

**EFFECT OF BOARD OF DIRECTORS COMPOSITION ON  
FINANCIAL PERFORMAMNCE OF COMPANIES LISTED IN  
NAIROBI SECURITIES EXCHANGE**

**BY: DAN OTIENO AMOLL**

**D61/63969/2013**

**A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILLMENT OF THE  
REQUIREMENTS OF DEGREE OF THE MASTER OF BUSINESS  
ADMINISTRATION, SCHOOL OF BUSINESS, UNIVERSITY OF NAIROBI**

**OCTOBER 2015**

## DECLARATION

This research project is my original work and has never been presented in any other university or college for an award of degree, diploma or certificate.

**Signed**..... **Date**.....

Dan Otieno Amoll

D61/63969/2013

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

**Signed**..... **Date**.....

Dr. Cyrus Iraya

Senior Lecturer, Department of Finance and Accounting

School of Business,

University of Nairobi

## **ACKNOWLEDGEMENTS**

First and foremost, I give thanks to the almighty God for his unending love and blessings. I am deeply obliged to my supervisor, Dr. Cyrus Iraya, for his exemplary guidance and support without which; this project would not have been a success. I also take this opportunity to express my deep gratitude to my loving family and friends who were a constant source of motivation and encouragement.

## **DEDICATION**

I dedicate this study to my family, for their support and encouragement as I worked on this research project.

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## **LIST OF ABBREVIATIONS**

<b>CBK</b>	Central Bank of Kenya
<b>CDSC</b>	Central Depository and Settlement Corporation
<b>CEO</b>	Chief Executive Officer
<b>CMA</b>	Capital Markets Authority
<b>DPS</b>	Dividends per Share
<b>EPS</b>	Earnings per Share
<b>GOK</b>	Government of Kenya
<b>IFC</b>	International Finance Corporation
<b>IPO</b>	Initial Public Offer
<b>NEDs</b>	Non-Executive Directors
<b>NSE</b>	Nairobi Securities Exchange
<b>RAO</b>	Return on Assets
<b>ROAM</b>	Return on Assets Managed
<b>ROCE</b>	Return on Capital Employed
<b>ROE</b>	Return on Equity
<b>ROS</b>	Return on Sales
<b>TMT</b>	Top Management Teams
<b>US</b>	United States of America

## ABSTRACT

Board management and corporate governance (CG) has received much attention in the current studies all over the world especially after many corporate scandals and the failures of some biggest firms around the world such as Commerce Bank (1991) Enron (2001), Adelphia (2002), and World Com (2002). Despite tight regulatory framework, Effective Board management continues to weaken in Kenya due to lack of professional management and governance malpractices. This study uses the current financial crisis as a quasi-experiment to examine whether and to what extent corporate boards affect the performance of firms. Therefore the purpose of this study was to establish the effect of board composition on financial performance of companies listed in Nairobi Securities Exchange.

The study undertook to examine four objectives: to establish whether Board Gender influences financial performance of companies listed in Nairobi Securities Exchange; establish whether Board age influences financial performance of companies listed in Nairobi Securities Exchange; establish whether Board Ethnicity influences financial performance of companies listed in Nairobi Securities Exchange; establish whether Board Independence influences financial performance of companies listed in Nairobi Securities Exchange . The target population for the study comprised board executives and members in all listed companies quoted at the NSE for the period of five years from 2010 to 2014. The sample size included 65 board management and executives from the firms. The researcher employed descriptive survey research design and used secondary data obtained from the NSE and CMA library. With the aid of Statistical Package for Social Sciences Program (SPSS) version 19.0,

A standard multiple regression model was used to establish the influence of board composition on performance of the firms listed under the NSE. Independent sample t-test was also used determine whether there was significant performance between executives and non-executives. The results were presented using tables in means, percentages and counts. The findings reveal that age had a unique and significant contribution to the performance of the Nairobi securities exchange,  $\beta=.382$ ,  $p<.01$  followed by level of education,  $\beta=.263$ ,  $p<.01$  and gender, which had a unique and significant contribution to the performance,  $\beta=.197$ ,  $p<.01$ . The least were board independence and ethnicity which had ( $\beta=-.199$ ,  $p<.05$ ) and ( $\beta=-.195$ ,  $p<.01$ ) respectively. These findings can facilitate better firm's management by enhancing the knowledge of the Board members in overseeing the management of the Institutions

# **CHAPTER ONE**

## **INTRODUCTION**

### **1.1 Background of the Study**

The board of directors is one form of internal control mechanisms in corporate Management since the board members appoint, supervise and remunerate top managers in organizations in addition to strategy formulation (Minguez & Campbell, 2010). Over many years, studies have investigated the effect of board composition on the performance of firms, majorly focusing on the proportion of non-independent directors such as Agrawal and Knoeber (1996), tenure of the board as in Hermalin and Weisbach (1991), shares held by directors as done by Weisbach (1988), board size as investigated by Kini *et al.* (1995), and board meetings studied by Vafeas (1999), Brick and Chidambaram (2007).

The new Central Bank of Kenya (CBK) guidelines has called attention to the need to study, understand, and improve the corporate governance of financial entities. The CBK especially advocates a governance structure composed of a board of directors and senior management. The role of boards as a mechanism for corporate governance of firms listed at the NSE is of special relevance in a framework of limited competition, intense regulation, and higher informational asymmetries due to the complexity of the running such firms. Thus, the board becomes a key mechanism to monitor managers' behavior and to advise them on strategy identification and implementation. Directors' specific knowledge of the complexity of the firm's business enables them to monitor and advice

managers efficiently. The debate on the impact of board diversity in the corporate world has continued to rage. The influence of the board members' individual gender type and educational qualification on corporate performance is the main issue of discussion. Scholars and practitioners as well as policy makers have for the last two decades debated on the role of boards of directors as one of the key pillars of corporate governance (Malin, 2007; Monks & Minow, 2008; Tricker, 2009). Board composition has proved to be critical in corporate performance especially in emerging and transition economies (Klein, 1998; Bhagat & Black, 2000).

### **1.1.1 Board Composition**

Board composition can be defined as the combination of executive directors (including the chief executive officer) and non-executive directors in the board (Agrawal and Knoeber, 1996). Sometimes non-executive directors are appointed from outside and they may not have any material interest into the firm also known as independent directors. (Hutchinson, 2002; Young, 2003; Weisbach, 2008). Corporate governance is concerned with the relationship between the internal governance mechanisms of corporations and society's conception of the scope of corporate accountability (Ayogo, 2005). It has also been defined by Park and Shin (2003) to include 'the structures, processes, cultures and systems that engender the successful operation of organizations'.

A board fulfills three major tasks (Goodstein et al., 1994). First, it links the organization to its environment and secures critical resources (Williamson, 1996). Second; the board has internal governance and monitoring task (Barnhart et al., 1994). It can discipline or

remove ineffective management teams. Various aspects play a role in increasing the monitoring role of (supervisory and management) boards. First, we have the size of the board. (Haleblian and Finkelstein 1993) argue that the main advantage of a large (management) board is that a large group has more problem solving capabilities. It is likely however that those very large boards are ineffective. (Jensen, 1993) notes that “as group’s increase in size they become less effective because the coordination and process problems overwhelm the advantages from having more people to draw from.” Lipton and Lorsch (1992) put it a little stronger and state that “. The norms of behavior in most boardrooms are dysfunctional.” Zahra and Pearce [1989] argue that there might be a threshold, where board size may have a negative effect on company performance. Empirical evidence on this issue is rather scarce though. A notable exception is Yermack (1996) who finds strong support for a negative relationship between firm performance and board size. Many researchers, such as Musila (2007), have argued that the erosion of investor confidence in Kenya has been brought about by companies’ board composition standards and a lack of transparency in the financial system. Universally acceptable to all corporate performance measures are hard to come by.

Davidson & Rowe (2004), note that there are several measurement issues such as differences in accounting and reporting across different industries that may make finding a relation between board composition and financial performance difficult at best.” While Sahin, Basfirinci & Ozsalin (2011) measure corporate performance in terms of financial performance and social responsibility performance, commonly used measures of firm performance are Return on Assets (ROA) and Tobin’s Q (a market based performance

measure) (Rashidet *al.*, 2010). Eklund, Palmberg and Wiberg (2009) used market value (defined as the total value of outstanding shares plus total debt) as a measure of performance. This study seeks to come up with recommendations on the relationship between board composition and company financial performance, using Kenyan Companies listed at NSE. This is to determine if the Kenyan situation is in line with global trend or if we can find a definite pattern of relationship between board composition and corporate financial performance for the Kenya corporate world.

### **1.1.2 Financial Performance**

According to Armstrong (2006), performance is often defined simply in output terms- the Achievement of quantified objectives. Firm performance is a multidimensional construct that consists of four elements (Alamet *al.* 2011). Customer-focused performance, including customer satisfaction, and product or service performance; financial and market performance, including revenue, profits, market position, cash-to-cash cycle time, and earnings per share; human resource performance, including employee satisfaction; and organizational effectiveness, including time to market, level of innovation, and production and supply chain flexibility.

Firm's financial performance have been 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=  $\text{EBIT} / \text{Average total Assets} - \text{in book value} -$ ), ROE (Return on Equity=  $\text{net profit} / \text{equity} - \text{in book value} -$ ), Change in market value of equity, Change in market

value of equity, adjusted for dividends and risk). Yasser et al. (2011) used return on equity (ROE) and profit margin (PM) for the measurement of firm performance. Market based measures of companies' performance were done by Shah et al. (2011) by Market value of equity divided by book value of equity and Tobin's Q (market value of equity + book value of debt/total of assets - in book value -), whereas financial reporting perspective was measured by ROE and Return on investment (net result + interest) / (equity +total debt). Bhagat & Black (1999) measured dependent variable firm performance by Tobin's Q, Return on assets (Operating income/Assets), Turnover ratio (Sales/Assets), Operating margin (Operating income/Sales), Sales per employee and also by Growth of Assets, Sales, Operating income, Employees and Cash flows. The study was focus on those measures that are strategically important for the success of the company. In that direction, the study would measure the financial performance of the companies by looking at profitability (Return on Assets, Return on Equity and Dividend Yield).

Return on Assets (ROA) refers to the amount of net income returned as a percentage of total assets. It can be decomposed as follows:  $\text{Return on Assets} = \text{EBIT} / \text{Average total Assets}$  – in book value while Return on Equity (ROE) refers to the amount of net income returned as a percentage of shareholders equity. Return on equity measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested. Each insurance firm's ROE has been obtained for its annual reports. ROE is expressed as a percentage and calculated as:  $\text{Net Income} / \text{Shareholder's Equity} * 100$  Net income is for the full fiscal year, before any

dividends are paid to common stockholders but after dividends are paid to preferred stock, Shareholder's equity does not include preferred shares.

### **1.1.3 Effect of Board Composition on Financial Performance**

Boards mostly compose of executive and non-executive directors. Executive directors refer to dependent directors and non-Executive directors to independent directors (Shah *et al.*, 2011). At least one third of independent directors are preferred in board, for effective working of board and for unbiased monitoring. Dependent directors are also important because they have insider knowledge of the organization which is not available to outside directors, but they can misuse this knowledge by transferring wealth of other stockholders to themselves (Beasley, 1996). A board composed of members who are not executives of a company, nor shareholders, nor blood relatives or in law of the family (Gallo, 2005). An independent board is generally composed of members who have no ties to the firm in any way, therefore there is no or minimum chance of having a conflict of interest because independent directors have no material interests in a company.

Theoretically, there are a number of arguments in favor of board composition. For example, Carter *et al.* (2003) identified five positive arguments for board composition in a principal agent framework. They opine that a more diverse board is able to make decisions based on the evaluation of more alternatives compared to a more homogenous board. A diverse board is seen to have a better understanding of the market place of the firm, which increases innovation and creativity. Board composition diversity may also



improve the image of the firm considering that positive image has positive effects on customers' behavior.

Daily, Ellstrand, and Johnson (1998) 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 (e.g., CEOs of other firms, former governmental officials, investment bankers, Social worker or public figures, major suppliers). Moreover, for advice/counsel inside or dependent directors are available to the CEO as a function of their employment with the firm; their appointment to the board is not necessary for fulfillment of this function. Staikouraset *al.* (2007) and Adusei (2010) find that board composition does not affect firm performance although its relationship with performance was found to be positive. At the same time, Alonso and Gonzalez (2006) studied 66 banks in OECD countries from 1996 to 2003. They established an inverted U shaped relation between the measures of bank performance and board size which they posit justifies a large board but imposing an efficient limit on size. According to Jensen and Meckling (1976), boards dominated by outsiders or NEDs may help to mitigate the agency problem by monitoring and controlling the opportunistic behavior of management.

#### **1.1.4 Nairobi Securities Exchange**

NSE was formed in 1954 as a voluntary organization of brokers and today it is one of the most active markets in Africa. It has played a very vital role in championing the increase in investor confidence by modernizing its infrastructure. It has led to promotion and

enhancement of culture of thrift and saving by providing alternatives avenues for investment and assists in the transfer of these savings to investment in productive enterprises and quoted stocks. The Kenyan government realized the need to design and implement policy reforms to foster sustainable economic development with an efficient and stable financial system in the 1980s. It set out to enhance the role of the private sector in the economy, reduce the demand for public enterprise on the exchequer, rationalize operations of the public enterprise sector to broaden the base of ownership and enhance capital market in the formation of a regulatory body “the capital market authority” in 1989, to assist in the creation of an environment conducive to the growth and development of country’s capital markets (Statistical Abstract, 1990).

In 1984, a study on the Development of Money and Capital Markets in Kenya was jointly undertaken by the Central Bank of Kenya (CBK) and the International Finance Corporation (IFC) with the objective of making recommendations on measures that would ensure active development and strengthening corporate performance in the financial sector. This became a blueprint for structural reforms in the financial markets. The Government further re-affirmed its commitment to the creation of a regulatory body for the capital markets in the 1986 Sessional Paper on “Economic Management of Renewed Growth” (Mbaru, 2008). In November 1988, the Government set up Capital Markets Development Advisory Council and charged it with the role of working out the necessary modalities including the drafting of a bill to establish the Capital Markets Authority (the Authority). In November 1989, the bill was passed in parliament and subsequently received Presidential assent (The Capital Markets Authority was set up in

1989 through an Act of Parliament (Cap 485A, Laws of Kenya)). The Authority was eventually constituted in January 1990 and inaugurated on 7th March 1990.

The NSE is poised to play an increasing role in the Kenyan economy and that is why the Government of Kenya (GOK), the Capital Market Authority (CMA) and the Central Bank of Kenya (CBK) have over the years played a principal role in developing and strengthening the NSE to enable it take up the various roles and functions. Measures taken include enactment of legislation, rules, policies and guidelines, adjustment in macroeconomic variables such as taxation rates, interest rates, exchange rates and working towards managing inflation in the economy, setting up institutions such as Central Depository and Settlement Corporation (CDSC) and Investor Compensation Fund (ICF). In 2006 the NSE initiated the automated trading systems which have resulted in high trading volumes. The implementation of automated trading system provided for longer trading hours, increased trading efficiency and price discovery (Economic Survey, 2007). The growth of NSE in the past five years has been attributed to positive growth rate registered by the Kenyan economy and the changing international perception of Kenya as a secure investment destination.

## **1.2 Research Problem**

Despite tight regulatory framework, Effective Board management continues to weaken in Kenya (Mang'anyi, 2011). According to Mureithi, (2009), many companies have been characterized by scandals since directors have acted illegally or in bad faith towards their shareholders. The lack of professional management and governance malpractices has

seen some stock brokers experience significant financial difficulties forcing the Capital Markets Authority to place them under receivership/statutory management. For example the recent collapse of firms listed in the NSE such as Uchumi and many stock brokerage firms in a period of just less than ten years and also the recent events in the global scene concerning high-profile corporate failures such as Enron in the US have intensified debate on the efficacy of board composition as a means of increasing corporate financial performance. However the available literature on the relationship between the board composition and firm financial performance reflects mixed results.

In the context of recent corporate failures, the focus on the appropriate composition of board of directors that would efficiently manage corporate resources and give managers access to independent and valuable advice to cope with the complexity of strategic choices to run the firms successfully is of great importance. The relationship between composition of board of directors and firm financial performance is complex and researchers have struggled with multiple variables and often been disappointed in searching for an optimum board composition that would positively impact on firm financial performance. To date, there are many studies on the relationship between board of directors and firm performance (Andres and Vallelado, 2008; Bouaziz, 2010 and Obura, 2010). Andres and Vallelado (2008) studied the role of board of directors in a sample of 69 large commercial banks from six developed countries for the period 1995-2005 focusing on only two measures duality and the size of the board.

Bouaziz (2010) studied the impact of board of directors on financial performance of a sample of 26 Tunisian companies listed on Tunisia Stock Exchange basing on three measures. Obura (2010) did a study on the relationship between board structure and board compensation on financial performance for companies listed at Nairobi Stock Exchange.

Gitobu (2000) studied the relationship between Corporate Governance and Firms performance while majority of the studies have examined the composite stock indices in relation to board composition of companies listed at the Nairobi Securities Exchange and examined whether companies incorporate available information, but did not determine what tasks the companies respond to in relation to board composition and to how important these tasks are to the financial performance of firms listed in Nairobi Securities Exchange and also did not establish the direction and magnitude of the interaction between board composition tasks and firms financial performance at the Nairobi Securities Exchange. In spite of all these alternative studies that have been carried out, a gap in the literature relating examining the effect of board composition on financial performance of firms listed in Nairobi Securities Exchange exist because there are still no conclusive results that have been arrived at and this study will expand from two to four measures of board composition, that is, Board Gender, Board age, Board Ethnicity, Board Independence. Therefore, this study seeks to fill this gap by critically evaluating the effect of board composition and financial performance of companies listed in the Nairobi Securities Exchange and determining what tasks in relation to board composition the companies respond to and how important these tasks are to the financial performance of

firms listed in Nairobi Securities exchange by answering the research question: Does board composition affect financial performance of companies listed in Nairobi Securities Exchange in Kenya?.

### **1.3 Objective of the Study**

The general objective of this study was to establish the effect of board composition on financial performance of companies listed in Nairobi Securities Exchange by seeking to:

1. Establish whether Board Gender influences financial performance of companies listed in Nairobi Securities Exchange
2. Establish whether Board age influences financial performance of companies listed in Nairobi Securities Exchange.
3. Establish whether Board Ethnicity influences financial performance of companies listed in Nairobi Securities Exchange.
4. Establish whether Board Independence influences financial performance of companies listed in Nairobi Securities Exchange

### **1.4 Value of the Study**

The findings of this study can enhance the efforts of the regulators in coming up with more regulations regarding Board composition that will govern the operations of Listed companies in the NSE. The researchers also gained immense knowledge in the way listed companies should be run and thus Organize programs aimed at creating awareness on how to run these institutions to the benefit of the shareholders.

The study can facilitate better firm's management by enhancing the knowledge of the Board members in overseeing the management of the Institutions, To listed companies, this study seeks to provide an understanding of the Relationship between board composition and financial performance in Nairobi securities Exchange listed companies which is very important to the need to have a robust team of decision makers with a broad range of perspectives and abilities, crucial to their financial success and in building trust among companies stakeholders. Future studies may build on the findings of this study as a source of empirical information regarding the relationship between board composition and the financial performance in the Nairobi Securities exchange listed companies in Kenya.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

This chapter is divided into four parts. Section 2.2 discusses the theoretical literature specifically discussing the theories the study was based on. Section 2.3 details on the components of Board Composition. Section 2.4 deals with measurement of Financial Performance. Section 2.5 deals with empirical literature on the board composition and seek to establish the effect of board composition on corporate financial performance in NSE listed firms in Kenya. Lastly section 2.6 presents a summary of the literature review.

#### **2.2 Theoretical Review**

The following theories try to explain the relationship between board composition and corporate financial performance literature.

##### **2.2.1 Agency Theory**

Agency theory is defined as the relationship between the principals, such as shareholders and agents such as the company executives and managers. In this theory, shareholders who are the owners or principals of the company, hires the agents to perform work. This theory was put forth by Mitnick (1975) and Ross (1974) in an attempt to explain the separation of ownership and control in corporations. It views the firm as an interrelated set of contracting relationship among individuals. The theory holds the assumption that both parties of the contract relationship will act to maximize their utility by using the



information available to them. In the agency theory, there is a principle who hires an agent to perform a task that the principle is unable to do. In this case, the principle and the agent are the parties in the theory. In the context of corporations, the principles are the shareholders of a company who delegate work to the agents who in this case are the management. Another assumption of the theory is that both the principal and the agent are motivated by self-interest. An assumption that implies that if both parties are driven by self-interest, agents are more likely to pursue self-interested aims that are deviant with the goals of the principle despite the fact that agents are to act in the sole interest of their principles.

Agency theory governs modern corporations which are characterized by large number of shareholders who allow separate individuals to control and direct the use of their collective capital for future gains. It offers many useful ways of examining the relationship between owners and manager and verify how the corporate objective of maximizing returns to the owners can be achieved. Shareholders in today's corporations may not always own shares but may possess relevant and needed professional skills in the management of the firm. Other theorists in developing the agency theory have suggested ways of minimizing the potential of agency problems. Jensen (1983) suggests two ways. First, he suggested efficient design of the principle- agent risk bearing mechanism and secondly the monitoring of the developed design through nexus of organizations contracts. The inevitable loss of firms value arising from the agency problem along with the monitoring and bonding costs are known as agency costs.

The idea behind agency theory is based on the idea that in a modern corporation, the separation of ownership and management leads to agency costs associated with resolving the conflict between the owners and the agents (Berle & Means, 1932; Jensen and Meckling, 1976). The implication of this and the agency theory in general is that management cannot be trusted, thereby calling for strict monitoring by the Board in order to protect shareholders' interest. The main concern of Agency Theory therefore, is effective monitoring which is achieved when Board have majority of outside and ideally independent directors. The position of Chairman and CEO should be held by different persons.

### **2.2.2 Upper Echelon Theory**

The Echelon theory was first put forth by Finkelstein and Hambrick (1996). The central premise of the theory is that top executives in organizations analyze the opportunities, threats, alternatives and likelihoods of various outcomes of their activities. These individualized construals of strategic situations arise because of executives' experiences, values, personalities and other human factors. Thus, according to the theory, organizations become reflections of their top executives. Proponents of the theory hypothesized that strategic choices cannot be separated from inherent demographic characteristics of decision makers. While most studies on corporate executives and corporate strategy have emphasized more on CEO and/or Top Management Teams (TMT), this study follows Finkelstein and Hambrick's (1996) suggestion that research needs to extend to board of directors because boards of directors have a significant influence in strategic decisions of the firm. Boards of directors provide advisory roles,

and play a major role in reviewing, approving, and facilitating strategic decisions. Golden and Zajac (2001) argues that demographic features of board of directors may influence the inclination of the company in terms of financial performance. This is particularly important because corporate governance will require the involvement of the board; in terms of advising, review, and approval of strategic decisions.

Hambrick and Mason (1984) hypothesizes that demographic characteristics of decision makers partially predict their strategic orientations. It proposes that organizational outcomes are related to top level decision makers possessing particular demographic profiles, and so ‘if you want to understand why organizations do the things they do, or why they perform the way they do, we must consider the biases and dispositions of the most powerful actors- their top executives’ (Hambrick, 2007: 334). The core assumption of Hambricks and Manson’s (1984) perspective is the belief that demographic characteristics of corporate executives serve as surrogates for their cognitive orientation, beliefs, values, perceptions and knowledge base, with implications for financial performance. According to Hambrick (2007), executives act based on their personalized interpretations of a given strategic situations they are confronted with, and the personalized interpretations are a function of their experiences, values, beliefs and personalities. The implication of this theory to organizations is that the actions of top management determine the development of the organization through preferences, behavior and abilities intertwined in their strategic choices. Top managers should therefore bring to organizations a set of values and beliefs that to their formal roles that

represent the means through which understanding and action are embedded within established corporate and social worlds.

### **2.2.3 Resource Dependency Theory**

Resource dependency theory concentrates on the role of board directors in providing access to resources needed by the firm. Resources Dependency Theory (RDT) originated from Pfeffer (1981). The theory characterizes the link between organizations as a set of power relations based on exchange resources. It proposes that actors lacking essential resources will seek to establish relationships with others in attempts to obtain needed resources. Similarly, organizations attempt to alter their dependence relationships by minimizing their own dependence or by increasing the dependence of other organizations on them. Within this context, organizations are viewed as coalitions altering their structure and patterns of behavior to acquire and maintain needed external resources (Pearce & Zahra 1992). Acquiring the external resources needed by an organization comes by decreasing the organization's dependence on others and/or by increasing other's dependency on it, that is, modifying an organization's power with other organizations. Resource dependency theory considers agents (management as well as the board) as a resource since they would provide social and business networks and influence the environment in favor of their firm (Johnson, et al., 1996; Carpenter & Westphal, 2001).

RDT is based on three assumptions. First is that Organizations are assumed to be comprised of internal and external coalitions which emerge from social exchanges that are formed to influence and control behavior, secondly, the environment is assumed to

contain scarce and valued resources essential to organizational survival. As such, the environment poses the problem of organizations facing uncertainty in resource acquisition and thirdly, organizations are assumed to work toward two related objectives: acquiring control over resources that minimize their dependence on other organizations and control over resources that maximize the dependence of other organizations on themselves. Attaining either objective is thought to affect the exchange between organizations, thereby affecting an organization's power.

The basic implication of this theory on corporate governance is that boards of directors are an important mechanism for absorbing critical elements of environmental uncertainty into the firm. Environmental linkages could reduce transaction costs associated with environmental interdependency. The organization's need to require resources leads to the development of exchange relationships between organizations. Hence, appointing directors that have influence and expertise is seen as an important strategy for survival because of their knowledge and prestige in their professions and communities, firms are able to extract useful resources.

### **2.3 Determinants of Board of Directors Composition**

The traditional understanding of board composition is through the paradigm of discrimination-and-fairness, both through programs such as affirmative action - attempting to select from under-represented groups - and through a numbers-based approach where statistics are the most important tool(Thomas & Ely, 1996). As looked at earlier in the study however, there are several other aspects that need consideration, in

assessing how board composition really is. Board size, gender, age, level of education and board independence as determinants of firm financial performance as discussed below.

### **2.3.1 Board Size**

The effect of board size on corporate performance varies depending on the specific characteristics of the company in question or even the country in which the company operates. Having a large board size becomes advantageous given the greater collective information that the board subsequently possesses and as a result larger boards contribute to increasing performance of the company. Ferreira (2009) argues that an increase in the number of non-executive positively impacts financial performance of companies than increase in the number of executive directors. While a large board may have its advantages, it may also be problematic and the potential problems will depend on the specific functions as well as effectiveness of the board depending on the institutional and legal environment. With large boards come the large coordination costs and increased free rider problems. Coordination costs arise from the difficulty in the arrangements of board meetings and reaching consensus during meetings and this may lead to slower and less efficient decision making. Additionally, board cohesiveness is destabilized as board members will be less likely to share a mutual purpose and reach a consensus that builds on the directors' different points of view. Increase of board size beyond ascertain point may lead to inefficiencies that outweigh the initial advantages of having more directors to draw on, leading to a lower level of corporate performance (Wegeet *al.* 2008)

### **2.3.2 Board Gender**

Recent research highlights the role of gender diversity for firm's performance (Campbell and Minguez-Vera, 2007). Adams and Ferreira (2009) also report the positive effect of female directors on firm's outcomes. The Boards with greater gender diversity are found to exhibit lower degree of non-attendance at the Board meetings. There are also arguments that increased board gender diversity might decrease firm performance. Earley and Mosakowski (2000) argue that members of homogeneous groups communicate more frequently as they are more likely to share similar opinions. Likewise, Tajfel and Turner (1985) and Williams and O'Reilly (1998) argue that homogeneous groups are cooperative and have less touching conflicts.

In Kenya, statistics on gender representation in boards of directors are scanty. However, scattered data and some anecdotal evidence reports that Kenyan boards are overwhelmingly male dominated (Business daily, 2010). This is not different from the UK situation as found out by Grosvoldet *al.* (2007). This, in Kenya, as provided by the anecdotal evidence is believed to arise from the recruitment process which is referred as old –boy network. The old boy network is whereby the old members of the boards introduce their own friends to be board members before they retire. At the same time it is believed that the corporate scene is male dominated because of inadequacy of the nominating committees as recommended by the Capital Markets Authority (Ibid, 2010).

### **2.3.3 Board Age**

Wegge *et al.* (2008) observes that age heterogeneity improve the ability of groups to solve tasks with high complexity. For groups working on simple tasks, however, age heterogeneity increased the number of self-reported health problems - which in turn indicates that groups of diverse ages should be utilized particularly for innovation or solving complex problems. Further, the positive result of age composition is attributed to extended job tenure. According to Dagsson *et al.*, (2011) the increasing use of organizational behavior theory can be used to predict board function and improve board processes. From this they argue that governance research should concentrate on “creating and testing a theoretically sound model of Board effectiveness, rather than trying to relate team attribute variables to firm financial performance”

Wiersema and Bantel (1992) focus on the demographic characteristics of the Board and their influence on firm’s strategic decisions. The age of Board members represents one of the demographic variables chosen for the study. Using a sample of 100 firms in 1983, they report a negative relationship between the average age of Board members and the changes in corporate strategies. This result shows that younger Boards are more tolerant to bear more risk and are more likely to accept major changes in the process of decision-making in comparison to older directors.

### **2.3.4 Board Ethnicity**

The phenomenon of the ethnic composition of corporate boards encompasses at least two significant, and interrelated, propositions. The first viewpoint holds that those competent



women and ethnic minorities with the human capital, external networks, information, and other characteristics of importance to the corporation deserve opportunities to serve on corporate boards and in upper management. The second proposition suggests that ethnic composition of directors results in better governance which causes the business to be more profitable (Carter *et al*, 2010).

### **2.3.5 Board Independence**

Independent directors represent the category of directors that are not employed in the company and do not have any material relationship with it. These directors are in the role of monitors of the Boards. They are also called outsiders or external directors. Board independence is measured by the proportion of independent directors to the Board size; While Insider Directors are those that participate in the day to day running of the company. They work full-time in the company and are responsible for the achievement of operational and strategic objectives. For example, the CEO represents an inside director Peng (2004) indicates that the effect of Board independence on firm performance is far from robust and depending on the measure of firm performance the effect is either insignificant, or positive. Klein (1998) also fails to find a significant relationship between Board committee structure and firm profitability, On the other hand John and Senbet (1998) argue that a board is more independent if it has more non-executive directors (NEDs). Cotter *et al*. (1997) support this view underscoring the important role of outside directors in protecting shareholders' interest through effective decision control. Some authors have also found that there is no significant relationship between proportion of NEDs and firm performance (Bhagat& Black, 2002). It has been shown that the

effectiveness of a board depends on the optimal mix of inside and outside directors (Baums, 1994). However, available theory is scanty on the determinants of optimal board composition (Weisbach, 2002).

## **2.4 Empirical Review**

The debate of whether board composition in the form of representation of outside independent directors may add value to the firm's financial performance is widely covered in the corporate governance literature. Ebrahimet *al.* (2012) in Kuwait carried out a study on the impact of board characteristics on firm performance. Their study focused on non-financial companies listed in the stock exchange and was descriptive in nature. They established that CEO tenure and leverage on firm performance had negative and significant effect at the chosen level of significance.

Theo *et al.*(2010) in their study focused on the board composition and firm performance in the Netherlands. They used instrumental variables in cross sectional data to determine the relationship. Their study found no relationship between performance and size of the management board. They also found that there exist a negative relationship between remuneration of supervisory boards and performance; especially since remuneration of total boards reflects their size.

Rashid et *al.* (2010), in their study on board composition and firm performance in Bangladesh. Their study which employed linear regression revealed that the outside (independent) directors cannot add potential value to the firm's economic performance.

The idea of the introduction of independent directors may have benefits for greater transparency, but the non-consideration of the underlying institutional and cultural differences in an emerging economy may not result in economic value addition to the firm.

Wang and Oliver (2009) studied board composition and firm performance in the context of Australia. Their descriptive study sampled 384 Australian companies and established a negative impact of executive directors on subsequent risk. Affiliated and independent directors, however, have no significant effect on the level of performance variance. Block holders give a positive influence on firm risk. Moreover, companies with poor dividend payout or low managerial shareholdings tend to be riskier.

In Nigeria Uadiale (2010) carried out a study on the impact of board structure on corporate financial performance in Nigeria. He used ordinary least squares to estimate the relationship and found that the relationship between board size and corporate performance was highly positive. Similarly, he established a positive relationship between outside directors and firm performance and a negative relationship between director stockholding and firm financial performance. Elsewhere in Uganda, Lukwago (2012) studied corporate governance and financial performance in Micro Finance Institutions. The study was both cross sectional and quantitative. The study revealed that there exists a positive relationship between corporate governance and financial performance and growth of micro finance institutions in general.

According to Ayogo (2005) in his study on Corporate Governance in Kenya and the Record and Policies for good Governance” argued that corporate governance is concerned with the relationship between the internal governance mechanisms of corporations and society’s conception of the scope of corporate accountability.

Musila (2007) in his study on Leadership Structure: Separating the CEO and Chairman of the Board” have argued that the erosion of investor confidence in Kenya has been brought about by companies’ board composition standards and a lack of transparency in the financial system.

Murage (2010), in his study on the Relationship between Corporate Governance and Financial performance of Parastatals in Kenya, concluded that large boards enhanced corporate performance and that when such boards were dominated by non-executive directors, it enhanced firm value. While the CEO duality did not significantly impact on financial performance measure of ROA, in his study, it had a positive relationship with financial performance in conflict with other studies.

Ongore and K’Obonyo (2011) in their study on Effects of Selected Corporate Governance Characteristics on Firm Performance concluded that the role of boards was found to be of very little value, mainly due to lack of adherence to board member selection criteria.

Wetukha (2013) carried out a study on the relationship between board composition and financial performance of listed firms in the NSE. His study that adopted descriptive research design and employed regression analysis revealed a positive relationship between board independence, board size, and CEO duality and financial performance of companies listed in Nairobi Securities Exchange. His study also found that gender diversity and the proportion of executive directors negatively affect the financial performance of companies listed at the NSE.

## **2.5 Summary of the Literature Review**

The available literature on the relationship between the board composition and firm performance reflects mixed results. The idea of endogenous relationship between board composition and corporate financial performance was advanced by Hermalin and Weisbach (2000), that is, board composition and corporate performance jointly influence each other rather the board composition influencing corporate performance or corporate performance influencing board composition. Davidson and Rowe (2004) note that board composition and financial performance influence each other but the effect is not immediate. Corporate governance relates to the way and manner in which financial resources available to an organization are prudently used to achieve the overall corporate objective of an organization. According to Kajola (2008), good corporate governance keeps the organization in business and guarantees an organization's future success. Jensen and Meckling's (1976) research ignited interest in empirical study on corporate governance as it relates to performance. Much of this research (reviewed extensively by

Shleifer and Vishney, 1997), examined whether corporate governance mechanisms or managerial decisions generate predictable stock price impacts.

Some scholars had observed that the relationship between board structure (as opposed to board processes) and company performance has been the most-studied aspect among all board investigations (Pearce and Zahra, 1989; Bhagat and Black, 2002). It is often assumed that a company's financial performance is mainly determined by board diversity. Pfeffer (1983) argued that it is not necessary to understand board processes as directors' performance can be inferred from their demographic characteristics. Other scholars have suggested that future research studies on the actual mechanisms and benefits brought by women on boards of directors and board composition would be fruitful extensions of their work (Hillman and Cannella, 2007; Bathula, 2008). Such an assumption requires data-supported justification. Indeed the analysis of the board composition is important as quantification of board structure and company performance is much easier than that of incorporating board attributes, processes and firm performance.

Recent corporate reforms encourage women participation in corporate governance practices. The aim is to promote gender diversity in the boards. Firms have been pressured by institutional investors, shareholder activists and interest groups to appoint directors with different ethnic and gender backgrounds as well as bases of expertise to their boards (Van der Walt et al., 2006). The underlying assumption is that greater diversity should lead to less insular decision-making processes and greater recognition of change (Westphal and Fredrickson, 2001; Bathula, 2008). Bilimoria (1995) argued that

women executives bring fresh and well-informed views related to market, environment and ethical issues and have an impact on the decision-making process of corporations and that boards with more than one female director have a greater influence over strategic decisions. Therefore, the diversity in the board of directors, whether viewed from one or a combination of attributes, can directly or indirectly explain company performance.

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

This chapter presents the research methods that were employed to facilitate execution of the study to satisfy study objectives. They include research design, population of interest, sample and sampling techniques, and data collection instruments, procedures and data analysis.

#### **3.2 Research Design**

Research design is the plan and structure of investigation so conceived as to obtain answers to research questions. The plan is the overall scheme or program of the research (Robson, 2002). A descriptive research design was used in this study. The major purpose of descriptive research design is to provide information on characteristics of a population or phenomenon (Mugenda & Mugenda, 2003).

#### **3.3 Population**

A population is an entire group of individuals, events or objects having common characteristics that conform to a given specification (Mugenda & Mugenda, 2003). The population of interest in this study constituted of all listed companies quoted at the NSE for the period of five years from 2009 to 2014. The study was limited to listed companies and currently we have a total of sixty one firms listed in NSE (Appendix 1).



### **3.4 Data Collection**

Secondary financial data sources was used for the study, where annual financial reports of individual listed firms' was used over the five year period where profitability was extracted and used as a measure of financial performance. The five year period ranged from 2009-2014. Board composition data was obtained from corporate governance disclosure of individual listed firms in NSE. The data is filed by NSE and CMA library that also files details of the board of directors like the age, name, position and whether independent or dependent director was obtained which is a requirement by the companies listed to file with them which is readily accessible and reliable.

### **3.5 Data Analysis**

Being a comparative study, multivariate and univariate analysis models was used. Univariate analysis involves a summary or descriptive statistics such as mean, frequencies, test of normality, mode, median, quartiles among others. Test of significance,  $R^2$ , ANOVA and T-test was used to establish the significance of the difference in financial performance means between the boards over the five-board term period from 2008- 2013 that was at 5% significant level. Statistical Package for Social Science (SPSS) was used to determine the nature and strength of the relationship between board composition and financial performance of the NSE listed companies.

#### **3.5.1 Analytical Model**

The study used a standard multiple linear regression model that seeks to establish the relationship between board composition and financial performance of NSE listed

companies through regressing factors such as gender, age, ethnicity and board independence within the period of interest. The regression model to be employed was

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \varepsilon$$

Where,

Y = Firms financial performance as determined by return on assets (ROA) expressed as:

$$\text{ROA} = \text{Net Income} / \text{Total Assets}$$

$\beta_0$  = constant or intercept-defines value of return on asset without inclusion of predictor variables

$\beta_1$  = Regression coefficient for board size

$\beta_2$  = Regression coefficient for gender

$\beta_3$  = Regression coefficient for age

$\beta_4$  = Regression coefficient for education level

$\beta_5$  = regression coefficients for board independence

$X_1$  = board size determined by the number of individuals in the board. Less than 5 board members represented 25%, 5-10 was another 25%, 10-15, another 25% and more than 15 the final 25% totaling to 100%.

$X_2$  = gender determined as a proportion of the female directors to the proportion of male directors. This was expressed as a percentage.

$X_3$  = age measured using a scale. The directors fit in any of the following age groups: 18-23, 24-29, 30-35, 36-41 and 42 and above. Each of the age group was assigned a score of 20% which will total to 100% for all the age groups.

$X_4$ = Education level which was: No education, certificate, diploma, graduate, or post graduate. Each of these levels of education was given a score of 20% all of which added to 100%.

$X_5$ =board independence measured by the percentage proportion of non- executive directors to that of the executive directors.

$\varepsilon$  = the "error" term reflecting other factors that influence financial performance.

## **CHAPTER FOUR**

### **RESULTS AND DISCUSSION**

#### **4.1 Introduction**

In this chapter the results of the data analysis are presented. The data were collected and processed in response to the problems posed in chapter 1 of this project. The main research objective of this study was to establish the effect of board composition on financial performance of companies listed in Nairobi Securities. The objectives of the study were; to Establish whether Board Gender influences financial performance of companies listed in Nairobi Securities Exchange, establish whether Board age influences financial performance of companies listed in Nairobi Securities Exchange, establish whether Board Ethnicity influences financial performance of companies listed in Nairobi Securities Exchange, establish whether Board Independence influences financial performance of companies listed in Nairobi Securities Exchange. The study findings are presented, first starting with the demographic information, response return rate and objective of the study.

#### **4.2 Descriptive Statistics**

##### **4.2.1 Demographic characteristics of the Board Members**

This section represents the demographic characteristics of the board members of the organizations involved in the study. The demographic characteristics that were examined were age, gender, level of education, and board independence. The results are as presented in Table 4.1;

**Table 4.1 Demographic Characteristics of the Board Members**

Demographic Data	Categories	n	%	Total f(%)
Gender	Male	48	78.7	61(100)
	Female	13	21.3	
Board independence	Executive	33	54.1	61(100)
	Non-executive	28	45.9	
Education Level	Diploma	0	0.0	61(100)
	Bachelor	28	45.9	
	Masters	16	26.2	
	Doctorate	17	27.9	
Age	18-23	0	0.0	61(100)
	24-29	3	4.9	
	30-35	30	49.2	
	36-41	18	29.5	
	42& above	10	16.4	

It is clear from the results in table 4.1 that most of the board and executive members of NSE and CMA were male, 48(78.7%) while the minority was female, which is in line with (Business daily, 2010 findings which showed a scattered data and some anecdotal evidence reports that revealed that Kenyan boards are overwhelmingly male dominated. Among these members, those who were executive were 33(54.1%) while the non-executive were 28(45.9%). For the level of education, none of the board members were diploma holders. Out of the 61 members, 28(45.9%) held a degree level, 16(26.2%) held a master's degree, and 17(27.9%) held a doctorate degree. It is also clear from the demographic data that majority of the executives and board members were aged 30-35 years 30(49.2%), followed by 18(29.5%) those aged between 36-41 years. 10(16.4%) were aged 42 years and above.

### 4.3 Correlation Analysis

To test the association between the study variables, correlation analysis was employed in this study. The test was conducted at the 5% level of significance with a 2-tailed test. Therefore, a correlation coefficient with a p-value of less than 0.025 indicated a statistically significant association between the variables whereas that with a p-value greater than 0.025 indicated a no significant evidence of the association between the variables. To measure the strength of the association, the Pearson's correlation scale was applied. The scale shows that a correlation value between 0.0 – 0.3 is a no correlation state, 0.3 – 0.5 is a weak correlation, 0.5 – 0.7 a moderate correlation while a correlation value above 0.7 is a strong correlation state. The results for the correlation test are as presented in Table 4.2 below;

**Table 4.2 Correlation Matrix**

		Financial performance	Board size	Gender	Age	Ethnicity	Board Independence
Financial performance	Pearson	1	.625**	.736*	.636*	.799**	.733*
	Sig.		.009	.018	.011	.006	.021
Board size	Pearson	.625**	1	.559**	-.499	-.065	-.723
	Sig.	.009		.000	.058	.262	.697
Gender	Pearson	.736*	.559**	1	-.090	.022	.028
	Sig.	.018	.000		.122	.701	.631
Age	Pearson	.636*	-.499	-.090	1	-.400**	-.438**
	Sig.	.011	.058	.122		.000	.000
Ethnicity	Pearson	.799**	-.065	.022	-	1	.796**
	Sig.	.006	.262	.701	.400**		.000
Board Independence	Pearson	.733*	.723	.028	-	.796**	1
	Sig.	.021	.697	.631	.438**	.000	.000

\*. Correlation is significant at the 0.05 level (2-tailed).

\*\*. Correlation is significant at the 0.01 level (2-tailed).

As illustrated in Table 4.2, the financial performance of the firms listed at the NSE is positively correlated with the board composition of these firms. Only ethnicity indicated a negative association with financial performance. All the other aspects of the board composition considered in the study indicated a positive correlation which is also statistically significant testing at the 5% level of significance. This is as all the variables indicated a p-value less than 0.025 the critical value at the 5% level. Based on the findings therefore, it is clear that, the board size has a positive and significant association with firms' financial performance as indicated by the Pearson's correlation coefficient of 0.625. The gender composition of the board indicated a correlation of 0.736 with financial performance which is a strong correlation. The age factor had a correlation of 0.636 with financial performance.

From the table also, a strong and negative correlation existed between financial performance and ethnicity of the board members. This had a correlation of 0.799 and a significant value of 0.006. The board independence as well indicated a strong correlation of 0.733 with the financial performance of the firms listed at the NSE.

#### **4.4 Regression Analysis**

The general objective of this study was to establish the effect of board composition on financial performance of companies listed at the Nairobi Securities Exchange. In order to achieve this, various objectives were involved which included; establishing whether the gender composition of the Board influences financial performance of companies listed in Nairobi Securities Exchange; to establish whether the ages of the Board members

influences financial performance of companies listed in Nairobi Securities Exchange; establishing whether Board Ethnicity influences financial performance of companies listed in Nairobi Securities Exchange, Establishing whether Board Independence influences financial performance of companies listed in Nairobi Securities Exchange. Therefore a standard multiple regression models was carried out as indicated in chapter three, in order to establish whether board gender, age, ethnicity, and board independence influenced performance. The results are presented as shown in table 4.3.

**Table 4.3 Model Coefficients contribution of board composition on performance**

		Unstandardized Coefficients		Standardized Coefficients	
Model		B	Std. Error	Beta	t
1	(Constant)	1.330	.338		3.934
	Gender	.110	.036	.197	3.031
	Age	.322	.064	.382	4.992
	Board independence	-.070	.028	-.199	-2.512
	Level of education	.276	.077	.263	3.595
	Ethnicity	-.073	.024	-.195	-3.003

a. Dependent Variable: mean of social interaction

The overall model coefficients results indicate that all the variables significantly contributed to performance of companies listed in Nairobi Securities Exchange. First, age had a unique and significant contribution to the performance of the securities exchange,  $\beta=.382$ ,  $p<.01$  followed by level of education,  $\beta=.263$ ,  $p<.01$  and gender, which had a unique and significant contribution to the performance,  $\beta=.197$ ,  $p<.01$ . The least were board independence and ethnicity which had ( $\beta=-.199$ ,  $p<.05$ ) and ( $\beta=-.195$ ,  $p<.01$ ) respectively.



The model significance results were presented as shown in table 4.4

**Table 4.4 Anova Results for Model Significance**

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	4.683	5	.937	44.466	.000 <sup>a</sup>
	Residual	1.474	55	.021		
	Total	6.158	60			

a. Predictors: (Constant), mean of frustrations, mean of fear, Stigmatization, Anxiety to speak, embarrassment while speaking

b. Dependent Variable: mean of social interaction

The model results in table 4.4 indicate that the overall model was significant,  $F(5, 55)=44.466$ ,  $p<.01$ . The F critical at the 5% level is 3.23 above which a F-value reveals a statistically significant model in presenting the relationship between the variables being reviewed. The calculated F value in this study is 44.466 which is greatly above the critical F value depicting the significance and reliability of the model developed through the regression analysis results. The overall model summary results were presented as shown in table 4.5.

**Table 4.5 Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				Sig. Change	F
					R Square Change	df1	df2			
1	.872 <sup>a</sup>	.761	.743	.14513	.761	44.466	5	55	.000	

a. Predictors: (Constant), mean of frustrations, mean of fear, Stigmatization, Anxiety to speak, embarrassment while speaking

b. Dependent Variable: mean of social interaction

The results in table 4.5 indicate that the overall model explained 74.3 percentage variance in the performance of companies listed in Nairobi Securities Exchange,  $R^2=.761$ , adjusted  $R^2=.743$ ,  $F(5, 55)=44.466$ ,  $p<.01$ . This is a very high percentage and implies that the board composition explained a large and significant variance in the performance of firms listed under Nairobi securities Exchange.

#### **4.5 Discussion of the Findings**

The study results has indicated that gender had a unique and significant influence on performance of firms listed under Nairobi Securities Exchange,  $\beta=.197$ ,  $p<.01$ . These results are in support of Earley and Mosakowski (2000) findings who argue that members of homogeneous groups communicate more frequently as they are more likely to share similar opinions. Likewise, Tajfel and Turner (1985) and Williams and O'Reilly (1998) argue that homogeneous groups are cooperative and have less touching conflicts. In the current study, majority of the board members were male, 48(78.8%) while the minority was female, 13(21.3%). Contrary to these findings, Adams and Ferreira (2009) reported the positive effect of female directors on firm's outcomes, which showed that female board members or executives were more likely to influence firm's performance. However, in the current studies, the results far much outweighs this theory and therefore gender having a high influence on performance is largely attributed by men executives.

With respect to the results in the current study, it is clear that age had the most significant influence on Performance of Companies Listed in Nairobi Securities Exchange,  $\beta=.382$ ,  $p<.01$ . Contrary to these findings, Wiersema and Bantel (1992) focus on the demographic characteristics of the Board and their influence on firm's strategic decisions, using a

sample of 100 firms in 1983, reported a negative relationship between the average age of Board members and the changes in corporate strategies. This does not reflect the current findings. In fact, Wegge *et al.* (2008) observed that age heterogeneity improves the ability of groups to solve tasks with high complexity. The current study findings are in line with these findings.

The study findings also indicated that board ethnicity had a unique and significant influence on financial performance of companies. The results show a negative significant influence,  $\beta = -.195$ ,  $p < .05$ . Even though some authors have found that there is no significant relationship between proportion of NEDs and firm performance (Bhagat & Black, 2002). The final aspect of board composition was board ethnicity, which had a unique and significant influence on firm's performance,  $\beta = -.195$ ,  $p < .01$ . These results disagree with the proposition that ethnic composition of directors results in better governance which causes the business to be more profitable as found out by (Carter *et al.*, 2010). Instead, the results revealed that the influence was unique and significant but negative.

The effectiveness of a board depends on the optimal mix of inside and outside directors (Baums, 1994), the current study shows majority of the firm's board directors and executives having a unique influence on security firm's performance. Most of the board members were executives, 33(54.1%) while the minority was non executives, 28(45.9%). From the findings, there is a significant influence, whereas Peng (2004) indicates that the effect of Board independence on firm performance is far from robust and depending on

the measure of firm performance the effect is either insignificant, or positive, which supports the current study results.

## **CHAPTER FIVE**

### **SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS**

#### **5.1 Introduction**

This chapter presents summary, conclusions and recommendations of the study as a whole. The section is divided into three. The first section addresses the summary of the research findings, as per the research objectives. The second section includes the conclusion of the study depending on the results from analysis of data. The last section comprises of the contribution of the study to the body of knowledge and the recommendations for further research.

#### **5.2 Summary of Findings**

The hitch of this study was to scan the previously unsubstantiated effect of board composition on organizational performance of firms listed under Nairobi Securities Exchange, so as to fill the gap left as a result of inadequate studies on the same resulting in a state that has led to lack of professional management despite tight regulatory framework. The lack of professional management and governance malpractices saw some stock brokers experience significant financial difficulties forcing the Capital Markets Authority to place them under receivership/statutory management. The study revealed the highest percentage of male executives, 78.3%, furthermore, the percentage of executives was higher than the none-executives 54.1%. The highest number of the executives was

those who had a bachelor's degree, 45.9%. It also emerged that most of the executive's age ranged between 30-35 years constituting a percentage of 49.2%.

The study revealed that the overall model explained 74.3 % variance in performance. As discussed in chapter four, regression model was used in the entire study, while t-test was used in objective four. The summary of the findings were reported as per the objectives of the study as discussed under subsections of the objectives.

### **5.2.1 Board Gender and Performance of firms listed under Nairobi Securities Exchange.**

From the demographic data of the board executives, there was irrational distribution of gender, leading to a state of homogeneity, such that male executives, 54.1% dominated the female executives, who were 49.1%. Earley and Mosakowski (2000) argue that members of homogeneous groups communicate more frequently as they are more likely to share similar opinions. Likewise, Tajfel and Turner (1985) and Williams and O'Reilly (1998) argue that homogeneous groups are cooperative and have less touching conflicts. The results in the study were similar, precisely; the influence achieved on performance could have been realized as a result of male dominance. Indeed, the unique contribution of gender affirms the notion. The values that were realized were significant and significantly contributed to the model.

### **5.2.2 Board Age on Financial Performance of Companies Listed in Nairobi Securities Exchange**

According to the literature findings, Wiersema and Bantel (1992) focused on the demographic characteristics of the Board and their influence on firm's strategic decisions. The age of Board members represents one of the demographic variables chosen for the study. Using a sample of 100 firms in 1983, they report a negative relationship between the average age of Board members and the changes in corporate strategies. The result showed that younger Boards were more tolerant to bear more risk and is more likely to accept major changes in the process of decision-making in comparison to older directors. In the current study, the regression model revealed a unique influence of age on performance of the firms.

### **5.2.3 Board Independence on Financial Performance of Companies Listed in Nairobi Securities Exchange**

The study revealed that majority of the board members were executive, constituting 54.1%. In an art to establish whether board independence influenced financial performance of the firms, a regression model revealed a significant influence of the board independence on performance.

### **5.2.4 Board Ethnicity and Financial Performance of Companies Listed in Nairobi Securities Exchange**

The results from the regression analysis revealed a unique significant contribution of the board ethnicity on performance of the NSE listed firms. In addition, the secondary

sources from literature findings on almost similar studies revealed that ethnic composition of director's results in better governance which causes the business to be more profitable.

### **5.3 Conclusions**

Board composition is vital to the performance of any given organization or firm. In this study, NSE and CMA are considered very important organizations in Kenya due to the financial positions they hold with other firms. The aspects that were under consideration, in assessing how board composition really was included board size, gender, age, level of education and board independence and were found to be main determinants of firm financial performance. With respect to their hypothesized impact on the firm's performance, the study sought clarity, which was achieved.

First, the study's findings that board gender influenced financial performance of the firm reflected a true scenario on the ground. Gender is vital aspect in leadership as revealed by the literature findings. However, it is clear that most of the dominants in management were male while the few were the female executives. It can therefore be concluded that gender has influence on financial performance of firms, and homogeneity of the gender leads to better performance.

The second conclusion can be drawn from the age of the board. Whereas most studies revealed that disparities in the board age would result into better management due to diversities, the results in the study revealed an impact within the age group 30-40 years.



Most of the management lie within this group and had an influence on the financial performance of the firm. The relationship between age and the financial performance was high and this proves that age has an influence on financial performance of the firms. Age is therefore deemed to be a very significant factor in the firm's financial performance at any given level.

Finally, board's independence and ethnicity were assessed and scanned. The results were not far from the norm. Firm's independence was revealed most of the executives, a good percentage being dependent on the firm, and therefore had a unique contribution to the financial well-being of the firm. It is therefore clear that if most of the board members are compost of executives, then the firm is likely to do better as compared to when most of the board members are no-executives. On the other hand, firm's ethnicity has a significant influence on the financial performance of firms as revealed.

#### **5.4 Recommendation of the Study**

Based on the findings and conclusions on the findings of this study, the study found it necessary to make these recommendations as a step to the implementation of the study objectives.

The board should make steps in ensuring stakeholders are involved in the managerial activities as executives, so as to work towards the protection of the firm. This can lead to better financial performance of the firm since board independence had an influence on the financial performance of the firm.

Secondly, Middle age managers and executives should be embraced in the firms due to their commitment to ensure better performance of the firm's financial position. This recommended as a result of the influence of the age on performance of NSE listed firms as revealed by the results.

Finally, the study recommends diversity of ethnicity in the firm's management in order to boost firm's financial performance. Since ethnicity was found to have an influence on the financial performance, a diverse composition would likely bring out better financial performance due to different ideas that would be contributed by the board members and executives.

### **5.5 Limitations of the Study**

The study was limited to the use of secondary data. The use of secondary data was a limitation due to the question of its reliability as a source of information for the study since it was not originally collected by the researcher which might not be suitable to the current study. It was also limited by availability of the data since not all the information required was readily available from the NSE/CMA bulletins.

### **5.6 Suggestion for Further studies**

Due to the limitations encountered during the study, the researcher therefore recommends further studies to be undertaken that would put into consideration other factors affecting board composition of the firms listed at the NSE. The study also suggests further scanning of the effects of ethnicity in firm's financial performance since the current study

did not deepen findings on the same. The study further suggests more studies done on the effect of board composition of other companies that are not listed as these would undergo different experiences as these companies are monitored by the management and therefore any decision is controlled by the management regardless of the views of other stakeholders.

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## APPENDIX 1 COMPANIES LISTED ON THE NSE AS AT 31<sup>ST</sup> DECEMBER 2014

Agricultural	Barclays Bank Ltd	East African Breweries
Eaagads Ltd Express Ltd	CFC Stanbic Holdings Ltd	Ltd
Kenya Airways Ltd	Diamond Trust Bank	Mumias Sugar Co. Ltd
Kapchorua Tea Co. Ltd	Kenya Ltd	Unga Group Ltd
Kakuzi	Housing Finance Co Ltd	Eveready East Africa Ltd
Limuru Tea Co. Ltd	Kenya Commercial Bank	Kenya Orchards Ltd
Rea Vipingo Plantations	Ltd	A.Baumann CO Ltd
Ltd	National Bank of Kenya	
Sasini Ltd	Ltd	Construction and Allied
Williamson Tea Kenya Ltd	NIC Bank Ltd	Athi River Mining
	Standard Chartered Bank	Bamburi Cement Ltd
Commercial and Services	Ltd	Crown Berger Ltd
Nation Media Group	Equity Bank Ltd	E.A.Cables Ltd
Standard Group Ltd	Co-operative Bank of	
TPS Eastern Africa	Kenya Ltd.	
(Serena) Ltd		
Scangroup Ltd	Insurance	
Uchumi Supermarket Ltd	Jubilee Holdings Ltd	
Hutchings Biemer Ltd	Pan Africa Insurance	
	Holdings Ltd	
Telecommunication and	Kenya Re-Insurance	
Technology	Corporation Ltd	
Access Kenya Group Ltd	Investment	
Safaricom Ltd	City Trust Ltd	
	Olympia Capital Holdings	
Automobiles and	ltd	
Accessories	Centum Investment Co Ltd	
Car and General (K) Ltd	Manufacturing and Allied	
CMC Holdings Ltd	B.O.C Kenya Ltd	
Sameer Africa Ltd	British American Tobacco	
Marshalls (E.A.) Ltd	Kenya Ltd	
Banking	Carbacid Investments Ltd	