

**EFFECTS OF CORPORATE GOVERNANCE ON FINANCIAL
PERFORMANCE OF COMPANIES QUOTED AT NAIROBI
SECURITIES EXCHANGE**

BY

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DECLARATION

This research project is my original work and has not been submitted for a degree in any other university.

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DEDICATION

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LIST OF ABBREVIATIONS

CEO	Chief Executive Officer
CMA	Capital Markets Authority
CMC	Cooper Motor Company
EAPCC	East Africa Portland Cement Company
EBIT	Earnings Before Interest and Tax
NSE	Nairobi Securities Exchange
ROA	Return on Assets
ROE	Return on Equity
ROI	Return on Investment
SACCO	Savings and Credit Cooperative
SPSS	Statistical Package for Social Sciences
SPV	Share Price Value
UK	United Kingdom
USA	United States of America

ABSTRACT

Good corporate governance system helps people tasked with decision making, accountability and responsibility within and outside a corporate body in making optimal decisions. It ensures varying interests of all stakeholders are obtained to an acceptable level. The purpose of this research was to analyze whether there is a relationship between corporate governance and financial performance of the 62 companies listed at the NSE. Data was obtained from 48 companies listed at the NSE for the period January 2009 to December 2013 using a check list to obtain data relevant to the study. The data obtained was analyzed on a multiple linear regression model using Statistical Package for Social Sciences (SPSS). The analysis included descriptive statistics, correlation coefficients, beta coefficients of the variables and the coefficient of determination. From the regression analysis it was revealed that Board Size, Board Composition, CEO duality and size of the firm to a constant zero, financial performance of listed companies would stand at 0.567, a unit increase in board size would lead to decrease in financial performance (ROA) of listed companies by a factor of 0.017, unit increase in Board Composition would lead to increase in financial performance of listed companies by a factor of 0.172, a unit decrease in CEO duality would lead to increase in financial performance of listed companies by a factor of 0.057 and unit increase in size would lead to increase in financial performance of listed companies by a factor of 0.109. The data analyzed showed that there was a positive relationship between corporate governance attributes and firm performance. The relationship was found to be significant at the 95% level. It can therefore be concluded that it would be beneficial for a firm to institute corporate governance practices and measures. The study recommends that public listed companies should carefully select board composition so as to strike a balance between executive and non-executive, female directors, should consider the age and the profession of the chair and other members of the board in relation to the nature of the company. The board needs to be comprised of well-educated people since they are actively involved in shaping firms strategy. Ownership concentration needs to be reduced to avoid control being in the hands of a few people as this will enhance monitoring. 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. Companies should consider adopting regular Corporate Governance Audits and Evaluations.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Adams (2002) perceives creation of the registered company to be the real starting point for any discussion on corporate governance. The rise of modern corporations led to a separation of control from ownership (Berle et al., 1967). This separation meant that owners of firms no longer controlled the firms' actions because that was the role of professional managers Kiel &(Nicholson,2003). This gave rise to the need for corporate governance frameworks to protect owners of firms from the actions of professional managers. According to Francis (2000) the concept of corporate governance gained prominence in the 1980s because this period was characterized by stock market crashes in different parts of the world and failure of some corporations due to poor governance practices. Corporate collapse was the predominant driver for change to corporate governance codes (United Nations, 1999). As more corporate entities in different parts of the world collapsed in 1980s, there was a change of attitude with much higher performance expectations being placed on management boards of firms. There was also a growing realization that managers are to run firms while boards are to ensure that firms are run effectively and in the right direction (Adams, 2002).

A great deal of attention has been given to understanding how corporate governance and ownership structures affect firm performance. Corporate governance can influence a firm's performance whenever a conflict of interest arises between management and shareholders and/or between controlling and minority shareholders. Managers will enjoy more power as they are part

of the board or act in connivance with the board and the controlling shareholders. In turn, the power of controlling shareholders relies in how effectively they can manipulate board decisions by way of voting majorities and other means; distortionary policies will then increase as the ratio of voting to cash flow rights is higher (La Porta et al, 1999: Claessens et al, 1999). Outsiders have two main instruments to counterbalance this power: the enforcement of adequate corporate governance standards and the quality of the regulatory and legal environment, which should discourage detrimental actions by insiders and, once committed, allow affected stakeholders to challenge them through corporate and judicial channels. However, prevention of corporate failure was not the only reason that led to adoption of the corporate governance ideals. On a positive note, there was a growing acknowledgement that improved corporate governance was crucial for the growth and development of the whole economy of a country (Clarke, 2004).

1.1.1 Corporate Governance

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 shareholders long-term value while taking into account the interest of other stakeholders. Capital Markets Authority (CMA) Gazette notice no. 3362. Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance.

Bairathi (2009) said “Corporate governance is not just corporate management; it is something much broader to include a fair, efficient and transparent administration to meet certain well-defined objectives. It is a system of structuring, operating and controlling a company with a view to achieve long term strategic goals to satisfy shareholders, creditors, employees, customers and suppliers, and complying with the legal and regulatory requirements, apart from meeting environmental and local community needs. When it is practiced under a well-laid out system, it leads to the building of a legal, commercial and institutional framework and demarcates the boundaries within which these functions are performed.” Good corporate governance should help local companies to gain access to foreign capital and foreign companies tend to gain investment opportunities providing portfolio diversification opportunities.

1.1.2 Financial performance

Financial performance is a measure of how well a firm can use assets from its primary mode of business to generate revenues. This term is also used as a general measure of a firm's overall financial health over a given period of time, and can be used to compare similar firms across the same industry (Oluoch, 2013). A firm's performance is measured in terms of accounting and market-based measures. The three financial firm performance measures used are return on equity (ROE), return on assets (ROA) and Tobin's Q, are considered as proxies for accounting returns and market returns. ROE is an accounting measure used to assess rates of return on shareholder equity and has been used in previous studies to measure firm performance (Epps & Cereola, 2008), whereas ROA which is also an accounting measure is used to assess the efficiency of assets employed to measure firm performance in prior studies (Haniffa & Hudaib, 2006). Tobin's Q is a measure of market performance, which compares the value of a company as given by financial markets with the value of the company's assets (Tobin, 1969).

A firm's financial performance is a measure of how well a firm uses its assets from its core operations and generates revenues over a given period of time. This measure is thus compared to some given industrial average standard of similar firms in the same industry. Brealey et al (2009) indicate that financial performance can be measured in terms of profitability, liquidity, solvency, financial efficiency and repayment capacity. Profitability is the measures of the profit generated by a firm through the use of its productive assets; liquidity measures the ability of a firm to meet its obligations when they fall due; solvency measures a firm ability to pay all its financial obligations if all of its assets are sold. Therefore, a firm financial performance can be measured using net income or net operating income, its assets performance or even its cash flows.

1.1.3 Corporate Governance and Financial Performance

According to LaPorta et al. (1999), Evidence suggests that firms in emerging economies as compared with their counterparts in developed countries are discounted in financial markets because of weak governance. Rajagopalan and Zhang (2009) firmly felt that investors gain confidence in those firms that practice good corporate governance and these firms are at added advantage in accessing capital compared to firms that lack good corporate governance. Rasheed (2010) Governor , central bank of Bahrain “ Corporate practices in the matter of disclosure, transparency, group accounting, role of directors, degree of accountability to the shareholders, lenders and overall public good are some of the critical issues which require a continues modification to suit to the changing dynamic business environment”. Quality of corporate governance in any country solely rests with the governments by bringing appropriate regulatory frame work from time to time. Otieno (2011) did a research paper to highlight the importance of good corporate governance practices, the measures of financial performance, of the past and

present state airline industry in Kenya. The study found that there is a significant relationship between corporate governance practices and financial performance of airlines.

Kenyan companies need to integrate ethics into their corporate culture and concentrate on putting appropriate corporate governance mechanisms in place (Muchoki, 2013). As the investors look for emerging economies to diversify their investment portfolios to maximize returns they are equally concerned about governance factors to minimize risks in these economies. The improvement of corporate governance practices is widely recognized as one of the essential elements in strengthening the foundation for the long-term economic performance of countries and corporations. Baker et al (2007) using a unique dataset from Alliance Bernstein, an international asset management company, with monthly firm-level and country-level governance ratings for 22 emerging markets countries over a five year period, report a significantly positive relation between firm-level (and country-level) Corporate Governance ratings and market valuation, suggesting lower cost of equity for better governed firms

Some of studies have used a broader measure of corporate governance through a composite corporate governance rating, including Gompers et al.,(2003) for the U.S., Klapper and Love, (2004) for fourteen emerging markets, Durnev and Kim, (2002) for twenty seven countries. These studies generally find a positive relationship between governance standards and firm value. Research has also shown that companies with higher corporate governance (based on developed indices) were performing better and had higher market value or Tobin's q. Moreover, a portfolio of companies with better corporate governance delivered a 2.1 per cent higher return as compared with companies of poor corporate governance (Aluoch, 2013). Additionally,

research conducted on firm-level data of corporate governance ratings across 14 emerging markets reveals that better corporate governance is correlated with better operating performance and market valuation (Heracleouse, 2001).

1.1.4 Nairobi Securities Exchange

The Nairobi Securities Exchange (NSE) has played an important role in mobilizing resources and providing a means by which companies can raise capital. By providing companies with an opportunity to be privatized, the NSE has ensured that ownership of such companies is widely distributed among members of the public (Otieno, 2010). The NSE has promoted inflow of capital since 1995 when the government permitted foreign investors to invest in local quoted companies (Jebet, 2001). Companies in the Nairobi Securities Exchange have different mechanisms through which boards and directors are able to direct, monitor and supervise the conduct and operation of corporations and their management in a manner that ensures appropriate levels of authority, accountability, stewardship, leadership, direction and control different governance structures.' The question is, is there any relationship between corporate governance and firm performance. In Kenya, Nairobi Securities Exchange (NSE) has 62 quoted companies divided into 8 categories depending on the economic activity of each company. Performance of the market and by extension of each company is monitored through the NSE 20 share index and the NSE all-share index (NSE website, 2014). This study examines whether the performance of companies listed in Nairobi Securities Exchange is affected by the corporate governance practices put in place.

1.2 Research Problem

It is a fact that the objectives pursued by shareholders and corporate managers tend to be differing and contradictory with regards to their own interests. Consequently, this has nurtured the conception of a wide spectrum of approaches and processes ensuring that conflicting interest' spill-over are minimized. One of the compromises that have been given birth to address this divergence is corporate governance (Lamport et al. 2011). Cheffins (2011) said "corporate governance first came into vogue in the 1970s in the United States (U.S). With the collapse of Enron and Arthur Andersen in the U.S and similar disasters in the U.K such as Marconi, corporate governance has become increasingly important. In the light of corporate financial crises in the latter part of the 1990s and 2000, the issue of corporate governance has risen to the head of the international agenda as an important component of the global financial architecture. In Kenya, cases where managers and directors have been accused of poor corporate governance resulting to corporate scandals include the collapse of Euro Bank in 2004, the placement of Uchumi Supermarkets under receivership in 2004 due to mismanagement, the near collapse of Unga Group, National Bank of Kenya and more recently Board room wrangles and the discovery of secret overseas bank accounts for siphoning company money by some directors at CMC Motors (Madiavale, 2011). The recently publicized huge losses and numerous unresolved disputes resulting to court cases by Kenya Airways and KenolKobil have also thrust corporate governance practices into the spotlight.

Leora, et al (2004) find that differences in firm-level contracting environment would affect a firm's choice of governance mechanisms, in line with arguments put forth in (Himmelberg et al. 1999). However with only one year data, they are not able to control the fixed effects and to test

the causality. In a study by Luo Lei, potential contribution can be obtained in this area by analyzing a number of corporate governance mechanisms based on time-varying firm-specific data. Using the methodology in Agrawal and Knoeber, (1996), he examined four mechanisms used in controlling agency problems — insider shareholdings, block holdings, institutional shareholdings and leverage status of the firm. Findings reveal an interesting relationship between governance and performance. It is the change of governance that determines performance rather than the governance level. Further he found that an investment strategy that buys firms with greatest improvement in governance and sells firms with largest deterioration in governance yields 36.7 percent excess returns over the sample period.

Wanjiku et al (2011) carried out a study to establish the Corporate Governance practices of firms and its relationship with the growth of Companies listed at the Nairobi Securities Exchange using a causal comparative research design. The study found a positive linear dependence of growth and Corporate Governance. Mang'unyi (2011) carried out a study to explore the ownership structure and Corporate Governance and its effects on performance of firms focusing on selected banks in Kenya. His study revealed significant difference between Corporate Governance and financial performance of banks. Wanjiru (2013) did a study on effects of corporate governance on financial performance of companies quoted at the NSE. She relied on 40 companies. The study found that a strong relationship exist between Corporate Governance practices under study and the firms' financial performance. There was a positive relationship between board composition and firm financial performance. However, the most critical aspect of board composition was the experience, skills and expertise of the board members as opposed to whether they were executive or non-executive directors. Similarly, leverage was found to positively affect financial performance of insurance firms listed at the NSE. On CEO duality, the

study found that separation of the role of CEO and Chair positively influenced the financial performance of listed firms. Many other researchers have examined the relationship between variety of governance mechanisms and firm performance. The results, however, are mixed. Some examine only the impact of one governance mechanism on performance as Himmelberg et al. did, while others investigate the influence of several mechanisms together on performance as was done by (Mutisya, 2006). Maigua (2013) in his research on effects of corporate governance on financial performance of insurance companies in Kenya did cover board size, dependent and independent directors, CEO duality, number of board meetings, number of board sub committees, age of the company and the value of the company's assets.

Most of the research identified was either focused on a specific sector of the economy, used a different methodology in carrying out the study and in measuring financial performance, obtained mixed and conflicting results or considered aspects of the board of directors as a key factor in corporate governance of companies in general and did not give it much thought given that it is the top most organ in governance that sets the tone. According to Choge Kipleting, further research should be carried out, more research on individual board structures are needed to assess the effects on its performance. Hence, the researcher intends to fill the gaps identified by giving much emphasis on the board covering board composition, board size, audit committee and CEO duality as variables of corporate governance that affects corporate financial performance of the companies quoted at the NSE guided by the following question: What is the effect of corporate governance on financial performance of companies quoted at the NSE?

1.3 Research objective

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

1.4 Value of the Study.

This research shall be of use in enhancing scope of theory that could be used by scholars and researchers in the field of finance on corporate governance, (Author, 2013).

Empirical results of this research shall be of use to players in the capital market such as CMA, NSE, and KRA. Recommendations shall be of use to these players by indicating areas in which improvements could be made in the legislation and enforcement of rules.

The research shall also be of use to the shareholders (current and prospective), directors, managers and policy makers through its recommendations. Shareholders could use recommendations in this research in constructing Corporate Governance Index that they could rely on in making investment decisions.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter summarizes information from what other researchers have done in the field of corporate governance and financial performance of companies.

2.2 Theoretical Review.

Neuman (2006) defines a theory as a system of interconnected ideas that condense and organize knowledge about the world. The agency theory and the stewardship theory are the main theories underlying the concept of corporate governance.

2.2.1 Agency Theory

It has been pointed out that separation of control from ownership implies that professional managers manage a firm on behalf of the firm's owners (Kiel & Nicholson, 2003). Conflicts arise when a firm's owners perceive the professional managers not to be managing the firm in the best interests of the owners. Eisenhardt (1989), the agency theory is concerned with analyzing and resolving problems that occur in the relationship between principal and their agents or top management. The theory rests on the assumption that the role of organizations is to maximize the wealth of their owners or shareholders (Blair, 1995). The agency theory holds that most businesses operate under conditions of incomplete information and uncertainty. Such conditions expose businesses to two agency problems namely adverse selection and moral

hazard. Adverse selection occurs when a principal cannot ascertain whether an agent accurately represents his or her ability to do the work for which he or she is paid to do. On the other hand, moral hazard is a condition under which a principal cannot be sure if an agent has put forth maximal effort (Eisenhardt, 1989).

According to the agency theory, superior information available to professional managers allows them to gain advantage over owners of firms. The reasoning is that a firm's top managers may be more interested in their personal welfare than in the welfare of the firm's shareholders. Donaldson and Davis (1991) argue that managers will not act to maximize returns to shareholders unless appropriate governance structures are implemented to safeguard the interests of shareholders. Therefore, the agency theory advocates that the purpose of corporate governance is to minimize the potential for managers to act in a manner contrary to the interests of shareholders. Proponents of the agency theory opine that a firm's top management becomes more powerful when the firm's stock is widely held and the board of directors is composed of people who know little of the firm. Therefore, the theory suggests that a firm's top management should have a significant ownership of the firm in order to secure a positive relationship between corporate governance and the amount of stock owned by the top management (Mallin, 2004).

In summary, the idea of agency theory can be attributed to Coase, (1937) but the ideals of the theory have only been applied to directors and boards since the 1980's. According to this theory, people are self-interested rather than altruistic and cannot be trusted to act in the best interests of others. On the contrary, people seek to maximize their own utility. The agency theory presents the relationship between directors and shareholders as a contract (Adams, 2002). This implies

that the actions of directors, acting as agents of shareholders, must be checked to ensure that they are in the best interests of the shareholders.

2.2.2 Stewardship Theory

According to Donaldson & Preston, (1995): and Freeman, (1984), stewardship theory, also known as the stakeholders' theory, adopts a different approach from the agency theory. It starts from the premise that organizations serve a broader social purpose than just maximizing the wealth of shareholders. The stakeholders' theory holds that corporations are social entities that affect the welfare of many stakeholders where stakeholders are groups or individuals that interact with a firm and that affect or are affected by the achievement of the firm's objectives. Stakeholders can be instrumental to corporate success and have moral and legal rights (Ulrich, 2008). When stakeholders get what they want from a firm, they return to the firm for more. Therefore, corporate leaders have to consider the claims of stakeholders when making decisions and conduct business responsibly towards the stakeholders (Manville & Ober, 2003; White, 2009). Participation of stakeholders in corporate decision-making can enhance efficiency and reduce conflicts (Rothman & Friedman, 2001).

In defining 'Stakeholder Theory' Clarkson, (1994) states: "'The firm" is a system of stake holders operating within the larger system of the host society that provides the necessary legal and market infrastructure for the firm's activities. The purpose of the firm is to create wealth or value for its stake holders by converting their stakes into goods and services'. This view is supported by (Blair, 1995:322) who proposes: the goal of directors and management should be maximizing total wealth creation by the firm. The key to achieving this is to enhance the voice of and provide

ownership-like incentives to those participants in the firm who contribute or control critical, specialized inputs (firm specific human capital) and to align the interests of these critical stakeholders with the interests of outside, passive shareholders.

According to Kaptein and Van Tulder (2003), corporations adopt reactive or proactive approaches when integrating stakeholders' concerns in decision making. A corporation adopts a reactive approach when it does not integrate stakeholders into its corporate decision making processes. Thus resulting into a misalignment of organizational goals and stakeholder demands (Mackenzie, 2007). Some authors attribute scandals such as those of Enron and WorldCom to the failure to consider stakeholder concerns in decision making. Following these scandals, some governments set up new regulations to align the interests of stakeholders with corporate conduct. For example, the Sarbanes-Oxley Act (SOX) was passed as a result of the collapse of Enron and WorldCom. Adams (2002) argues that the stewardship theory remains the theoretical foundation for much regulation and legislation. A proactive approach is used by corporations that integrate stakeholders' concerns into their decision-making processes and that establish necessary governance structures (de Wit et al., 2006).

In summary, the stewardship theory suggests that a firm's board of directors and its CEO, acting as stewards, are more motivated to act in the best interests of the firm rather than for their own selfish interests. This is because, over time, senior executives tend to view a firm as an extension of themselves (Clarke, 2004). Therefore, the stewardship theory argues that, compared to shareholders, a firm's top management cares more about the firm's long term success (Mallin, 2004).

2.2.3 Transaction Cost Theory

According to Williamson (2008), this theory attempts to view the firm as an organization comprising people with different views and objectives. The underlying assumption of transaction theory is that firms have become so large they in effect substitute for the market in determining the allocation of resources. In other words, the organization and structure of a firm can determine price and production. The combination of people with transaction suggests that transaction cost theory managers are opportunists and arrange firms' transactions to their interests (Williamson,2008). The expanded universe of securities available internationally suggests the possibility of achieving a better risk-return trade-off than by investing in the domestic securities. This leads to higher returns for the same level of risk or less risk for the same level of expected return. Diversifying across nations whose economic cycles are not perfectly synchronous, investors should be able to reduce still further the variability of their returns.

In summary, the transaction cost approach to the theory of the firm was created by (Coase 1937). Transaction cost refers to the cost of providing for some good or service through the market rather than having it provided from within the firm. He describes in his article "The Problem of Social Cost" the transaction costs he is concerned with. He observes that market prices govern the relationships between firms but within a firm decisions are made on a basis different from maximizing profit subject market prices. Within the firm decisions are made on through entrepreneurial coordination.

2.2.3 Enforcement Theory of Regulation

Becker, (1983) highlights the difficulties of implementing and enforcing regulation in a way that is socially beneficial. Against this backdrop, Djankov, (2004) proposed the enforcement theory of regulation. Their premise is that all strategies for implementing socially desirable policies

such as creating deep and functioning capital markets are likely imperfect and that optimal institutional design involves a tradeoff between imperfect alternatives. Shleifer, (2005) applies this theory to securities regulation and argues that the “inequality of weapons” between corporate insiders and promoters on the one side and (often unsophisticated) outside investors on the other side makes it unlikely that private contracts with litigation are an efficient solution in securities markets. He suggests that, in this situation, regulation that prescribes what firms have to disclose to investors could be beneficial because it limits the discretion of courts and mitigates the “inequality of weapons” problem and in turn improves the performance of the capital markets.

2.3 Determinants of Financial Performance

Financial performance is part of financial management in organizations which involves the art and science of managing financial resources of an organization (Jacobs, 2001). This is an area that requires knowledge, skills and experience and whose goals include: maximising profits, sales, capturing a particular market share, minimising staff turnover and internal conflicts, survival of the firm, and maximising wealth (Jacobs, 2001). For any organization to measure financial performance there is need to conduct performance measurement. Performance measurement can be separated into two categories: financial performance measurement and non financial performance measurement. Financial performance measurement generally looks at a firm’s financial ratios which are usually calculated using the accounting figures obtained from financial statements of an organization such as liquidity ratios, activity ratios, profitability ratios, and debt ratio (Maigua, 2013).

2.3.1 Board Composition

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 (Wanjiru, 2013) . According to Wanjiru (2013), Executive directors are also needed in an organization as they have insider knowledge and experience of the organization, however, if not properly checked they can misuse this knowledge by transferring wealth of other stakeholders to themselves.

On the other hand an independent board of directors is generally composed of members who have no ties to the firm in any way; therefore there is minimum or no chance of having conflict of interest because independent directors have no material interests in the company. According to Dalton et al. (1998: Jacobs, 1985), independent directors are important because executive directors may have no access to external information and resources that are enjoyed by the firm's outside or independent directors (e.g., CEOs of other firms, former governmental officials, investment bankers, Social worker or public figures, major suppliers).

2.3.2 Board Size

Hermalin and Weisbach, (2003) put forth that there is a possibility that larger boards can be less effective than small boards. They argued that when boards consist of too many members agency problems may increase, as some of the directors may not work as expected and tag along as free-riders. In their analysis, they tried to come up with an effective balance as far as board size is concerned as when aboard becomes too big, it often moves into a more symbolic role, rather than fulfilling its intended function as part of the management. On the other hand, very small boards

lack the advantage of having the spread of expert advice and opinion around the table that is found in larger boards. Furthermore, larger boards are more likely to be associated with an increase in board diversity in terms of experience, skills, gender and nationality (Dalton, 2005). Expropriation of wealth by the CEO or inside directors is relatively easier with smaller boards since small boards are also associated with a smaller number of outside directors. The few directors in a small board are preoccupied with the decision making process, leaving less time for monitoring activities.

Vafeas, (2000) reported that firms with the smallest boards (minimum of five board members) are better informed about the earnings of the firm and are thus better placed to monitor the activities of the company. Echoing the above findings, Mak and Yuanto, (2003) reported that listed firm valuations of Singaporean and Malaysian firms are highest when the board consists of five members. Bennedsen, Kongsted and Nielsen, (2004), in their analysis of small and medium-sized closely held Danish corporations reported that board size has no effect on performance for a board size of below six members but found a significant negative relation between the two when the board size increases to sevenmembers or more (Wanjiru, 2013). On the other hand, Bhagat and Black (2002), found no solid evidence on the relationship between board size and performance.

2.3.3 Audit Committee

The primary function of the audit committees is to assist the board in fulfilling its oversight responsibilities by reviewing the financial information that will be provided to the shareholders and other stakeholders, the systems of internal controls, which management and the board of directors have established, and all audit processes. Several studies have been undertaken on the

audit committees' oversight responsibilities. In general, the findings indicated wide variations in both perceived and stated responsibilities. Cooper and Lybrand (1995) and DeZoort et al. (1997) found that audit committee responsibilities revolved mainly in the areas of financial reporting, auditing and overall corporate governance. Kalbers and Fogarty (1993) found that the responsibilities of audit committee included oversight of financial reporting, external auditor and internal controls.

2.3.4 CEO Duality

CEO duality means that “the CEO is also holding a position as a chairman of the board of directors”. Agency theorists argue that “when a board chairman is also a CEO, he will gain sufficient controlling power to gain more private benefits”. On the contrary when CEO is also a chairman would help organization in improving performance and one responsible person holding accountability for the board actions. Multiple studies that examined CEO dual role have found that the existence of a weak legal system encourages companies to have its CEO act as a chairman of the board. On the contrary Ehiokoya (2009) at their study said CEO duality has a way of influencing the overall performance of the firm. Board becomes ineffective in monitoring and evaluating CEO role when CEO is also chairman of the board thus creating agency costs resulting in lower performance. Coles et al. (2001) found that high CEO compensation is associated with weak governance structures including CEO duality.

2.4 Empirical Review

Lacker et al. (2004) they examined the relation between a broad set of corporate governance factors and various measures of managerial behavior and organizational performance. Using a

sample of 2,126 firms they distilled 38 structural measures of corporate governance (board characteristics, stock ownership, anti-takeover variables) to 13 governance factors using principal components analysis. For a wide set of dependent variables (abnormal accruals, excessive CEO compensation, debt ratings, analyst recommendations, Q and over-investment) found out that the 13 governance factors on average explain only 1 percent to 5.5 percent of the cross-sectional variation using standard OLS multiple regression techniques and 1.4 percent to 9.1 percent of the variation using exploratory recursive partitioning techniques. Overall, results suggest that the typical structural indicators of corporate governance used in academic research and institutional rating services have very limited ability to explain managerial behavior and organizational performance.

Okwee (2011) carried out a study on corporate governance and financial performance of SACCOs in Lango sub region of Uganda. The study involved a sample size of 63 SACCOs that were drawn from a population of 75 SACCOs in Lango sub region. The study made use of questionnaires that were distributed to each of the SACCOs, through drop and pick method. The findings from the analyzed data revealed that a significant number of SACCOs were found to comply less with corporate governance guidelines, risk was found to be weakly and negatively correlated with corporate governance and financial performance where as corporate governance and financial performance were found to be strongly positively correlated. The study also outlined a number of corporate governance practices that are likely to impact on the financial performance of organizations. These practices include CEO dualism, board size and the skills of the board members.

In a study by Opiyo, (2011) about the relationship between Financial performance and Corporate Governance with specific reference to SACCO's operating in Nairobi. A sample of 98 SACCO's was selected from a population of 131 and a regression analysis was performed for purposes of data analysis to determine the relationship between the dependent and independent variables. Four dimensions of corporate governance practices (i.e. CEO duality, Gender diversity, Audit Committee, Board composition on gender, and Number of board meetings) were considered as independent variables and two on financial performance i.e. ROA as well as ROI as dependent variables in the regression model. The findings are that corporate governance did not have significant relationship on ROA but the same is reverse for ROI where it is revealed that there is significant relationship with dimensions of corporate governance used in the study. Specifically the corporate governance variable of Audit committee has higher positive relationship on ROI while that of Number of board committee meetings records a negative relationship.

Otieno, (2011) did a research paper to present the relationship between corporate governance practices and financial performance of local airlines in Kenya. A total of 30 local airlines were considered for study which is the total population of operational local airlines in Kenya. No sampling was done as the entire population was considered small hence all the element in the entire population was considered for study. The study employed drop and pick questionnaires. The type of the data was quantitative in nature, which was analyzed using SPSS computer package. The study found that there is a significant relationship between corporate governance practices and financial performance of airlines. And airlines with strong corporate governance practices also have better financial performance, with a degree of variation on Return on assets at 81percent.

In a research done by Wanjiru (2013), the main objective of her study was to investigate the effects of Corporate Governance on the financial performance of listed companies at (NSE). Specifically, the study examined board size, board composition, CEO duality and leverage and how they affect the financial performance of listed Companies at (NSE). Firm performance was measured using Return on Assets (ROA) and Return on Equity (ROE). The study adopted a descriptive research design while her population was all those Companies which were quoted on the Nairobi Securities Exchange as at December 2012. Secondary data were collected using documentary information from Company annual accounts for the period 2008 to 2012. Both descriptive and inferential statistics were used. Data was analyzed using a multiple linear regression model. The study found that a strong relationship exist between the Corporate Governance practices under study and the firms' financial performance. There was a positive relationship between board composition and firm financial performance. However, the most critical aspect of board composition was the experience, skills and expertise of the board members as opposed to whether they were executive or non-executive directors. Similarly, leverage was found to positively affect financial performance of insurance firms listed at the NSE. On CEO duality, the study found that separation of the role of CEO and Chair positively influenced the financial performance of listed firms.

Mutisya, (2006) did a study on the relationship between corporate governance and financial performance of companies listed at the Nairobi Stock Exchange. The methodology employed comprised running a multivariate regression model. The dependent variable, company performance was measured using two measures, Return on Investment (ROI) and Market to Book Value (MBV). Independent variable included, board size, proportion of outside directors, proportion of inside directors, average age of director, number of meetings held by the board in

the year, proportion of shares held by the directors, proportion of shares held by the top 10 shareholders and the number of women in the board, also investigated was the ages of the chairpersons, their professions and the number of chairmanships held. The study covered the period between 2000 to 2005. The regression model showed that 4.3 percent of the changes in profitability were accounted for by the aspects of corporate governance studied when profitability was measured using ROI and 22 percent when profitability was measured using MBV. Board size, number of meetings in a year and the proportion of shares held by the top directors were the most significant variables in the model. The number of women sitting on the corporate boards was found to be very small, just 2 percent.

2.5 Summary of Literature Review

Even though there is a growing body of literature on corporate governance practices and company performance, there is a diversity of results due to the different theoretical perspectives applied, selection of methodologies, measurement of performance, conflicting views on board involvement in decision making and the contextual nature of individual firms. The area of corporate governance and organizational performance has attracted many researchers in the recent past. The theoretical literature has divergent views on corporate governance and performance of organizations. The agency theory suggests that managers pursue their own interests at the expense of the shareholders whereas the stewardship theory indicates that managers are reasonable people who can pursue actions that can benefit the organizations and the owners. Transaction cost theory provides that the combination of people with transaction suggests that transaction cost theory managers are opportunists and arrange firms' transactions to their interests while enforcement theory of regulation suggests that regulations that prescribes

what firms have to disclose to investors could be beneficial because it limits the discretion of courts and mitigates the “inequality of weapons” problem and in turn improves the performance of the capital markets.

Empirical literature both global and local, show evidence of some relationship between corporate governance and financial performance of organizations. However, results from findings are mixed and are focused on specific sectors of the economy. Research done at the NSE by most researchers covered general aspects of corporate governance and financial performance and thus failed to give much emphasis on the aspects of the board of directors that influence decision making and hence governance of corporates. In addition most research in the area of corporate governance has been conducted in the developed economies. The fact that studies done in this area have focused on more general aspects of the board or used a different methodology to measure performance or focused on a specific sector, the researcher sort to bridge this knowledge gap by giving more emphasis on aspects of the board that affects corporate decision making and hence financial performance of companies listed at the NSE.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter sets out various stages and phases that are to be followed in completing the research. It involves a blueprint for the collection, measurement and analysis of data. This section is an overall scheme, plan or structure conceived to aid the researcher in answering the raised research question. Specifically the following subsections were included; research design, population, data collection and finally data analysis.

3.2 Research Design

Kothari, (2004) research design is defined as framework that shows how problems under investigation will be solved. A descriptive survey is a design that involves establishing what is happening as far as a particular variable is concerned. This research adopted a descriptive research survey to determine the effects of corporate governance on financial performance of listed companies in Kenya. As noted by Miller, (1991), descriptive design is the precise measurement and reporting of the characteristics of the phenomena under investigation, and describes phenomena, situations and events. This is mainly because the focus of the research is to gain an understanding and insight on the role of corporate governance on financial performance of companies at NSE.

3.3 Population

Target population in statistics is the specific population about which information is desired. According to Mugenda and Mugenda, (2003), a population is a well-defined set of people, services, elements, and events, group of things or households that are being investigated. The target population consists of all the 62 companies quoted at the NSE between January 2009 and December 2013. List attached as (Appendix I)

3.4 Data Collection

The study used secondary quantitative and qualitative data to analyze the relationship between corporate governance and financial performance. Secondary data was obtained from corporate governance statements and financial statements for the 62 companies as published by NSE. This data covered January 2009 to December 2013. The data collected included: - number of directors, number of executive and non-executive directors, number of meetings held in each year of study, age of the directors, proportion of women directors, profession of the chairperson, CEO duality, audit committee, while financial data included total assets and net revenue.

3.5 Data Analysis

The researcher used regression analysis to establish the relationship between corporate governance and financial performance of Companies quoted at the NSE. The following analytical model was used in analyzing the relationship between the dependent and independent Variables:

$$F_p = a + b_1X_1 + b_2X_2 + b_3X_3 + b_4X_4 + b_5X_5 + b_6X_6 + b_7X_7 + b_8X_8 + b_9X_9 + e$$

Where:

F_p is the financial performance of companies at the NSE as measured by return on asset (ROA).

x_1 is the size of the board;

x_2 is the number of board sub committees available in the company in proportion to minimum required

x_3 is the number of board meetings per year under study compared with the minimum required

x_4 is the number of independent directors as a proportion of the entire board

x_5 is the average age of the board members

x_6 is the profession of the chair to the board

x_7 is the proportion of women directors

x_8 is the CEO duality status

x_9 is the size of the company as measured by average assets

e is the error term to capture all other variables not included in the model

$$\text{Return on Assets (ROA)} = \text{EBIT} / \text{Average total Assets}$$

Return on assets is the ratio of annual net income to average total assets of a business during a financial year. It measures efficiency of the business in using its assets to generate net income. It is a profitability ratio. Earning Before Interest and Tax (EBIT) can be found on income statement. Average total assets are calculated by dividing the sum of total assets at the beginning and at the end of the financial year by 2. Total assets at the beginning and at the end of the year can be obtained from year end balance sheets of two consecutive financial years.

3.5.1 Tests of Significance

a) F-Test

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

b) T-Test

To establish the significance of individual variables in the model, T-Test will be applied at 5% levels of confidence.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter presents the findings from data collected from annual reports of NSE quoted companies and checklists responded to by officers in top level of management of these firms. The study findings are presented on the effects of corporate governance on the financial performance of the firms listed in Nairobi Securities Exchange. The information gathered has been analyzed using statistical package for social science (SPSS) presented and discussed as per the key objectives and research questions investigated in this study.

4.2 Response Rate

The study targeted all the 62 listed companies at the Nairobi Securities Exchange out of which 48 respondents filled in and returned a checklist designed for the research. This translates to 77.4% return rate. According to Punch (2003), response rates are more important when the study's purpose is to measure effects or make generalizations to a larger population; less important if the purpose is to gain insight. Since the response rate is more than 70%, it is considered very good and adequate for the generalization of the findings to the population of interest. This commendable response rate was made a reality after the researcher made personal calls and visits to remind the respondent to fill-in and return the checklist. However, the statistical results were triangulated with extensive literature to draw lessons learnt.

4.3 Descriptive Analysis

The study sought to establish background information of the companies including Type of organization, Years in operation, Age of firms, Period Company has been listed at the NSE and Number of employees.

4.3.1 Type of organization

The study sought to find the type of organizations listed in the NSE. Results from analysis shows that about 36.1% of the listed companies were found to be in the manufacturing industry, 23.3% were in the banking industry, and 22.2% were in the service industry while 18.4% of the companies were in the insurance industry. The chart below summarizes the findings.

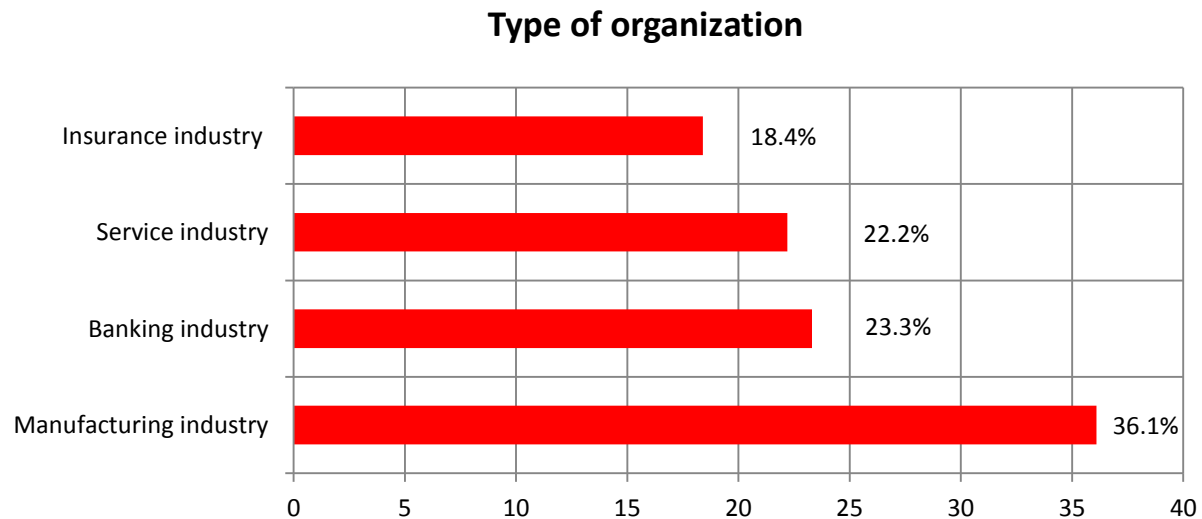


Figure 1 Type of organization

4.3.2 Years in operation

In relation to the years in operation, the study findings established that Mortality rate of enterprises in Kenya is high since out of ten enterprises started only one survives to celebrate the

first birthday due to various reasons including lack of implementation of corporate governance. The oldest firm in this study was established 56 years ago (30.7%) while the most recent one were established in less than 10 years (11.9%). Majority (57.4%) were established “between” 11 to 20 years. This means that most surveyed firms are old enough to have implemented corporate governance in their firms and have the varied information. The chart below summarizes the findings.

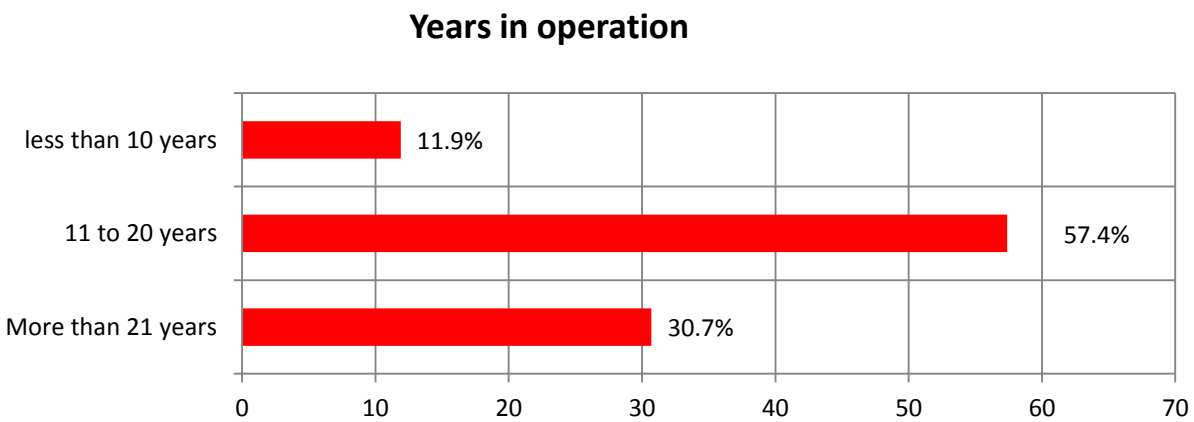


Figure 2 Years in Operation

4.3.3 Period company has been listed at the NSE

The study sought to establish the period the organizations had been listed at the NSE. Results from analysis shows that 31.6% had been listed for a period of 6-11 years, 16.7% had been listed in the NSE for 12-17 years, 19.4% had been listed for a period of 18-23 years, and 23.4% had been listed for over 24 years while 8.9% had been listed for less than 5 years. The chart below summarizes the findings.

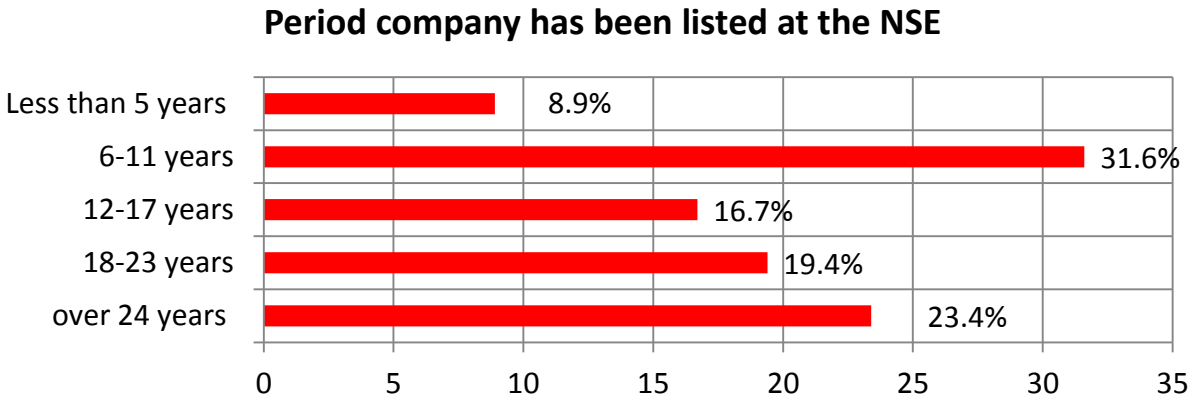


Figure 3 Period Company has been Listed at NSE

4.3.4 Number of employees

Companies listed at the Nairobi Securities Exchange plays a key role in offering employment for many Kenyans i.e. both fulltime employment and casual employment. In this study, majority of the firms (67.1%) had employed more than 51 employees, 24.6% had employed between 21-50 employees while 8.3% had employed less 20 employees. This findings show that this firms contributes heavily to both wealth creations for Kenyans, but also for the people who buy shares in this firms. The study revealed that those employed in permanent terms ranged between 9 and 115, those employed on casual ranged between 5 to 50 persons and those employed on contract ranged between 500 to 700 persons. The chart below summarizes the findings.

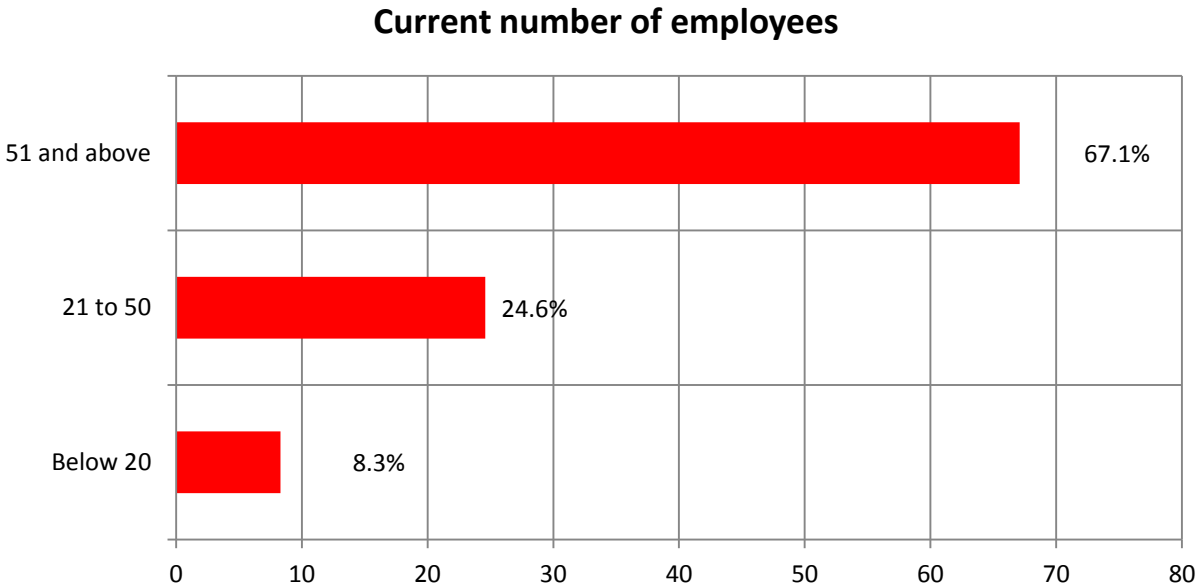


Figure 4 Current Number of Employees

4.3.5 Board Size

The study sought to establish the effects of board size on the financial performance of listed firms in NSE. Results from analysis shows firms maintained a minimum number of 7 to 9 directors while few increased while others reduced. Hermalin and Weisbach (2003) argued that there is possibility that larger boards can be less effective than small boards. Large boards may result to increase in agency problems as some directors may tag along as free-riders. Vafeas (2000) also reported that firms with the smallest boards (minimum of five board members) are better informed about the earnings of the firm and thus can be regarded as having better monitoring abilities. Yokishawa and Phan (2004) found that board size and performance (measured by market-to-book ratio and return on assets) was negatively correlated for Japanese firms. The chart below summarizes the findings.

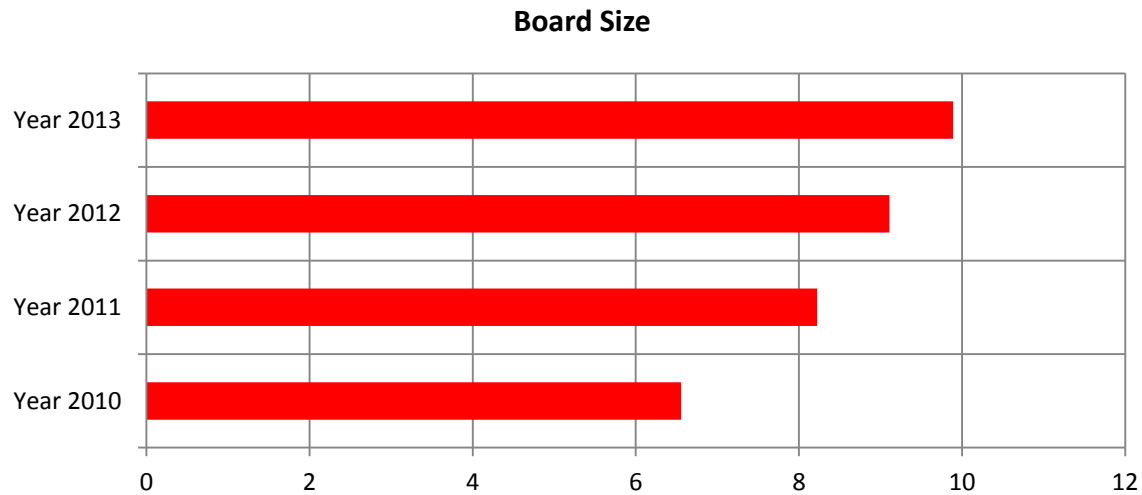


Figure 5 Board Size

4.3.6 Board Composition

The study sought to ascertain the effects of board composition on financial performance of listed firms. Results from analysis shows that Boards were composed of directors with good mix of skills, experience and competences that could take the business to greater heights. About 70% of the board of directors was sourced from outside the firms. Outside directors are better able to challenge and discipline the CEO and management also, about 32.4% were female while 67.6% were male.

Gender of board of directors

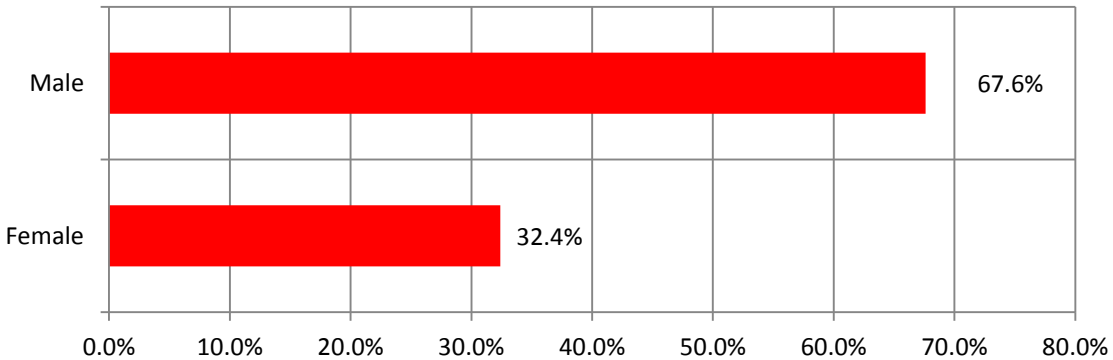


Figure 6 Gender of Board Directors

The findings of the study concur with the findings of Dalton et al., (1998) who states that independent directors are important because inside or dependent directors may have no access to external information and resources that are enjoyed by the firm's outside or independent directors. Staikouras et al. (2007) found that board composition does not affect firm performance although its relationship with performance was found to be positive. Adusei (2010) also found that board composition had a positive effect on companies' efficiency.

4.3.7 CEO Duality

The study further sought to examine the effect of CEO duality on the financial performance of listed firms. Results from analysis shows that majority of CEO (82.6%) were not acting as the Chairman of Board while 17.4% acted as both CEO and chair of the board. The role of the Chairman of Board and CEO should be separated and not vested in the same person. CEO tenure should be fixed. Bhagat and Jefferis, (2002) found that the tenure of a CEO is also an important determinant of the firm's performance. The chart below summarizes the findings.

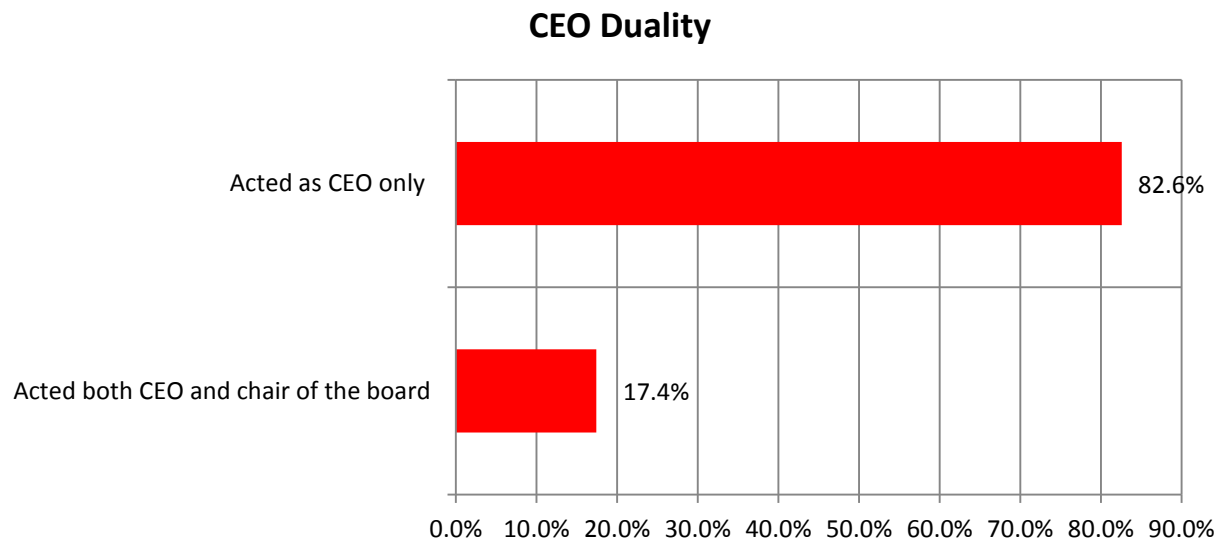


Figure 7 CEO Duality

4.3.8 Number of BOD meetings

Most Boards (30%) have 4 meetings in a year. An average of 7 meetings per year with a range of 4 to 12 meetings was recorded for all the firms studied. In all the cases, the directors receive board papers at least 1 week before Board meetings. It was also established that there are several ways through which Board’s deliberations are communicated to stakeholders. These include: Circulation of minutes; At the Annual General Meetings; Quarterly publications; The most commonly used mode of decision making by the Boards is consensus (70%) followed by a combination of both consensus and vote depending on the magnitude of the matter (30%). The chart below summarizes the extent of the assessment of performance and effectiveness of the Boards, individual board members and the Chief Executive officers.

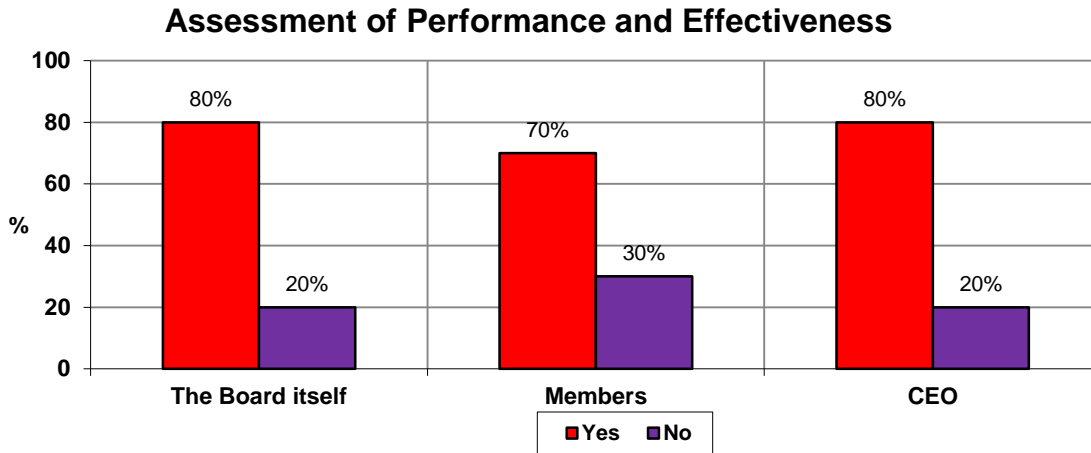


Figure 8 Assessment of Performance and Effectiveness

4.4 Descriptive Statistics

This section explains the characteristics of corporate governance attributes that affects financial performance of companies listed in (NSE). The analysis commenced by examining data for certain governance variables used in the empirical research. Variables including, duality of the CEO, size of the board of the directors, composition of the board of directors and size of the firm were tested. Secondary data was collected from the firms' financial statements and report for the years covering 2009 to 2013. The study collected data on Return On Assets which was measured as amount of net income earned expressed as a percentage of total assets, independent variables used were Board Size measured by the number of directors, Board Composition measured as a ratio of outside directors to total number of directors, CEO Duality status measured as a dummy variable of 1 if the CEO and the chairperson of the Board were one and the same person; 0 if the positions' holder were different people, and size of the firm which was measured as an average of assets. In order to test for multi-collinearity the researcher conducted a Pearson Product Moment correlation.

Table 4.4.1 Descriptive statistics summary

Years	Average Board Size	Board Composition	CEO Duality	Size	ROA
2009	8	0.38	0	0.84	0.038
2010	8	0.25	0	0.82	0.60
2011	8	0.38	0	0.82	0.060
2012	7	0.71	0	0.84	0.068
2013	7	0.76	0	0.86	0.073

Table 1 Descriptive Statistic Summary

Variables	ROA	BSIZE	BCOMP	CEO	AUDCOM	Age of firm
Mean	0.9029	9.2571	6.8143	0.8571	0.8662	19.40150
Median	0.4750	9.0000	7.0000	1.0000	0.8300	8.720765
Std. Dev	1.5703	2.3700	2.3154	0.3512	0.1175	23.00000
Minimum	-1.98	5.00	3.00	0.00	0.50	
Maximum	9.37	16.00	12.00	1.00	1.00	

The average board size of the 62 firms used in this study is 8, while the proportion of the outside directors sitting on the board is about 7. The result also indicates that 85.7% of the firms have separate persons occupying the posts of the chief executive and the board chair, while mere 14.3% of the firms have the same person occupying the two posts. A majority of the firms (86.6%) have audit committees composed of at least 83% of outside members.

4.5 Correlation Analysis

Tables 3a present correlations among the variables. From Table 3a, using the Pearson correlation, ROA is positively correlated with the firm's board size and is significant (sig 0.000). Similar results appear for board composition and chief executive status. However, ROA has a negative relationship with audit committee, but not significant (sig 0.434).

Table 4.5.1: Correlations (Pearson) - ROA as a firm performance proxy

	ROA	BSIZE	BCOMP	CEO	AUDCOM
ROE	1.000				
BSIZE	0.428	1.000			
BCOMP	0.390	0.773	1.000		
CEO	0.245	0.209	0.303	1.000	
AUDCOM	-0.014	-0.079	0.221	0.001	1.000

Table 2 ROA as Performance proxy

4.6 Regression Analysis

Table 4.6.1: ANOVA- ROA as a dependent variable

Model	Sum of Sq	Df	Mean Sq	F	Sig
1 Regression	72.527	4	18.132	9.058	0.000
Residual	270.220	135	2.002		
Total	342.747	139			

Table 3 ROA as a Dependent Variable

Table 5 shows the results of the coefficient estimates. Board size has a coefficient of -0.017. This indicates a negative relationship between it and ROA and is statistically significant at 5% and 10% levels. The relationship between the chief executive status and ROA is positive and statistically significant at 10% level. However, both board composition and audit committee show no significant relationship with ROA at 1%, 5% and 10% levels.

		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
	(Constant)	.567	0.210		1.953	0.105
	Board Size	-.017	0.009	-.443	-1.820	0.007
	Board Composition	0.172	0.053	1.221	3.507	0.025
	CEO Duality	0.057	0.021	1.079	3.167	0.015
	Size of the firm	0.109	0.145	0.135	.725	0.038

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

$$Y = 0.567 - 0.017 X_1 + 0.172 X_2 + 0.057 X_3 + 0.109 X_4$$

Regression on ROA

Model Summary

Model	R	R Square	Adjusted Square	R	Std. Error of the Estimate
1	.943a	.889	.879		.46258

Table 4 Model Summary

Adjusted R squared is coefficient of determination which tells us the variation in the dependent variable due to changes in the independent variable.

4.6 Discussion of Research Findings

The study established that a majority of the listed companies are in the manufacturing industry at 36.1% followed by those in the banking industry at 23.3%. The study also found out that most of the companies listed, 57.4% were less than 20 years old. This indicates that corporate mortality rate is high in Kenya as most of the companies don't live to enjoy their 20th birthday. This could partly be attributed to poor governance at their infancy. NSE quoted companies were found to offer a large number of employment to Kenyan a majority having a staff base of over 51 employees at 67.1%. This finding reveals that quoted companies contribute immensely to wealth creation in Kenya by offering employment.

Average number of the board of directors was established to comprise of about 8 members. The analysis indicated that a board with members more than 8 tended to be less effective as it would take long to make a decision while a board with less than 8 members will lack the pool of expertise needed to make effective decisions. Data analyzed indicated that a majority, 82.6% of the companies had a different person acting as CEO and chair to the board. Separation of the posts meant that decision making, implementation and monitoring was effective.

From the regression analysis it was revealed that Board Size, Board Composition, CEO duality and size of the firm to a constant zero, financial performance of listed companies would stand at 0.567, a unit increase in board size would lead to decrease in financial performance (ROA) of listed companies by a factor of 0.017, unit increase in Board Composition would lead to increase in financial performance of listed companies by a factor of 0.172, a unit decrease in CEO duality would lead to increase in financial performance of listed companies by a factor of 0.057 and unit increase in size of the firm would lead to increase in financial performance of listed companies

by a factor of 0.109. At 5% level of significance and 95% level of confidence, Board Composition had a 0.025 level of significance; size of the firm showed a 0.038 level of significance, CEO duality had a 0.015 level of significance while Board Size showed 0.007 level of significance hence the most significant factor is Size of firm. Overall Size of the firm had the greatest effect on the financial performance of listed companies, followed by CEO duality, then size of the board and Board Composition had the least effect to financial performance of listed companies. All the variables were significant ($p < 0.05$).

The findings of adjusted coefficient of determination R squared was 0.879 an indication that there was variation of 87.9% on the financial performance (ROA) of listed companies due to changes in Board Size, Board Composition, CEO duality and size of the firm at 95% confidence interval. This shows that 87.9% changes in financial performance of listed companies could be accounted for by Board size, Board Composition, CEO duality and size of the firm.

The result of the relationship between the chief executive status is clear. It implies that the majority of the sampled firms, in the period under study, have separate persons occupying the posts of chief executive and the board chair. This has influence on the financial performance of the sampled firms and in line with the tenet of the code of corporate governance best practices of Kenya. Audit committees being occupied by majority of outside members have no influence on the firm's performance. This is because this study shows that the relationship between the audit committee and the performance measure is not statistically significant.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This section provides a summary of the findings from section four, and also gives conclusion and recommendations of the study based on the objectives of the study. The objectives of this study were: to assess the effect of board size, composition, CEO duality and audit committee as corporate governance attributes on financial performance of listed companies at NSE.

5.2 Summary of Findings

The study found that majority (92%) of the companies indicated that corporate governance affected financial performance of their firm. The study also found that corporate governance systems were mechanisms for establishing the nature of ownership and control of organizations. The study examined the relationship that exists between firm performance, using ROA and four corporate governance mechanisms (board size, board composition, CEO duality status and audit committee). A population size of 62 NSE quoted companies for the period 2009 - 2013 was used. The method of analysis was multiple regressions and the method of estimation was Ordinary Least Square. The study revealed the following results: There was a positive and significant relationship between ROA and board size. There was a positive and significant (at 10% level) relationship between ROA and CEO duality status. There was no significant relationship between ROA, board composition and audit committee.

The results of the investigation are quite revealing. There is significant evidence that there is a need for equity ownership to be concentrated in the hands of individuals, corporations or institutional bodies. This will create better incentives for shareholders to undertake the monitoring process, and thus lead to superior performance. The investigation shows that when major shareholdings are acquired in a firm, control cannot easily be disputed and the resulting concentration of ownership may lower agency costs. The regression results further suggest that firms with higher levels of ownership concentration have a higher market valuation.

The adverse effect of CEO duality on performance indicates the need for firms to separate the post of CEO and Chair in order to ensure optimal performance. The separation of the position of CEO and Chair will encourage efficiency in decision-making mechanisms. It will also serve as a monitoring mechanism to ensure that the agent does not indulge in opportunistic behavior. It was also found that firms where a board has no system of checks and balances created an opportunity for some members to manipulate the activities of the board.

The results suggest that firms with board member having the required skills, and which encourage learning, have superior performance. Thus, there is a need for firms to have policies that ensure the consideration of potential board members' skills before appointment to the board. Also, there is the need for continuous training and development for board members to ensure efficient discharge of their responsibilities. This suggests that on average, larger firms perform better than smaller firms.

5.3 Conclusion

The corporate governance procedures applied on the 62 NSE firms have been effective to some extent in achieving the goals and objectives upon which they were set, but corporate governance

is still in its infancy in Kenya. It is therefore recommended that strategic training for board members and senior managers be intensified by stakeholders in corporate governance to promote good corporate governance in these institutions. They should be guided to understand that “to remain competitive in a changing world, organizations must innovate and adapt their corporate governance practices so that they can meet new demands and grasp new opportunities and that the government has an important responsibility for shaping an effective regulatory framework that provides for sufficient flexibility to allow markets to function effectively and to respond to expectations of shareholders and other stakeholders” – OECD.

From the findings on the effects of Board Size, composition, audit committee and CEO duality status on the financial performance of listed companies, the study found that various aspects of board size affect the financial performance to a great extent. The study established that bigger the size of the board, the less effective the board in monitoring and the higher the agency cost. From the regression analysis, board size was found to negatively affect the financial performance of companies listed at the NSE as it had a coefficient of -0.017 . On the effects of board composition on the financial performance of listed firms, the study established that composition of the board affect the financial performance by a factor of 0.172 . The study thus concludes that composition of the board positively influence financial performance of listed companies. Findings on effects of CEO duality on the financial performance of listed firms, the study found that when the CEO is not the chair of the board, this positively influenced financial performance of the said listed firms by 0.057 . Thus the study concludes that separation of the role of CEO and Chair positively influenced the financial performance of firms listed at the NSE.

Findings on effects of size of the firm on the financial performance of listed firms, the study established that size of the firm positively influenced the financial performance of firms listed in

the NSE. The study thus concludes that size of the firm positively influenced the financial performance of firms listed in the NSE.

5.4 limitations of the Study

The researcher encountered challenges such as time which was very short to allow for a thorough study into all corporate governance issues in place. The fact that the intended mode of data collection was mainly secondary with help of a check list to complement secondary data collected. To furnish the respondents with the checklist and get it back immediately was not possible therefore they were dropped and picked after a few days. This meant control over who filled them could not be verified.

The researcher also experienced a challenge in obtaining secondary data from the audited accounts of some of the quoted companies since some of these companies did not disclose some aspects corporate governance or had not yet published there audited accounts as at the time of this research. The researcher was also limited by the funds available for the carrying out of the research.

Although this study contributes to the body of literature on various dimensions, results are not conclusive. Observations covering a period of five years and in one country may not be representative, and the results may not be generally applicable to developing countries.

5.5 Recommendations

The board needs to be comprised 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 financial performance of the organization. Employees should be encouraged to be more active in financial management aspects of the business.

This research evidently brought out the fact that most of the boards are men dominated. It would therefore be of great interest that quoted companies come up with an affirmative action so as to increase the numbers and the role that women play in the board.

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 regular Corporate Governance Audits and Evaluations.

5.6 Suggestions for Further Research

The present study sought to shed light on the relationship between corporate governance practices and financial performance of companies listed at the NSE. A similar study should be carried out after a period of five years to establish whether quoted entities are still following the codes of good corporate governance. The study should cover a much longer period than the five years period carried by the research.

A research should be carried out in the similar manner but to place more emphasis on the role of other board subcommittees such as the governance and monitoring committee and the remunerations committee so as to effectively assess their effects in the financial performance of the quoted companies.

A research should be carried out covering all the companies quoted at the NSE but this time around relying on the usage of the primary data. This will help the researcher in unearthing some of the corporate governance issues that could not obtained from the published financial statements. I recommend a questionnaire be developed and used to collect such information.

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APPENDICES

LIST OF COMPANIES LISTED IN NAIROBI SECURITY EXCHANGE AS AT

31ST DECEMBER, 2013

SECTOR

AGRICULTURE

- 1 EAAGADS LTD
- 2 KAKUZI LTD
- 3 KAPCHORUA TEA CO. LTD
- 4 THE LIMURU TEA CO LTD
- 5 REA VIPINGO PLANTATIONS LTD
- 6 SASINI LTD
- 7 WILLIAMSON TEA KENYA LTD

AUTOMOBILES & ACCESSORIES

- 8 CAR & GENERAL (K) LTD
- 9 CMC HOLDINGS LTD
- 10 MARSHALLS (E.A) LTD
- 11 SAMEER AFRICA LTD

BANKING

- 12 BARCLAYS BANK OF KENYA LTD
- 13 CFC STANBIC OF KENYA HOLDINGS LTD
- 14 DIAMOND TRUST BANK KENYA LTD
- 15 EQUITY BANK LTD
- 16 HOUSING FINANCE CO. KENYA LTD
- 17 I&M HOLDINGS LTD
- 18 KENYA COMMERCIAL BANK LTD
- 19 NATIONAL BANK OF KENYA LTD
- 20 NIC BANK LTD
- 21 STANDARD CHARTERED BANK KENYA LTD
- 22 THE CO-OPERATIVE BANK OF KENYA

COMMERCIAL AND SERVICES

- 23 EXPRESS KENYA LTD
- 24 HUTCHINGS BIEMER LTD
- 25 KENYA AIRWAYS LTD
- 26 LONGHORN KENYA LTD
- 27 NATION MEDIA GROUP LTD
- 28 SCANGROUP LTD
- 29 STANDARD GROUP LTD
- 30 TPS EASTERN AFRICA
- 31 UCHUMI SUPERMARKET LTD

CONSTRUCTION

- 32 ARM CEMENT LTD
- 33 BAMBURI CEMENT LTD
- 34 CROWN PAINTS KENYA LTD
- 35 E.A.CABLES LTD
- 36 E.A .PORTLAND CEMENT CO LTD

ENERGY & PETROLEUM

- 37 KENGEN CO LTD
- 38 KENOLKOBIL LTD
- 39 KENYA POWER & LIGHTING CO LTD
- 40 TOTAL KENYA LTD
- 41 UMEME LTD

INSURANCE

- 42 BRITISH –AMERICAN INVESTMENTS
- 43 CIC INSURANCE GROUP
- 44 JUBILEE HOLDINGS LTD
- 45 KENYA RE INSURANCE CORPORATION LTD
- 46 LIBERTY KENYA HOLDINGS LTD
- 47 PAN AFRICA INSURANCE HOLDINGS LTD

INVESTMENTS

- 48 CENTUM INVESTMENTS CO LTD
- 49 OLYMPIA CAPITAL HOLDINGS LTD
- 50 TRANS-CENTURY LTD

MANUFACTURING & ALLIED

- 51 A.BAUMAN& CO LTD
- 52 B.O.C KENYA LTD
- 53 BRITISH AMERICAN TOBACCO KENYA LTD
- 54 CARBACID INVESTMENTS LTD
- 55 EAST AFRICA BREWERIES LTD
- 56 EVEREADY EAST AFRICA LTD
- 57 KENYA ORCHARDS LTD
- 58 MUMIAS SUGAR CO LTD
- 59 UNGA GROUP LTD

TELECOMUNICATION & TECHNOLOGY

- 60 ACCESKENYA GROUP LTD
- 61 SAFARICOM LTD

GROWTH ENTERPRISE MARKET SEGMENT

- 62 HOME AFRICA LTD

Source: Capital Market Authority

CORPORATE GOVERNANCE CHECKLIST

This checklist is designed to gather information for an academic research on “Corporate Governance and Firm performance. This research is a requirement for a partial fulfilment of a Masters of Business Administration Degree. Kindly read each question and give your most sincere answer. Your input will be treated with utmost confidentiality.

PART A: PERSONAL DETAILS

1. Name of corporation. _____
2. Year of establishment. _____
3. Current number of employees? a) Below 20 b) 21-50 c) 51 and above

PART B: OWNERSHIP, BOARD AND MANAGEMENT STRUCTURE

1. When was the company listed at the NSE? **Yes** [] **No** []
2. Please complete the table below

	2009	2010	2011	2012	2013
Does the company have shareholders owning more than 25% of the company’s share capital?(Yes/No)					
Total number of directors					
Total number of independent directors					
Total number of female directors					
Was the CEO also acting as firm’s chairman? (Yes/No)					
Did the company have frequent Board meetings? (Yes/No). How many?					

3. In the company, how do you rate the following?

Key

5- Always, 2-Occasionally, 1- Never

	Always	Occasionally	Never
There is a clear separation of roles and responsibilities of the chairman and the chief executive			
Board members are selected based on qualification, skills and experience			
There is a mechanism to ensure that Independent (non-executive) directors Are not current employees, related to other director(s) or immediate family members of Company employee.			
There are mechanisms to ensure that suppliers, direct customers or other trading associates of the company cannot become non-executive (independent) directors.			
There are mechanisms to ensure that non-executive (independent) directors constitute at least one third of the board.			
The board reviews on a regular basis the adequacy and integrity of the company's internal control, acquisition and divestitures and management information systems including compliance with applicable laws, regulations, rules and guidelines.			
The organization has fraud, corruption and whistle blowing policy.			
The background of the potential board members is			

		Always	Occasionally	Never
	investigated.			
	There is a procedure for hiring and firing senior managers			
	There is a mechanism to ensure that senior Management Team are not family members or related to directors			
	There is a mechanism to monitor trading activities of senior managers			

PART C: OPERATIONS, INTERNAL CONTROL AND RISK MANAGEMENT.

1. Does the company have the following? Please tick.

	Yes	No
a Internal audit unit	[]	[]
b Board Audit Committee	[]	[]
c External auditor	[]	[]
d Compliance/Risk management officer	[]	[]
e The company's code of business conduct and ethics.	[]	[]
f Directors and senior executives liability insurance	[]	[]
g Professional indemnity insurance?	[]	[]

2. In the company, how do you rate the following?

Key: 5- always, 2-occasionally, 1- never

	Always	Occasionally	Never
The Company maintains back up and contingency plans for dealing with specified eventualities, including catastrophic information technology failure, the loss of records and the loss of access to business premises;			
There are mechanisms to ensure that employees are fit, qualified and experienced for their job and that there is no evidence of lack of integrity or unusual financial difficulties.			
There is a procedure for hiring and firing employees			
There is continuous training of employees to enhance their expertise			

END

Thank you very much for participating in this study

Yours truly

Joseph Kigotho

LETTER OF INTRODUCTION