as well as those of the shareholders. Subsequently Samuel O. Oyieke (2014) found out that nationality, experience, lagged values of performance variables have positive effect on performance.

Despite tight regulatory framework, the reputation of Kenya's Capital Markets Authority has been put to test in the recent past due to corporate governance lapses leading to scandals in several listed companies The Corporate Governance Steering Committee (2014), Corporate Governance continues to weaken in Kenya (Mang'unyi, 2011). According to Muriithi, (2009), many companies have been characterized by scandals, this is not unique in Kenya only, but also in developed economies a case in time being Lehman Brothers collapse on 15 September 2008

under the very watch of Institute of Management Accountant of US and after enactment of Sarbanes-Oxley Act.

Directors have acted illegally or in bad faith towards their shareholders. Indeed, the Insurance Regulatory Authority identified poor Corporate Governance in insurance Companies as one of the threats to achieving its strategic plan 2008-2012. This is worrying especially in the banking and insurance sector since the industry has witnessed in the past, the collapse of firms such as Kenya National Assurance Company, Euro Bank, Lake Star Assurance Company, Standard Assurance, Trade Bank, Stallion Insurance, Nyaga Stock Brokers and Blue Shield Insurance Company and as well as other sectors where Uchumi Ltd, East Africa Portland cement, CMC Motors have had their own share of board room woes and almost ruining the companies.

Even though corporate governance principles have always been important for getting good rating scores for large and publicly-held companies, they are also becoming much more important for investors, potential investors, creditors and governments (Gompers et al., 2001). Corporate governance therefore, receives high priority on the agenda of policymakers, financial institutions, investors, companies and academics (Heracleous, 2001). A number of studies have sought to investigate the relation between corporate governance mechanisms and share returns (e.g. Berglof, von Thadden, 1999) Most of the studies have shown mixed results without a clear-cut relationship. E.g. a study by Becht et al., (2002) show that corporate governance practices positively influences the profitability of the organization while MacAvoy and Millstein (2003) found that board composition does not have any effect on share returns. Further, the limited studies in the area have focused mainly on developed economies (Becht et al., 2002). It is crucial to examine the relationship in the context of a developing economy.

Locally, Jebet (2001) conducted a study of corporate governances the case of quoted companies in Kenya, Muriithi (2005) did a study on the relationship between corporate governance mechanisms and performance of firms quoted on the NSE, Manyuru (2005) researched on corporate governance and organizational performance the case of companies quoted at the NSE while Matengo (2008) did a study on the relationship between corporate governance practices and performance.

This study focuses on the impact of corporate governance on share return of the listed companies at NSE which has been avoided by a number of scholars.

1.3 Research Objective

The general objective of this study is to investigate the relationship between corporate governance and the share return of the firms listed at Nairobi Securities Exchange.

1.4 Value of the Study

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

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

The policy makers especially C.M.A would obtain knowledge of the various firm dynamics and the responses that are appropriate.

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

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter summarizes the information from other researchers who have carried out their research in the same field of study. The specific areas covered here are theoretical review, Shareholder theory, Stakeholders theory, Agency theory, corporate governance, relationship between corporate governance and share returns, separation of ownership and control, board size and composition and share returns, independence of directors, independence of committees, empirical review, conclusion and conceptual framework.

2.2 Theoretical Review

This section contains review of theories relevant to the study

2.2.1 Agency Theory

Corporate governance is based on agency theory, which is the relationship between agents and principals. Agency theory explains how best the relationship between agents and principals can be tapped for purposes of governing a corporation to realize its goals. Interest on agency relationships became more prominent with the emergence of the large corporation.

There are entrepreneurs who have a knack for accumulation of capital, and managers who had a surplus of ideas to effectively use that capital. Since the owners of capital (principals) have neither the requisite expertise nor time to effectively run their enterprises, they hand them over to agents (managers) for control and day-to-day operations, hence, the separation of ownership from control, and the attendant agency problems. In an agency relationship, principals and agents have clearly defined responsibilities: Principals are select and put in place governors (directors and auditors to ensure effective governance system is implemented, while agents are responsible for the day-to-day operations of the enterprise.

Historically, definitions of corporate governance also took into consideration the relationship between the shareholder and the company, as per "agency theory", i.e. director-agents acting on

behalf of shareholder-principles in overseeing self-serving behaviors of management. However, broader definitions of corporate governance are now attracting greater attention (Solomon and Solomon, 2004). Indeed, effective corporate governance is currently understood as involving a wide number of participants. The primary participants are management, shareholders and the boards of directors, but other key players whose interests are affected by the corporation are employees, suppliers, customers, partners and the general community.

Therefore, corporate governance, understood in these broadening social contexts, ensures that the board of directors is accountable not only to shareholders but also to non-shareholder stakeholders, including those who have a vested interest in seeing that the corporation is well governed. Some corporate governance scholars (Carter and Lorsch, 2004; Leblanc and Gillies, 2005) also argue that at the heart of good corporate governance is not board structure (which receives a lot of attention in the current regulations), but instead board process (especially consideration of how board members work together as a group and the competencies and behaviors both at the board level and the level of individual directors). As a result, the current scholarly discourse about the nature of corporate governance has come to reflect this body of research.

This separation is however, linked and governed through proper "agency relationship" at various levels, among others "between shareholders and boards of directors, between boards and senior management, between senior and subordinate levels of management" (ISDA, 2002). In such a principal-agent relationship, there is always "inherent potential for conflicts within a firm because the economic incentives faced by the agents are often different from those faced by the principals" (ISDA, 2002). According to ISDA (2002), all companies are exposed to agency problems, and to some extent develop action plans to deal with them. These include establishing such measures as: "controls on the actions of agents, monitoring the actions of agents, financial incentives to encourage agents to act in the interest of the principals, and separation of risk taking functions from control functions" (ISDA, 2002).

2.2.2 Stakeholders Theory

There are two main theories of stakeholder governance: the abuse of executive power model and the stakeholder model. Current Anglo-American corporate governance arrangements vest excessive power in the hands of management who may abuse it to serve their own interest at the expense of shareholders and society as a whole (Hutton, 1995). Supporters of such a view argue that the current institutional restraints on managerial behavior, such as non-executive directors, the audit process, the threat of takeover, are simply inadequate to prevent managers abusing corporate power.

Shareholders protected by liquid asset markets are uninterested in all but the most substantial of abuses. Incentive mechanisms, such as share options, are means through which managers can legitimize their abnormal overpayment (viewed by some as a symptom of the breakdown of governance (Keasey et al., 1997). The abuse of executive power is particularly embedded in the problem of executive overpay since executive remuneration has risen far faster than average earnings and there is at best a very weak link between compensation and management performance (Conyon et al., 1995; Gregg et al., 1993).

The only restraint on executive pay seems to be the modesty of executives themselves, and the creation of so-called independent remuneration committees by large companies is not effective. What is worse is that it legitimizes self-serving managerial behaviors.

2.2.3 Shareholder Theory

There are two main theories of shareholder-oriented governance: the principal-agent or finance model and the myopic market model. The principal-agent model starts from an assumption that the social purpose of corporations is to maximize shareholders' wealth (Coelho et al., 2003; Friedman, 1970). The principal-agent model regards the central problem of corporate governance as self-interested managerial behavior in a universal principal-agent relationship.

Agency problems arise when the agent does not share the principal's objectives. Furthermore, the separation of ownership and control increases the power of professional managers and leaves

them free to pursue their own aims and serve their own interests at the expense of shareholders (Berle and Means, 1932).

There are two problems occurring in the agency relationship with which agency theory is concerned.

The first is that because it is difficult or expensive for the principal to verify what the agent is actually doing, the principal cannot verify that the agent has behaved appropriately.

The second problem is that the principal and the agent may prefer different actions because of the different attitudes toward risk (Eisenhardt, 1989).

Those two problems bring about a particular type of management cost incurred as principals attempt to ensure that agents act in principals' interests: "agency cost" (Jensen and Mechling, 1976). To solve those problems, agency theory must determine the most efficient contract governing the principal-agent relationship and an optimal incentive scheme to align the behaviour of the mangers with the interest of owners. While the principal-agent model agrees upon the failure of corporate internal control, it denies the inherent failure of market mechanisms, insisting that markets are the most effective regulators of managerial discretion, the so-called "efficient market model" (Blair, 1995).

The myopic market model shares a common view with the principal-agent model that the corporation should serve the shareholders' interests only, but criticises that the Anglo-American model of corporate governance because of "competitive myopia" (Hayes and Abernathy, 1980) and its consequent pre-occupation with short-term gains in return, profit, stock price and other performance measures induced by market pressures. The myopic market model holds that what is wrong with corporate governance is that the system encourages managers to focus on short-term performance by sacrificing long-term value and competitiveness of the corporation. The financial markets often force managers to behave in a way divergent from the maximization of long-term wealth for shareholders (Blair, 1995). The myopic market view contends that corporate governance reform should provide an environment in which shareholders and managers are encouraged to share long-term performance horizons.

Shareholders' loyalty and voice should increase, whereas the ease of shareholders' exit should reduce. Policy proposals for the reform include the encouragement of "relationship investing" to lock financial institutions into long-term positions, restrictions on the takeover process and on voting rights for short-term shareholders, and the empowerment of other groups such as employees and suppliers that have long-term relationships with the firm (Keasey et al., 1997).

2.3 The Determinants of Share returns in Listed Companies

The sectoral and economic wide effect of corporate governance may ultimately be reflected in the stock prices. Policy makers, economists, business owners, regulators and the Kenyan public are grappling with figuring out the relationship of stock prices and corporate governance.

Matolcsy & Wright (2011) measured firm performance by ROA, ROE. Yasser et al. (2011) used return on equity (ROE) and profit margin (PM) for the measurement of share return performance. Market based measures of companies' performance were done by Shah et al. (2011) by Market value of equity divided by book value of equity and Tobin's Q.

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

Corporate governance should ensure that the management is willing and able to lead a company to fulfill its goals towards the shareholders and other stakeholders (Kleinsschnmidt, 2007). This implies that the selection of proficient managers as well as aligning managers towards maximizing shareholders wealth depends on the ability of a company to adopt good corporate governance.

 Saad (2010) notes that an efficient corporate governance should ensure that the selection of new CEOs and managers is transparent and formal. To do this, an organization must set-up a special

committee of the board in order to ensure that candidates with the required abilities, qualifications and experiences are selected.

According to Ongore and K'Oboyo (2011) corporate governance systems in the world are now well documented. This is due to the significant transformations that have occurred in the area of corporate governance in the past two decades due to low corporate profits as well as the collapse of many companies. Additionally, abuse of power by the top management has been perceived as the main cause of corporate failures hence the increased focus on the role of board of directors. The current debate on corporate governance is mainly focused on the powers of the board as opposed to the discretion of the management in making decisions. Furthermore, governments' play the role of regulating corporations hence boards must ensure that they comply with the laid down regulations.

2.4 Empirical Studies

Kenyan legal system plays an important role in determining the success of corporate governance system in the country. Nevertheless, the recent movement towards privatization of public corporations has made the country to adopt codes of corporate governance that were drafted from a combination of codes from countries which are considered to be well developed (Musikali, 2008). Financial scandals like Anglo-Leasing and Goldenberg have indicated that the country cannot effectively regulate its corporations due to inefficiencies in its legal system. Therefore, corporate governance in the country is based on codes drafted from countries with strong legal systems and corporate structures.

Wanjiku (2011) carried out a study to establish the Corporate Governance practices of firms and its relationship with the growth of Companies listed at the Nairobi Securities Exchange using a causal comparative research design. The study focused on corporate communication, leadership and technology application. The study found a positive linear dependence of growth and Corporate Governance

According to Ongore and K'Obonyo (2011) board composition and processes should be accountable to the shareholders by ensuring effective monitoring and strategic guidance of a

company. Additionally, the composition of the board should ensure that it is able to keenly guide the company and supervise management.

Mang'unyi (2011) carried out a study to explore the ownership structure and Corporate Governance and its effects on performance of firms. His study focused on selected banks in Kenya. His study revealed that there was significant different between Corporate Governance and share returns of banks. The study recommended that corporate entities should promote Corporate Governance to send positive signals to potential investors and those regulatory agencies including the government should promote and socialize Corporate Governance and its relationship to firm performance across firms.

Miring'u and Muoria (2011) analyzed the effects of Corporate Governance on performance of commercial state corporations in Kenya. Using a descriptive study design, the study sampled 30 SCs out of 41 state corporations in Kenya and studied the relationship between share returns, board composition and size. The study found a positive relationship between Return on Equity (ROE) and board compositions of all State Corporations.

Wanjau (2007) notes that for the board to be able to supervise the actions of the management and to direct the company it must be provided with sufficient independence. This can be achieved by having some members in the board who are not part of the management of the company and have no relationship with other stakeholders.

Boards consisting individual members are important elements of corporate governance. This is because they assist in ensuring that all the necessary qualifications for an efficient board are available. Furthermore, the internal structure of a board plays a significant role in ensuring effective corporate governance (Machuki and Oketch, 2010). Board members should be divided into sub-committees in order to enable them tackle specific goals. Moreover, the board should make sure that individuals in a corporation exercise their duties efficiently and effectively. This requires the board to hold frequent meetings, set agendas for the company and obtain the necessary information so as to determine which issues the board should give preference.

In theory, good corporate governance should be related to high-corporate valuation. A number of empirical studies have found that investors are willing to pay a premium averaging 10-12 percent

for good corporate governance (Monks and Minow, 2004). 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.

In a Nigerian study, Sanda et al. (2003) found that firm performance is positively related with small, as opposed to large boards. Since the duties of the Supervisory Committee are largely technical, it would be appropriate if at least one of the people elected to it has some experience or training in auditing or book-keeping. It is from whoever has some knowledge that the other members of the committee can be guided.

John and Senbet (1998) report empirical evidence showing that the presence of monitoring committees (audit, nomination, and compensation committees) is positively related to factors associated with the benefits of monitoring. However, the presence of insiders in the compensation committees increases the probability of making decisions in favor of the CEO's interests (Newman and Mozes, 1999).

Corporate governance mechanisms assure investors in corporations that they will receive adequate returns on their investments (Shleifer and Vishny, 1997). If these mechanisms did not exist or did not function properly, outside investors would not lend to firms or buy their equity securities. Overall, economic performance would likely suffer because many good business opportunities would be missed and temporary financial problems at individual firms would spread quickly to other firms, employees and consumers. Previous evidence suggests that corporate governance has a positive influence over corporate performance.

Research has shown that companies with a higher corporate governance (based on developed indices) were performing better and had higher market value or Tobin's q (Bauer and Guenster, 2003; Beiner et al., 2004; Schmidt and Zimmermann, 2004). Moreover, a portfolio of companies with better corporate governance delivered a 2.1 per cent higher return as compared with companies of poor corporate governance (Bauer and Guenster, 2003)

2.5 Summary of Literature Review

Good Corporate Governance is of paramount importance in all organizations regardless of their industry, size or level of growth. Even the best run organizations it was further observed need good Corporate Governance as it sets the Tone at the Top, which in turn influences what transpires at the lower levels. A good practice that organizations including listed companies should consider adopting is the conduct of regular Corporate Governance Audits. Good Corporate Governance has a positive economic impact on the Institution in question as it saves the organization from various losses e.g. those occasioned by frauds, corruption and similar irregularities. Besides it also spurs entrepreneurial enabling the organization to better seize the economic opportunities that come its way. The main corporate governance themes that are currently receiving attention are adequately separating management from the board to ensure that the board is directing and supervising management, including separating the chairperson and chief executive roles; ensuring that the board has an effective mix of independent and non-independent directors; and establishing the independence of the auditor and therefore the of financial reporting, including establishing an audit committee of the board. Good Corporate Governance aims at increasing profitability and efficiency of organizations and their enhanced ability to create wealth for shareholders, increased employment opportunities with better terms for workers and benefits to stakeholders. Indicators of Good Corporate Governance identified in the study include independent directors, independence of committees, board size, split chairman/CEO roles and the board meetings. Thus, the main tasks of corporate governance refer to: assuring corporate efficiency and mitigating arising conflicts providing for transparency and legitimacy of corporate activity, lowering risk for investments and providing high returns for investors and delivering framework for managerial accountability.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

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

3.2 Research Design

The design is more appropriate as it enabled respondents to give their relevant information on the issue of interest to the study, (Cooper & Schindler, 2003).Kumar, (2005) defined a research design as a procedural plan that is adopted by the researcher to answer questions validly, objectively, accurately and economically. A research design helps a researcher to conceptualize an operational plan to undertake the various procedures and tasks required to complete the study and to ensure that these procedures are adequate to obtain valid, objective and accurate answers to the research questions.

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

3.3 Population

A population refers to an entire group of individuals, events or objects having common observable characteristics (Mugenda and Mugenda, 2003). Target population is defined as a computed set of individuals, cases or objects with some common observable characteristics of a particular nature distinct from other population. According to Ngechu (2004), a population is a well-defined or set of people, services, elements, and events, group of things or households that are being investigated. The population was made up of all the 61 companies listed in the NSE.

3.4 Sample

A sample is a small group obtained from accessible population, (Mugenda & Mugenda, (2003). Sampling is the procedure a researcher uses to gather people, places or things to study, (Kombo & Tromp, 2006). The purposive sampling was used to get appropriateness and required sample because it is a technique that allows a researcher to use cases that the required information with respect to the objective (Mugenda 2003).The sample of 20 listed companies was appropriate.

3.5 Data Collection

Secondary data was collected from published annual reports and websites of the selected Companies. The secondary data provided a reliable source of the information needed by researcher to investigate the phenomenon and seek efficient ways for problem solving situations (Uma, 2003) Specifically the data was collected from the portion expounding on corporate information, statement of Corporate Governance as well as the directors' profile. Data on share returns was collected from final statements such as balance sheets, statements of cash flows, statements of changes in equity and statements of comprehensive incomes provided in the cash flows. Secondary data was easy to collect owing to the ease of availability. The period of study was from 2010 to 2013 financial year.

3.5.1 Data Validity and Reliability

An instrument is considered reliable if the results of a study can be reproduced under a similar methodology (Joppe 2000). Reliability is therefore the extent to which measures yield consistent results (Zikmund 2000). To be considered reliable, the measuring instrument must be free of errors and the results or observations must be replicable or repeatable (Joppe, 2000).

The consistency or reliability implied in the research instrument relates to three issues namely (1) the degree to which a measurement, given repeatedly, remains the same (2) stability of a measurement over time and (3) the similarity of measurements within a given time period (Kirk and Miller 1986). Reliability of a measuring instrument is established by determining the association between the scores obtained from different administrations of the instrument (Joppe, 2000). An instrument is considered reliable if the degree of association is high. Validity of the measuring instrument determines whether the research truly measures that which it was intended to measure or how truthful the research results are (Joppe 2000, Jones 1993, Smit 1991). Validity thus involves ascertaining whether the means of measurement are accurate and whether they are actually capturing the variable.

3.6 Data Analysis

Both quantitative and qualitative analysis data were obtained from the study. For quantitative data, analyze it for and the statistical package for social science (SPSS) was used to tabulate and analyze the data. Percentages, means and frequency distribution tables were used to describe the data. Percentages, means and frequency distribution tables were used to describe the sample. Relationships between the independent and dependent variables were established by means of regression analysis.

3.6.1 Model Specification

Multiple regressions model was used. Hair, Black, Babin, Anderson and Tatham (2006:209) claimed that multiple regressions are the best method used to predict multivariate association. This study will employ the following model;

$$Y = \beta o + \beta 1X1 + \beta 2X2 + \beta 3X3 + \beta 4X4 + \beta 5X5 + \mu$$

Where:

Y= share return (Dependent variable)

X1= EPS

X2= NED

X3= DY

X4= AUDIT COMMITTEE

X5= CEO DUALITY

β_o = Coefficient of parameters

$\beta1$= Slope of the regression line; incremental change in share return per unit change in EPS ratio.

B2, $\beta3$, $\beta4$ $\beta5$= Incremental change in share return per unit change in number of NED, DY, Audit Committee and CEO duality.

μ= Error Term

Y= Share return; which is the price at which one unit of a company's stock is sold. The share return is calculated by adding up the daily average share returns of the companies under study and dividing the result by the number of days the shares are traded.

EPS= Earnings per share; which represents how much money shareholders would receive for each share of stock they own if the company distributed all of its net income for the period. This is obtained from the annual reports of the companies under study.

NED= represents independent Board Size; the terms of measurement was the number of non executive directors to total number of directors on the board.

The strength of the independent variables was tested at a p value of 0.05. This implies that independent variables with a p value of less than 0.05 were declared to have a significant effect on the share return.

The R squared (coefficient of determination) was checked to reveal the goodness of fit of the model. The analysis of variance (ANOVA) was checked to reveal the overall model significance. In particular, the calculated f statistic was compared with the tabulated f statistics. A critical p value of 0.05 was also used to determine whether the overall model is significant or not. The individual regression coefficients were checked to see whether the independent variables (Earning per Share, Non executive directors, dividend yield, Audit committee and CEO duality) significantly affected the share returns.

3.6.2 Test of Significance

In this study, the level of significance was 5% which means that all statistical tests were done and compared against the 5% level of significance.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSIONS

4.1 Introduction

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

4.2 Descriptive Statistics

This section explains the characteristics of corporate governance factors that affects the financial performance of companies listed in (NSE). Some demographic variables including, presence of audit committee, ratio of the non executive directors to the total number of the board members of the firm were tested using T-tests, ANOVA.

Table 4.2.1: Descriptive Data Analysis
 Descriptive Statistics

	Mean	Std. Deviation	N
Yt	27.80	23.916	20
EPS	10.94	8.786	20
DY	2.80	2.016	20
NED ADCOM	1.90	1.647	20
M	2.25	.910	20
CEODU AL	1.6	1.7	20

Table 4.2.2 :ANOVA

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	9953.402	4	2488.351	40.846	.000[b]
	Residual	913.798	15	60.920		
	Total	10867.200	19			

Source: Research Findings

Secondary data was collected from the firms' financial statements and report for the years between 2010 and 2013. The study collected data on Earning per Share which was measured as amount of EBIT on share capital as a ratio, DY which was measured as the MPS on EBIT percentage of shareholder equity, the various independent variables were non executive directors which was measured by the number of independent directors to the total board number, presence of audit committee which was measured as number of independent directors frequency of meeting then multiplied by dummy variable 1 if there is existing committee and 0 if was non.

Table 4.3: Regression Results and Analysis

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.957[a]	.916	.893	7.805

Source: Research Findings

Adjusted R squared is coefficient of determination which tells us the variation in the dependent variable due to changes in the independent variable Yasser et al. (2011) used return on equity (ROE) and profit margin (PM) for the measurement of share return performance. From the

findings in the above table, the value of adjusted R squared was 0.916, an indication that there was variation of 91.6% on the share return of companies due to changes in number of independent directors, frequent meeting of the Audit Committee at 95% confidence interval. This shows that 91.6% changes in share return of companies could be accounted for by Earning per Share, Dividend yield, Non Executive Directors and Audit Committee. R is the correlation coefficient which shows the relationship between the study variables. The findings show that there was a strong positive relationship between the study variables as shown by 0.957.

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	5.761	4.873		1.182	.255
	EPS	1.213	.290	.446	4.180	.001
	DY	1.762	1.228	.149	1.435	.172
	NED	7.220	1.425	.497	5.067	.000
	ADCOMM	.716	2.299	.027	.311	.760
	CEODUAL	.915	1.80	.030	.422	.602

Source: Research Findings

4.4 Correlation of financial performance indicator and corporate governance

factors

The first step was to construct correlation matrix for various possible combinations of dependent and independent variables. The outcome of this exercise was the understated correlation matrix as shown below.

Correlations

		Yt	EPS	DY	NED	ADCOMM
Pearson Correlation	Yt	1.000	.856	.659	.857	.379
	EPS	.856	1.000	.586	.633	.306
	DY	.659	.586	1.000	.473	.516
	NED	.857	.633	.473	1.000	.280
	ADCOMM	.379	.306	.516	.280	1.000
	CEODUA	.699	.370	.722	.335	
Sig. (1-tailed)	Yt	.	.000	.001	.000	.049
	EPS	.000	.	.003	.001	.095
	DY	.001	.003	.	.018	.010
	NED	.000	.001	.018	.	.116
	ADCOMM	.049	.095	.010	.116	.
	CEODUA	.001	.002	.190	.019	
N	Yt	20	20	20	20	20
	EPS	20	20	20	20	20
	DY	20	20	20	20	20
	NED	20	20	20	20	20
	ADCOMM	20	20	20	20	20
	CEODUA	20	20	20	20	20

Source: Research Findings

The correlation matrix highlighted that there is significant correlation between independent variables and the dependent variable. EPS and NED showed a strong and significant relationship with financial performance, (Pearson's r = 0633., Sig. = 0.001)

4.5 Summary and interpretation of the Findings

In summary, this study found that implementation of proper corporate governance is an important element in the financial performance from the regression equation it was revealed that EPS, Dividend Yield, Non Executive Director and Audit Committee. A unit increase in independent director Board Size would lead to increase in share return of companies by a factor of 7.22, unit increase in Audit commitee would lead to increase in Share return of companies by a factor of 0.716, a unit increase in EPS would lead to increase in share return of companies by a factor of 1.213 and unit increase in Dividend Yield would lead to increase in return on share by a factor of 1.762. At 5% level of significance and 95% level of confidence, EPS had a 0. 001 level of significance; DY showed a 0.172 level of significance, while Audit committee showed 0.760 level of significance hence the most significant factor is. All the variables were significant ($p<0.05$).

There is a convergence of agreement on the argument that board size is associated with bank financial performance consequently the study of Kyereboah-Coleman (2007) rather indicated that large boards enhanced shareholders' wealth more positively than smaller ones. Corporate governance has positive relation with share return hence the introduction of various governance policies will improve the share return and performance efficiency as it was observed by John and Senbet (1998) report empirical evidence showing that the presence of monitoring committees (audit, nomination, and compensation committees) is positively related to factors associated with the benefits of monitoring.

Many different claims by different authors such as Miring'u and Muoria (2011) analyzed the effects of Corporate Governance on performance of commercial state corporations in Kenya, Saad (2010) notes that an efficient corporate governance should ensure that the selection of new CEOs and managers is transparent and formal. explaining the impact of corporate governance on the performance of firms listed at (NSE) have been explored and analyzed vis-à-vis the findings of the study.

Competing explanations to the various arguments have also been shown but the Corporate governance mechanisms assure investors in corporations that they will receive adequate returns on their investments (Shleifer and Vishny, 1997). If these mechanisms did not exist or did not function properly, outside investors would not lend to firms or buy their equity securities. Overall, economic performance would likely suffer because many good business opportunities would be missed and temporary financial problems at individual firms would spread quickly to other firms, employees and consumers. Previous evidence suggests that corporate governance has a positive influence over corporate performance.

It was not, however possible to confirm the relationship between share return and some of the prepositions because of lack of relevant comparative data from other groupings of firms not listed at (NSE). Future work should attempt to explore the linkages between transparency, communication, and performance in more depth and by use of different techniques.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

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

In summary the study found that the board size and composition affected the financial performance to a little extent. The number of non-executive directors affected the performance of the companies was a challenge the board faced to a great extent. From the study it was revealed that the number of non-executive directors affected the financial performance of the companies to great extent. The directors were involved in making the internal corporate governance mechanisms to a great extent. Reducing ownership concentration affected the share return of the companies to a great extent. It was established that the authority to determine the corporate governance are the lies with the shareholder and government corporate governance policy.

It was also clear that listed companies have policies on corporate governance. It was agreed that BoDs have regular meeting. There are also various committees such as compliance, risk, insurance and compensation committees to run various business affairs in the bank. It was also found that banks have clear procedures and specifications covering issues as; rights of shareholders, duties of the Directors, rules and disclosure issues.

However as share return is not an absolute, level of corporate governance will vary based on a variety of factors and the levels may change from year to year as the firm's operation environment changes. Managing the levels of share return are therefore key challenges the firms has to resolve. The study also found that other potential variables which are evidenced by other researchers in other study settings as significant factors affecting share return is turnover and implementation.

5.2 Conclusion

From the findings on the effects of Board Size on the share return of listed companies, the study found that various aspects of board size affect the financial performance of companies to a great extent. From the regression analysis, board size was found to a positive affect to the share return of companies listed at the NSE.

The relevance of corporate governance cannot be over-emphasized since it constitutes the organizational climate for the internal activities of a company. Corporate governance brings new outlook and enhances a firm's corporate competitiveness. The study examined the effect of corporate governance on the performance of the listed companies in Kenya by using return on shares based performance measures. Indeed, corporate governance plays a vital role in the success and prosperity of the companies and other business firms. The regression results show further that the direction and the extent of firm's performance is dependent on the predictors being examined.

On the effects of board composition on the share return of listed firms, the study established that various aspects of composition of the board affect the financial performance to a great extent. The study thus concludes that composition of the board positively influence the share return of c ompanies listed to a great extent.

From the findings on effects of Audit committee on the share return of listed firms, the study found that various aspect of Audit committee positively influenced the share return of firms listed to great extent. Thus the study concludes that separation of the role of Audit committee positively influenced the share return of firms listed to great extent. From the findings on effects of Leverage on the financial performance of listed firms, the study established that leverage of the firm positively influenced the share return of firms listed in the NSE. The study thus concludes that EPS and DY of the firm positively influenced the share return of firms listed in the NSE.

5.3 Policy Recommendation

The study recommends that the board size and composition be considered since they affect the share return of the companies listed at (NSE). The number of nonexecutive directors needs to be selected well since they affect share return of the firms. For companies to have sustainable growth and stability they should embrace best practices of corporate governance which will ensure that shareholders wealth is looked after in the best way possible, that adequate risk management measures are put in place and that standards are not only in writing but that they are practiced on a day to day basis.

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

The Capital Market Authority has to encourage companies to implement corporate governance practices through enacting rules and regulations. Corporate governance practices will ensure that companies maintain the level of risk they can handle and give stakeholders sufficiently safe level of their investments.

The findings provide shareholders with information that they have an important role to force the management to implement good corporate governance. In order to control the managers to implement good corporate governance, they should establish certain control mechanisms.

Employees should be encouraged to be more active in financial management aspects of the business. Finally, the study recommends that financial monitoring should be done thoroughly by the board. A constitution which clearly indicates how to select and replace the CEO and directors need to be adopted. Companies should consider adopting conduct of regular Corporate Governance Audits and Evaluations.

Good Corporate Governance has a positive economic impact on the institution in question as it saves the organization from various losses such as those occasioned by frauds, corruption and similar irregularities.

5.4 Limitations of the Study

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

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

In addition, since the assessment of the pretest and post test was conducted by the author himself, it is unavoidable that in this study, certain degree of subjectivity can be found.

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

5.5 Suggestions for Further Studies

The area of education related to corporate governance's knowledge and levels of share return offers opportunities for additional research. Instead of using a survey, other methods of data collection i.e. interviews may provide different results.

It is expected that two-way communication via an interview could produce other meaningful results; however, non-anonymous methods such as interviews can be problematic in revealing the truth, especially when questioning respondents regarding governance matters, as failure to appropriately address the questions would harm or embarrass respondents.

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

The same study should be carried out in other sectors not listed in Nairobi Security Exchange for example banks and microfinance institutions to find if the same results will be obtained.

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APPENDIX I LIST OF COMPANIES LISTED AT NAIROBI SECURITIES EXCHANGE

Eaagad ltd
Kapchorua Tea
Kakuzi
Limuru Tea
Rea Vipingo
Sasini Ltd
Williamson Tea Kenya
Car & General (K) Ltd
CMC Holdings
Sameer Africa Ltd
Marshalls E.A Ltd
Barclays Bank Ltd
Cfc Stanbic
I&M Holdings
Diamond Trust Bank Kenya
Housing Finance Co
Kenya Commercial Bank
National Bank of Kenya
NIC Bank Ltd
Standard chartered Bank Ltd

Equity Bank Ltd
Cooperative Bank of Kenya Ltd
Express Ltd
Kenya Airways
Nation Media
Standard Group Ltd
TPS Eastren Africa Ltd
Scangroup Ltd
Uchumi Supermarkets
Hutching Biemers Ltd
Longhorn Kenya Ltd
Athi River Mining
Bamburi Cement
Crown Berger Ltd
E.A Cables ltd
E.A Portland Cement
KenolKobil Ltd
Total Kenya Ltd
KenGen Ltd
Kenya Power & lighting Co Ltd

Umeme Ltd
Jubilee Holdings
Pan Africa Insurance Holding
Kenya Re Insurance Corporation Ltd
Liberty Kenya Holding Ltd
British- American Investment Compnay
CIC Insurance
Olympia Capital Holding
Centum Investment Co Ltd
Tran-Century Ltd
Nairobi Securities Exchange
B.O.C Kenya Ltd
British American Tobacco Kenya
Carbacid Investment Ltd
East Africa Breweries
Mumias Sugar
Unga Group
Eveready East Africa
Kenya Orchard
Baumann Ltd

| Safaricom Ltd |
| Home Afrika Ltd |

Appendix II Secondary Data Collection Sheet

Section A: Share returns of Listed Corporation

YEAR/Information required	EBIT	DY	FCF	Number of Share
2010				
2011				
2012				
2013				