THE EFFECT OF CORPORATE GOVERNANNCE ON FINANCIAL PERFORMANCE OF KTDA MANAGED FACTORIES IN KENYA

BY

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DECLARATION

I declare that this is my original work and has never been presented in any other institution of higher learning for any academic purpose.

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

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DEDICATION

I dedicate this research project report to my wife Eunice, and children Samuel, Clinton, Obama, and Juliet for their moral support and understanding during the time I was doing this study.

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ABBREVIATIONS AND ACRONYMNS

KTDA	Kenya Tea Development Authority
CEO	Chief Executive Officer
OECD	Organization for Economic Development
ROA	Return on Assets
SPSS	Statistical Package for Social Sciences

ABSTRACT

This study was carried to examine the relationship between corporate governance and financial performance for KTDA managed factories in Kenya. The study was motivated by the limelight about KDTA managed factories as a result of changes in the governance practices. The objective of the study was therefore to examine the effect of corporate governance and financial performance for KTDA managed factories in Kenya. The study used a descriptive research methodology. The target population for the study was board of directors for KTDA managed factories in Kenya. Simple random sampling was used to select 20 tea KTDA managed factories to participate in the study. Multiple regression analysis was used to examine the relationship between corporate governance practices and financial performance for KTDA managed factories. The study findings indicated that, for most of KTDA managed factories, there was no audit committee and the case where the audit committee is present, there were hardly any meetings. For most of the factories (86.9%) the audit committee reports to the chief Executive officer instead of reporting the chairman of the committee. The independence of the internal auditor seems compromised with 79.2% of the factories indicating that the internal auditor is not independent. Most of the factories had demonstrated recommendable practice with regards to disclosure and transparency. Financial performance varies at 49.5% for KTDA managed factories. The study variables at a correlation coefficient of 0.704.There is a relationship between corporate governance practices and financial performance for KTDA managed factories as expressed in the equation $Y = 0.503 + 0.161\ X_1 +0.027\ X_2 - 0.304\ X_3+0.944\ X_4$. The study concluded that there is a significance relationship between corporate governance practices and financial performance for KTDA managed factories. Weak positive correlation coefficient between corporate governance practice and financial performance could be an indicator that enhancing governance practices among KTDA managed factories could increase the financial performance. A negative correlation coefficient value between disclosure activities and financial performance could be an indicator that disclosure of activities reveal the true financial status for these factories and therefore could be a significant indicator in shaping cost policy for the organizations. The study recommended; an improvement in the adoption of standard corporate governance practices among KTDA managed factories, a need to reduce the gender gap by increasing the number of women in board of directors. It was recommended that a further study be carried out to examine the effect of corporate governance in other agricultural sectors such as sugar and coffee industry. A study could also be carried out on factors affecting the involvement of audit committee among KTDA managed factories in Kenya.

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

Kenya is one of the world biggest tea exporters with hundred thousands of tea farmers earning a living from the commodity. The tea industry is however, screeching to a halt with statistics in 2014 indicating that farmers sold 40% less than the three previous years because they had started to switch to alternative crops. As a result of the challenges facing the tea industry, there has been renewed focus on governance practices with the tea board of Kenya being given the mandate to vet industry players and ensure compliance with corporate governance principles.

This partly comes as a result of privatization of KTDA, with the governance problems facing the industry being associated with board of directors and managers' failure to focus on larger stakeholders. Of particular concern has been the influence of the governance practices on financial performance of tea factories. According to Kenya Tea Development Authority (2010), there is deficiency of governance as well as other challenges such as high dependence on export markets, low yields of small holder farmers, high cost of production and lack of credit facilities faced tea production factories. These challenges continue to attract concerns continue to attract interest of many stakeholders and financial analysts. All over the world, there has been documented evidence of corporate governance practices and how effective use of these practices can enhance a firm's financial performance. This has been particularly true for the Kenya's tea industry. Governance practices in the industry have more often than not been associated with financial well-being of the tea industry, however, mixed reaction continue to span as majority of studies linking corporate governance and financial performance examine the issue from a general industry perspective without having specific analysis of specific factories.

1.1.1 Corporate Governance

The concept of corporate governance has been widely defined. According to Adrian (2012), corporate governance is the system by which a corporation is directed, controlled and held to account. According to Cho and Kim (2009), corporate governance is concerned with relationship between internal governance mechanisms and corporations and society's conceptions of the scope if corporate accountability. Among the measurements of corporate governance include integrity of the board of directors that is director should have a certificate of good conduct, clearance from KRA, clearance from Ethics and anti-corruption commission, clearance from Credit Bureaus and minimum education qualification; organizational reporting structure of the internal auditor and the internal auditors independence, disclosure and transparency whereby we disclose all material facts on the footnotes of financial statements including international financial reporting standards. Others include accountability by the board of directors, monitoring and evaluation, checks and balances of the chairman and the chief executive officer, adoption of minutes and resolutions of the board of directors.

Kim et al (2010), indicated that corporate governance was important in the promotion of better business, efficient performance and thus, despite being widely talked about, the practices continue to be relevant in today's organization. Private Sector Corporate Governance Trust (1999) define corporate governance as the manner in which the power of a corporation is exercised in the stewardship of the corporation's total portfolio of assets and resources with the objective of maintaining and increasing shareholder value and satisfaction of other stakeholders in the context of its corporate mission.

Corporate governance is therefore concerned with creating a balance between economic and social goals and between individual and communal goals while encouraging efficient use of resources, accountability in the use of power and stewardship and as far as possible to align the interests of individuals, corporations and society (Baker, et al, 2007). Corporate governance according to OECD (2009), is founded in different dimensions that include attitudes, ethics, and values of society regarding accountability of power. According to World Bank (2010), good governance practices seek to build a consensus in favour of appropriate policy and regulatory framework that seek to maximize the value of a firm. Governance is therefore operationalized in different contexts, based on the standard guidelines on what laid down governance practices. Within the context of the current study, governance practice was operationalized in the context of board diversity, educational level of board of directors, the role of audit committee and the rate of disclosure and transparency in terms compulsory and voluntary disclosure.

Corporate governance as measured by the organizational structure. According to Tricker,(2012), good governance practices provide independence of the the internal acudit committee. In the context of the current study, an examination of the orgarnizational structure in terms of reporting of the internal auditor.Training as been considered as important tool of enhncing performance and continuous proffessional development (Jackson,2010). Like in other proffesions continuous training of boards of directors is presumed to enahance their professional development. In the case of the present study, training for board of directors was considered and important aspect of governance practice that could significantlt affect a firms financial performance. Other dimensions in which governance is measured is disclosure and transparency. According to Jackson,(2010) disclosure and transparency provide concrete advantages for market, for a firm and adherance to laid down legal framework.Discloure and transparency, in the context of the current study was measured through comparing different financial statement, disclosure of corporate social responsibility activities and their value, tax compliance and compliance with aduiditing standards.

1.1.2 Financial Performance

Financial performance measures the general health of a firm over a given period of time and thus an important construct in comparing similar firms across the same industry or sectors of aggregation (Riahi-Belkaoui, 2003).Several and mixed opinions have been raised on measurements of financial performance, in the quest to answer the question of; what is the best measure and under what circumstances are the measures used able to provide significant results in relation to the constructs under examination. Most of the empirical reviews identify Return on Equity and Return on Assets as important ratios through which financial performance should be measured.

Return on Equity focuses on return to the shareholders of the company. It is typically income before extra ordinary expenses and discontinued operations divided by common equity (Philip, 2009). Return on Assets is an indicator of how profitable a company is in relation to its total assets and calculated by dividing a company's annual earnings by its total assets (Philip's 2009). From a financial management perspective, one could say that ROA provides an idea of how financial decisions enhance use of a firm's assets to generate earnings. Many writers treat return on asset as an indicator of firm's financial performance whatever their objective may be. Jiang (2014), called ROA the key index of business success as it was one of the most popular indicator of financial performance with a widespread use in the empirical research. ROA has been used as an independent variable in models designed to explain or predict executive compensation, (Albuquerne, 2009), Watson, (2011), Dhan, Srn & Wang, (2012). Other measures of financial performance include profitability index and internal rate of return.

1.1.3 Corporate Governance and Financial Performance

Financial performance of a firm remains a major concern for investors, creditors and all other stakeholders of a firm. As capital providers, investors and creditors rely on a company's financial conditions for both the safety and profitability of their investments. More specifically, investors and creditors need to know where their money went and where it is now. As a result, management of a firm as directed by governance practices is perhaps one of the firm's management practices that remain relevant over time and whose effectiveness may significantly affect a firm's financial performance.

The subject of corporate governance and financial performance has been researched in various dimensions. In a study carried out on 50 Pakistan non-financial firms, (Tariq, 2008), the corporate governance index for these firms was measured against financial performance, with the results indicating that corporate governance index scores were positively associated with ROA, ROE and price to book ratio.

Amba (2009) examined the impact of corporate governance on financial performance in the kingdom of Bahrain. Corporate governance variables examined in the study included CEO duality, Chairman of Audit Committee, Proportion of Non-executive directors, concentrated ownership, and institutional investors on firm's financial performance. The study found that corporate governance variables influenced firm's performance. CEO duality and leverage had negative influence while board member as a chair of audit committee. The proportion of institutional ownership was found to have positive influence on firm's financial performance.

In a study to examine the effect of corporate governance on firms performance (Cheng, 2010) used return on assets, stock return and Tobin Q to measure financial performance against governance variables that included; board size, CEO duality, stock pledge ration and deviation between voting and cash flow right. The findings indicated a positive relationship between board's independence and insider ownership. From the afore mentioned studies, it is evident that there is mix of conclusions as far as corporate governance and financial performance is concerned. It is also notable that the effect of corporate governance and firm's financial performance may be industry, firm or country specific and therefore there has been no studies done to exhaustively provide conclusive results on the effect of corporate governance on financial performance.

1.1.4 Kenya's Tea Industry

Kenya's tea sector is divided into production systems or sub-sectors. The smallholder farmers and the integrated multinationals with their own plantations and factories (estates or plantations). Since independence, the smallholders sector has gain and overturned importance in front of the extensive plantations, accounting for 60 percent of the national tea production and 65 percent of the area harvested (KTDA, 2011). In front of the strongly integrated plantations process their own tea through 39 factories, the smallholders are integrated by law (CPDA, 2007) under the Kenya Tea Development Agency (KTDA) that groups, coordinates, process and market the entire smallholders' production. The KTDA is the country's biggest private company with over 15,000 employees and 63 tea factories in 2010 (KTDA, 2012). Both smallholders and plantations sell most of their tea through the Mombasa Tea Auction, the second biggest tea auction in the world, operated by the East African Tea Trade Association (EATTA). During recent years, the industry has been facing several challenges that can be summarized as follow: high dependence on a few export markets; low yields of smallholder farmers, high costs of production and lack of credit facilities; low participation of the stallholders in the upper segment of the value chain and in the regulatory bodies; deficient governance and management by the KTDA, cess and levies paid by the farmers do not return to their benefit; (5) lack of innovation, research and extension service; and weak local marketing and limited value adding. As a result the aforementioned challenges, financial performance among the industry players has been a cause of major concern. This continuously pushes the concern as to

Tea was first grown in Kenya in Limuru, Kiambu County by Mr. G.W.L Caine in 1903 from India on experimental purposes (Gikang'a, 2008) .Commercial cultivation began in 1924 and remained the exclusive preoccupation of the colonialists until 1956 when African growers were allowed to start planting tea. According to the KTDA Ltd operations manual handbook (2000), the organisation manages the factories at a fee of 2.5 % of the sales proceeds. On governance structures, KTDA, is a private agency registered under the Companies Act. The factories managed by KTDA became limited by liability companies governed under the ACT, this gave farmers the right to elect their directors. Since 1993, changes in tea commerce have moved towards reducing government control in KTDA and privatizing smallholder tea. KTDA has thus played a leading role in enhancing performance tea factories in Kenya.

1.2 Research Problem

Corporate governance is an important aspect in creating a balance between economic and wealth maximization goals of a firm. The practice of corporate governance has therefore been considered important aspect of a firm's financial performance. Governance practices should elicit sound business judgment practices and policies that should ensure that an organization continues to perform competitively in the industry (Bourke,2013).Governance practice has particularly been an area of focus with emphasis on governance parameters that promote wealth maximization of firms which in most cases has been translated into financial performance.

KTDA managed factories has particularly been on the limelight, as a result of governance changes taking place. According to KTDA report (2012) the organization has been on a strategy to improve it governance practice on board integrity, education, organizational structure and disclosure and transparency. It is however not clear how the practice is impacts on KTDA managed firms.

Various studies have indicated mixed relations between corporate governance and financial performance.Tariq (2008), indicated that corporate governance index scores were positively associated with ROA, ROE and price to book ratio. Amba (2009) found that CEO duality, chairman of audit committee, proportion of Non-executive directors, concentrated ownership, and institutional investors affected firms financial performance, Cheng (2010) found negative relationship between CEO duality and financial performance. From these findings, it is notable that corporate governance in relation to financial performance is situation specific and thus studies done still remain .in exhaustive.

The tea industry has been particularly on the limelight as a result of decreasing production and earning from the sector (Njoroge,2012). It is therefore on this basis that this study seeks to examine effects of corporate governance practices on financial performance of KTDA managed factories in Kenya. The study seeks to answer the question, to what extent do governance mechanisms set by KTDA affect the financial performance of KTDA managed factories in Kenya.

1.3 Objective of the Study

The study sought to establish the relationship between corporate governance and financial performance of KTDA managed factories in Kenya

1.4 Value of the study

The study comes in the wake of the government effort to encourage public-private partnership as an important player in economic development in line with Vision 2030 blueprint. Public-private partnership presupposes a corporate sector environment that is attractive to foreign direct investment. These findings may help the government to assess the existing corporate governance framework and possibly formulate a strategy that would address the existing corporate governance inadequacies.

While there have been several studies on corporate governance, most of the studies have either been too wide and not specific to the scope under consideration in this study. They have therefore resulted to findings that are too general or not specific to Kenya. This study therefore sought to fill this research gap by specifically analysing factors determining the effectiveness or lack thereof of corporate governance practices in Kenya in relation to the tea industry. Corporate governance as a key determinant of corporate performance dictates the direction to which capital flows and therefore the study will give investors an insight into whether Kenya remains a favourable investment destination or not. This study was carried out to examine the corporate governance practices and how they influence financial performance of tea factories in

Kenya. The study basically examine shareholders participation, role of internal audit, effectiveness of board of directors and disclosure and transparent on financial performance. The financial performance was measured through return on assets.

Future researchers were expected to use this study as a point of reference to similar research studies on corporate governance in relation to financial performance in the tea sector. Governance being a regulatory practice especially registered companies in Kenya, the study formed a suitable basis for government regulatory framework as far as governance practice is concerned. This was expected to help the government of Kenya in modification and improvement of governance practices that would enhance performance of the tea sector.

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

This chapter explores the literature available on corporate governance practices and their influence on financial performance. This chapter covers Agency theory, Stakeholders theory, Resource Dependence theory, Stewardship theory, Signalling theory and Stockholders theory. The literature has been discussed under theoretical review, empirical review and conceptual framework.

2.1 Theoretical Review

2.2.1 Agency theory

The study was based on the Agency Theory whose origin is Alchian & Demsetz (1972) and Jensen & Meckling (1976). Agency theory re-establishes the importance of incentives and self interest in organizational thinking (Perrow,1986) . In agency theory information is regarded as a commodity which has a cost and can be purchased which then makes it possible for organizations to invest in formal information systems such as budgeting, MBO and Board of Directors. Informal systems include managerial supervision. All these investment is geared to control agent opportunism. Agency theory extends organizational thinking by pushing the ramifications of outcome uncertainty to the implications of creating risk. This implies therefore that outcome uncertainty coupled with differences in willingness to accept risk is likely to influence the contracts between principal and agent.

Jensen and Meckling (1976) defined Agency theory as the relationship between shareholders who they termed as the principals and the company executives and managers who they see as the agents. Agency theory is an appreciation of the contractual view of the firm. Agency problem therefore arises in the need to separate the suppliers of finance from the management of the firm. The principal-agent relationship is beneficial in that it creates room for the shareholders to specialize as risk bearers, the principal, who hires and retains the agent who is endowed with specific talents, knowledge and capabilities to increase the value of the asset through efficient allocation of resources (Melyoki,2005). In this principal-agent relationship the agent only enjoys a part of the outcomes of his efforts (Denise and McConnell, 2003).

The theory is based on the assumption of goal conflict between the principal and the agent (Jensen and Meckling, 1976). Due to the human opportunistic behaviour, the agent may make decisions that are incongruent to the best interest of the principals (Padilla, 2002). Agency theory therefore calls for close monitoring of the agents due to the prospect that they serve their own interest rather than of those of the owner principal.

The monitoring results to agency costs that are meant to align the interests of the shareholders to that of the executive and reduce internal inefficiencies. According to Jensen and Meckling (1976) the agency cost comprises of three different components: monitoring costs, bonding cost and residual cost. Monitoring costs are meant to cushion the principal from the devious behaviour of the agent. Bonding cost are meant to encourage the agent to make decisions that are beneficial to the principal while residual loss is the cost borne by the principal when the monitoring cost and bonding cost fail to contain the devious behaviour of the executive.

Fama and Jensen (1983) looks at Agency theory as having a basic feature of decision rights: decision management rights and decision control rights. Decision management rights refer to right to initiate a decision coupled with the right to implement the decision. On the other hand, decision control right ratify the final decision. The rights also include the decision-monitoring rights which are inclusive of a number of sub-rights, among them the right to measure the performance of the agents as well the right to reward or punish an agent on the basis of the outcome of their decision (Melyoki, 2005).

The delegation of management rights by the principal to the agent creates a situation where the agent has more information about the outcomes of his efforts (Hart, 1995). The ensuing information asymmetry where the agent has more information on the outcomes than the principal implies that the principal cannot fully measure the outcomes of the agents (Melyoki, 2005). This therefore means agency costs can only be minimized but not eliminated (Hart, 1995).Agency problems exhibit itself in two forms: the failure of managerial competence and the failure of managerial integrity (Moldoveanu & Martin, 2001). Failure of managerial competence arises from ignorant mistakes made in executing managerial responsibilities. These can occur due a situation where the principal cannot adequately ascertain the agent's ability to execute the responsibilities for which he is hired or paid for. On the other hand, failure of managerial integrity arises from moral hazards and relates to the wilful behaviour on the part of the managers that reduces the value of firm's asset (Melyoki, 2005).

The monitoring solution by shareholders, especially major ones constitutes an important mechanism for encouraging managers not to deviate from shareholders interest. In cases where ownership is fragmented, the board of directors is viewed as an alternative mechanism (Jensen, 1993 and Denise, 2001). Agency theory has a basic conclusion that value of a firm cannot be maximized as managers normally hold executive power which allows them to expropriate value for their own interest (Turnbull,1997).However despite the claim that the conflicts between the principal and the agent cannot be eliminated Agency theory provides a broad analytical framework to examine how successful corporate governance systems can curb opportunistic managerial behaviour, securing a fair return on investment for suppliers of finance.

2.2.2 Stewardship Theory

Stewardship theory is a theory that rejects the assumptions of agency theory (Davis et al, 1997). Stewardship theory has its roots in the socio-psychological model of human behaviour, with the main assumption that manager's behaviour is pro-organizational and collectivistic, achieving higher utility by serving an organization than working to satisfy personal goals(Tipuric,2008).Gay (2002) on the other hand, looks at stewardship theory as having been derived from economic model of human behaviour which McGregor classified as Theory Y, whose main assumption is that people are inherently motivated to work and perform a good job. In this theory managers are considered good stewards who will act in the best interest of the owners (Donaldson & Davis 1991). According to Smallman (2004) when the wealth of the shareholders is maximized, the steward's utilities are maximized too, because organizational success will serve most expectations and the stewards will have a clear mission.

Stewardship theory sees a strong relationship between managers and the success of the firm, and therefore the stewards protect and maximize shareholder wealth through firm performance. A steward, who improves performance successfully, satisfies most stakeholder groups in an organization, when these groups have interests that are well served by increasing organizational wealth (Davis, Schoorman & Donaldson, 1997). Where the CEO couples as the chairman the fate of the organization and the power to come up with a strategy becomes the power of an individual (Kumudini, 2011). The focus of stewardship theory therefore becomes structures that facilitate and empower rather than monitor and control (Davis, 1997). Therefore stewardship theory takes a more relaxed view of the separation of the role of the chairman and CEO, and supports appointment of a single person for the position of chairman and CEO and a majority of specialist executive directors rather than non-executive directors (Clarke, 2004).

2.2.3 Stakeholder Theory

Freeman (1994) defined Stakeholder theory as any group or individual who can affect or is affected by the achievement of the organization's purpose. The theory is derived from a combination of two academic disciplines: sociological and organizational (Wheeler et al, 2002). Stakeholder theorists suggest that all individuals or groups with legitimate interests participating in an enterprise do so in order to obtain benefits giving no priority of one set of interests and benefits over another (Smith, 2003). Therefore managers in an organization have an elaborate network of relationships to serve. Solomon (2010, p.15) in explaining the theoretical basis of stakeholder theory states as follows: "companies are so large, and their impact on society so pervasive, that they should discharge accountability to many more sectors of society than solely their shareholders .Not only are stakeholders affected by companies, but they in turn affect companies in some way". Freeman (1984), further argue that the core idea of stakeholder theory is that organizations that manage their stakeholder relationships effectively will survive longer and register better performance than organizations that do not.

In support of the role and in appreciation of every stakeholder in corporate governance Fama (1980), argues that, “the firm is viewed as a team whose members act from self-interest but realize that their destinies depend to some extent on the survival of the team in its competition with other teams,” the productivity of each member manifesting a direct effect on the team and on the other members. Thus, through the team, every manager has stimulants in order to monitor the activities of the other managers, being subordinates or superiors. A position further articulated by Cadbury et al (2004) who holds the view that that a corporation is not formed for the sole purpose of serving the shareholders but to also serve the diverse range of people who have a legitimate concern in the organization’s outcome and performance, and further serve a broad societal purpose.

2.3 Determinants of Financial Performance

The financial performance of a firm is multifaceted and can be determined by a number of factors. The following sections, provide as discussion on determinant of financial performance.

2.3.1 Corporate Governance

Various attempts have been made in the quest to examine the effect of corporate governance on financial performance. Nirosha (2012) examined the effect of corporate governance on financial performance for Sri- Lankan listed companies between 2006-2010).The study findings indicated a positive relationship between corporate governance and firm agency costs. These findings supported Tricker,(2012) observations corporate governance differences among institutions affect financial performance and agency costs. Corprate governance framework adopted by a firm has been associated with development of new products innovative activities and the financial growth of a firm. According to Anderson (2009), corporate governance was said to affect firms financial performance through its ability to impinge upon firms processes.

In a study to examine wether corportae governance variables affected financial performance for firms in Nigeria Adenkunke (2014), showed that there was a positive and significant relationship between composition of board member, board size as independent variables and firm performance. CEO status was also found to have a positive relationship with firm performance but insignificant at $P<0.05$. However, ownership concentration was found to have a negative relationship with (ROA) but positive with profit margin.

2.3.2 Cost of production

McGlaphren (2003) cites that production costs are expenses, such as materials and labour that a company incurs in the course of producing the product to sell to consumers. In general, the lower the production cost, the higher the profit, or the amount left over after subtracting expenses from sales revenue. However, low production costs do not necessarily guarantee a high profit. A business may have unsustainably high fixed costs, such as rent, or may cut production costs of producing an inferior product that nobody wants. This as

Tricker, (2012) noted may also be attributable to governance practices in place. A firm maximize shareholders wealth by operating where marginal revenue equal marginal costs. A change in fixed costs has no effect on the profit maximizing output or price. The firm merely treats short term fixed costs as sunk costs and continues to operate as before. This can be confirmed graphically. Using the diagram illustrating the total cost–total revenue perspective, the firm maximizes profit at the point where the slopes of the total cost line and total revenue line are equal. An increase in fixed cost would cause the total cost curve to shift up by the amount of the change. There would be no effect on the total revenue curve or the shape of the total cost curve. Consequently, the profit maximizing point would remain the same. This point can also be illustrated using the diagram for the marginal revenue–marginal cost perspective. A change in fixed cost would have no effect on the position or shape of these curves (Tajika and Yui 2000).

2.3.3 Financial leverage

Leverage refers to the proportion of debt to equity in the capital structure. It can be aptly described as the extent to which a business or an is using the borrowed money. Business companies with high leverage are considered to be at risk of bankruptcy if, in case, they are not able to repay the debts, it might lead to difficulties in getting new lenders in future. According to Jensen (2006) there's an optimal debt ratio that maximizes the value of a firm. Corporations are usually financed partly with debt and partly with equity. It states that there is an advantage to financing with debt (Kraus and Litzenberger, (1963).The financing or leverage decision is a significant managerial decision because it influences the shareholder's return and risk and the market value of the firm. The ratio of debt-equity has implications for the shareholders' dividends and risk, this affect the cost of capital and the market value of the firm (Pandey, 2007).

2.3.4 Liquidity

Liquidity measures the extent to which a firm has cash to meet immediate and short term obligations or assets that can be quickly converted to do this. In accounting Liquidity is the available cash for the near future after taking into account the financial obligations corresponding to that period (The International Financial Reporting Standards, 2006). Proper management of working capital components helps in reducing the costs of the firm and this highly contributes in reducing the liquidity risk of the firm and thus mitigating any financial losses that might be attributed to lack of finances to take advantage of profitable investments Other researchers have different views on liquidity, for example Jovanovic (2008) in his theoretical model suggested that a moderate amount of liquidity may propel entrepreneurial performance, but that an abundance of liquidity may do more harm than good. Therefore, the effect of liquidity on firms' financial performance is ambiguous.

2.3.5 Firm characteristics

Various firm characteristics are believed to have implications on firms financial performance. performance. The size of a firms is considered a potential explanatory determinant of differences in leverage among other firms. Other, than governance practices, firms characteristics has been empirically linked to efficiency of operations of a firm According to Swanson (2009). In exploring the linkage between firms efficiency and performance of a firm with reference to returns on equity, Swanson, (2009) noted that two firms two with similar characteristics and facing the same operational conditions are presumed to have the same value and same rating as in corporate performance.However, a firm may be priced (lower) than the other implying that one firm is more less efficient.

Age of a firm has also been empirically linked with various firm perfomance indicators. A descriptive analysis of Spanish firms in a study by Teuruel (2009) indicated that young firms were smaller, less productive, and less profitable, but in thir early years they experience higher growth rates in terms of sales , productivity and profits. Teurel noted that as firms get older, the weight of external financial sources steadily decreases while equity ration steadily becomes more important financial source.The autocorrelation analysis of the results showed that its coefficienct remain negative for older firms suggesting that firms growth remains an erratic process even for experienced firms. Erratic growth could be linked to erratic corporate firm performance.The autocorrelation analysis shows its coefficients remain negative for older firms, suggesting that firm growth remains an erratic process even for experienced firms (Cirillo, 2010). Other research has focused on differences in performance and behaviour across firms of different ages. For instance, it has been suggested that the age of a firm is positively related to its productivity measured by the extend of its financial performance.

2.4 Empirical Review

Several studies from both international and local scope have been undertaken in relation to corporate governance practices and financial performance.

2.4.1 Global Evidence

Various studies linking corporate governance and financial performance have been undertaken. In a study carried out among Turkey firms Isik, (2013) used panel data for period between 2003 -2010 for 164 firms listed in Instanbul stock exchange. The study empirically explored the impact of large shareholders on firm performance measured by ROA.Empirical findings based on panel data analysis suggested that large shareholders had a significant positive effect on performance of a firm. Wiwattanakantang (2009) investigated the relationship between controlling shareholders and company value, measured by Tobin's Q, ROA and sales-assets ratio by using a sample of 270 non-financial firms listed in the Stock Exchange of Thailand in the year 2006. Findings obtained from the regression models reveal two different results in terms of expropriation hypothesis.

The first one indicated that the large shareholders at each ownership levels are positively linked to corporate performance, measured by ROA and sales–asset ratio. In addition the findings indicated that when shareholders are involved in management and hold (25–50%) of the shares of the company, the large shareholders' involved in the management is negatively linked to corporate performance, measured by ROA and sales–asset ratio. In a study using a dataset of 185 Turkish industrial companies listed on the Istanbul Stock Exchange (ISE) for the period of 1992-1998, Gonec (2010) investigates the effect of ownership concentration measured by the percentage of shares owned by the three largest shareholders and managerial ownership measured by the percentage of shares owned by management on the company performance, modelling the ownership structure as an endogenous variable. Both ROA and market-to-book ratio have been used as performance variables in the analysis.

Documented evidence indicates that board of director play an important role in maintaining effective corporate governance**.** This is particularly with reference to publicly held corporations which are prone to agency problems due to separation of ownership and control (Bhagat, 2009). In a study conducted by Bonn (2004) in Germany, it was found that the management body in a firm responsible for suggesting and implementing major policies, a responsibility that may lead to agency problems between the management and shareholders. Several authors agree that the board of directors is one of the several mechanisms that can mitigate agency conflicts within the firm, moreover, in the dynamic business environment, boards are important smooth function of organizations (Eisenhardt, 2012; Roberts, 2012).

2.4.4 Local Evidence

Wanyama, (2012) examined the effect of corporate governance on financial performance of listed insurance firms in Kenya. The study specifically examined board size, board composition, CEO duality and leverage. Firm performance was measured using return on Assets (ROA) and Return on Equity (ROE). The study adopted a descriptive research design with the population of all insurance firms listed in Nairobi Securities Exchange as at December (2012). Data was analysed 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. Board size was found to negatively affect the financial performance of insurance companies listed at the NSE. 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.

Kimanthi et al (2015) examined the effect of corporate the governance on financial performance of savings and credit cooperatives. The study looked at five theories related to corporate governance namely: agency theory stakeholder theory, stewardship theory, simple finance model and the political model. It looked at work by others in Kenya, Uganda, Nigeria and Korea. There are 121 Sacco's in Nakuru, out of which there are fifty active Sacco's. The study did a survey of three Sacco's which have the majority of Sacco members. The study targeted all employees of the Sacco's. The study adopted a census method. They were availed to the respondents so that they could fill and return them. The study was carried out between May 2013 and December 2013. The study used Spearman's rank correlation to analyse and present findings in tables showing percentages, frequency distribution, and also bar graphs, and pie charts. The study found out that there was a significant relationship between financial reporting and financial performance of savings and credit cooperatives. Sacco's with more frequent financial reporting structures showed better financial performance.

The study found out that there was a significant relationship between management style and financial performance of savings and credit cooperatives. Participative management with democratic leadership enhanced the financial performance of Sacco's. The relationship between size of the board and financial performance was insignificant at 5% significance level. The study recommended that financial reporting should be done as frequently as possible, and management should use a leadership style that is most comfortable to employees and Sacco size should be kept where financial performance is least affected adversely. The study further recommended that studies should on corporate governance be carried out in other areas such as microfinance institutions, commercial banks and the financial sector as a whole.

Otieno (2014) examined the Corporate Governance factors and Financial Performance of commercial banks in Kenya. The study aimed at establishing the effects of corporate governance practices and policies on financial Performance of commercial banks. A cross sectional and analytical research design was in this study. The population involved in this study was all the 44 commercial banks in Kenya. A sample ratio of 0.3 was used to obtain sample representation of the entire population. In this case, 13 CEOs from the sampled banks were subjected to the study. Primary data were obtained by administering questionnaires to CEOs of the sampled banks. Secondary sources were also used to obtain information; data from the published annual reports and company sources spanning five years.

The content validity of the two instruments of data collection was assured by ensuring that each of the items in the questionnaire and interview schedule addressed specific contents and objectives of the study. Statistical Package for Social Scientists (SPSS) was used and Spearman Correlation Coefficient and Multiple Regression Analysis to determine the magnitude of the relationship and prediction of financial performance respectively were applied. It was found out that corporate governance play an important role on bank stability, performance and bank's ability to provide liquidity in difficult market conditions. From the findings, corporate governance factors (CGPR, CGPO, DPP and SRR) accounts for 22.4 % of the financial performance of commercial banks, derived from adjusted R square value of the regression test.

2.5 Summary of Literature

It is evident from the literature reviewed that studies have been conducted especially over the last two decades on various issues revolving around corporate governance and financial performance. These studies represent a wide range of opinions among with results not convergent. On the international scope, a positive relationship has been established between and shareholders in terms of concentration and type of shareholders (Isik, 2003) Wiwattanakantag (2009), and Gonec (2010). Performance of a firm has also been linked with management of the board in terms of governance policies in place (Gonec, 2010).

Corporate governance in Kenya is also widely focussed. The duality of the chief executive officer, was found to positively relate with financial performance for insurance firms (Wanyama,2012).Among the savings and credit cooperatives, a relationship was found to exist between the size of board and financial performance (Kimanti et al (2015).

Governance practices and policies was found to account for 22.4% financial performance of commercial banks. While these studies indicate substantial evidence of efforts that has been carried out in the quest to examine the effect of corporate governance and financial performance. It is important to note how different they are from the current study in terms of economic sectors that they focussed as well as corporate governance measurement tools used. This study sought to measure corporate governance within the context of the profession of board of directors, presence of internal audit committee, independence of the audit committee and disclosure and transparency. The study was done within the tea sector where related research on corporate governance and financial performance is limited. It is thus on this basis that this study sought to examine the effect of corporate governance on financial performance for KTDA managed factories in Kenya.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter presents the research methodology that was adopted in examining the influence of the corporate governance practices on performance of KTDA managed factories in Kenya. The chapter presents the research methodology under the following subsections; the research design, target population, sampling procedure and sample size, research instruments, validity and reliability, data analysis procedures and ethical considerations.

3.2 Research design

Research design entails a logical sequence that connects the empirical data to a study's initial research questions and ultimately to its conclusions (Yin, 2008). It is the collection, analysis of data and a plan to obtain answers to research questions (Coopers & Schindler, 2006).The proposed study used descriptive research design to accomplish its objectives. A descriptive design is effective in gathering quantitative data that describes the relationship between corporate governance and the financial performance of KTDA managed factories in Kenya. According to Kenya Institute of management (2009) a descriptive design describes responses to questions about a phenomenon or situation with aim of understanding the study phenomenon as it exists. This was therefore suitable in the current study as it sought to examine the relationship between corporate governance practices and financial performance at KTDA managed factories in Kenya.

3.3 Population

The target population for this study was sixty (66) KTDA managed factories in Kenya (KTDA, 2015). The study's unit of analysis was therefore be KTDA factories. KTDA managed factories was identified because of their reporting as far as financial performance is concerned and their application of corporate governance. According to KTDA reports (2012), the corporation has recently focussed on corporate governance for the companies under her management.

3.3.1 Sample Size

A sample size is a small representation of the population selected through appropriated sampling procedure. In the case of the current study, simple random sampling was used to select the KTDA managed companies to participate in the study. According (Kothari (2010) a sample size of at least 10% of the total population is considered adequate in a social science study. Other consideration made is the representation in terms of population proportions and the practicability of the researcher to do the study. This study selected 30% of 66 KTDA managed companies, forming a sample size of 20 factories.

3.4 Data Collection

Both primary and secondary sources was used to collect data. Primary data was collected through an interview with the board of directors for different factories selected to participate in the study. The interview contained questions measuring governance practice as far a profession of the board of directors, presence of internal audit committee, independence of the audit committee and disclosure and transparency. Secondary data measured the financial performance of the companies examined in terms of profitability. Data on net earnings from the sector was collected between 2010 and 2013.

3.5 Data Analysis

Descriptive statistics was employed to describe quantitative data. Statistical measures such as measures frequency, percentages and mean and standard deviation was generated on quantitative data. A correlation analysis was undertaken on items measuring corporate governance practices and financial performance. A multiple regression model was used to examine the extent and strength of relation between governance practices and financial performance of the selected companies.

3.5.1 Analytical Model

Regression analysis and descriptive statistics was used to analyse data on corporate governance practices and firm performance. A multi regression analysis is to be done by regressing firm performance against governance practices namely board of director's integrity, education level of the board, organizational structure, professional development, disclosure and transparency. The model showed how well the governance factors was able to predict financial performance. It was also tell how much unique variance each of the independent variables (governance indicators) explains in the dependent variable (company performance), over and above the other independent variables included in the factor.

The analytical model

Where:

$$Y= \alpha_0 + \alpha_1X_1 + \alpha_2X_2 + \alpha_3X_3 + \alpha_4X_4 + \alpha_5X_5 + \varrho$$

Y= Firm Financial performance

X_1 = Board diversity in terms of professions

X_2 = Presence of audit Committee

X_3 = Independence of Audit Committee

X_4 = Disclosure and Transparency (Compulsory disclosures and voluntary)

α_0 = Constant

Ai = {1, 2, 3, 4,} Regression coefficients

ϱ = Error term

The study is premised on the assumption that the highlighted independent variables explain the dependent variable.

3.5.2 Test of Significance

The study test of significance was done at 95% level of confidence using Analysis of Variance (ANOVA) and F test and coefficient of determination the models fitness in predicting performance of Y.Y represented the dependent variable financial performance, β_0 was the regression. $\beta_1\beta_{3\ldots}B_n$ was the coefficients of the variables in regression model. Correlation was used to establish the relationship between the variables in question.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter has provided the presentation of the findings on the study, the effect of corporate governance on financial performance of KTDA factories in Kenya. The analysis and discussion of the findings have been done as laid in the research methodology and the research objective. The data used in this study was obtained from KTDA management factories board of Directors as well as factories record on financial performance for the last five years.

4.2 Descriptive Analysis

The results and discussion of the findings in this study has been segmented into background information about respondents, corporate governance practices and financial performance.

4.2.1 Background Information

The study background information covers the study response rate, sex of the respondents, sex composition of board members, profession and highest level FO educational qualification attained.

4.2.1.1 Response Rate

The study sampled 140 respondents drawn from 20 KTDA managed factories in Kenya. Out of this sample 120 participated in the study. The findings for the study response has been presented on figure 4.1.

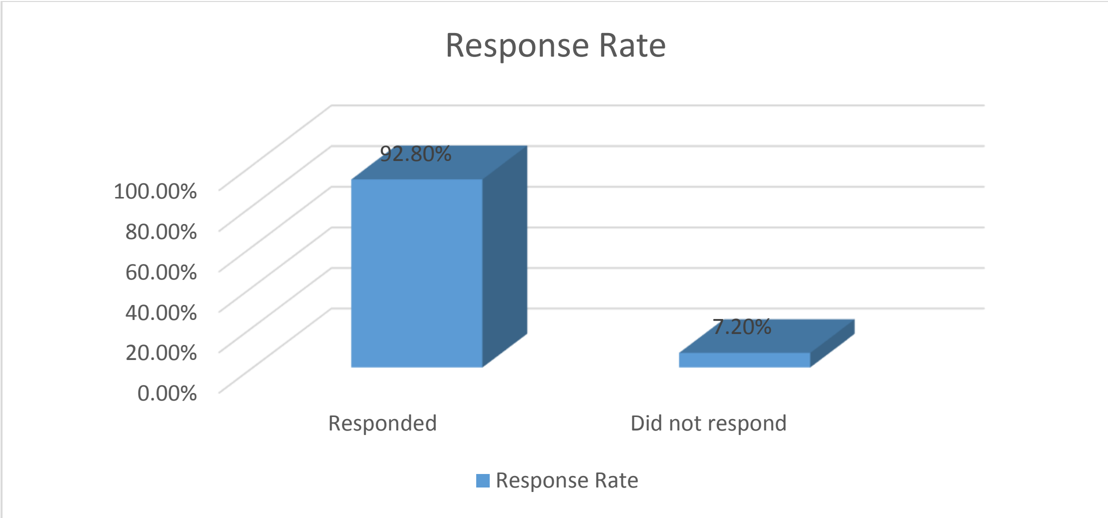


Figure 4.1: Response Rate

Based on the study findings in figure 4.1, 92.8% of the study participants responded to the study while 7.2% did not respond. Based on Kothari (2010) recommendations for response rate in a social study, this response rate was considered very good for analysis and reporting.

4.2.1.2 Sex of the respondents

Respondents were asked to indicate their sex. The findings are presented in figure 4.2.

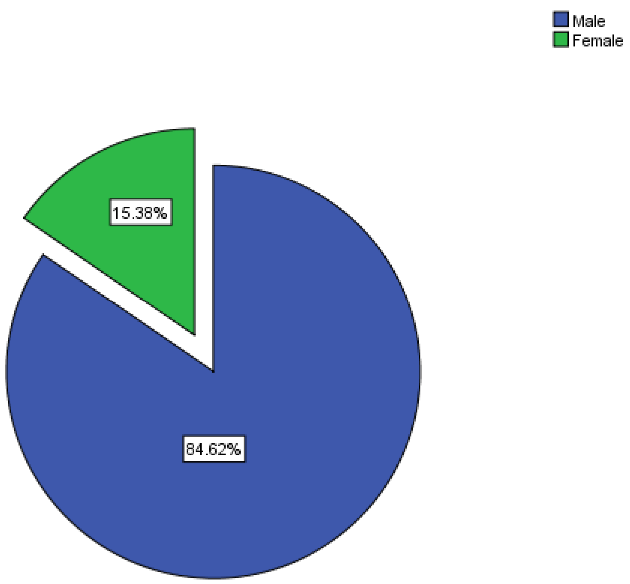


Figure 4.2 Sex of the respondents

From the study findings, 84.6% of the respondents interviewed were male while 15.3% were female. The study findings indicate that a large proportion of the board of directors within KTDA managed factories are male.

4.2.1.3 The trend in the sex composition of the board of directors

The study examined the trend in the board composition of the board of directors, in order to examine the extent to which KTDA managed factories had complied with the affirmative action of a third, women representation. The findings are as indicated on figure 4.3

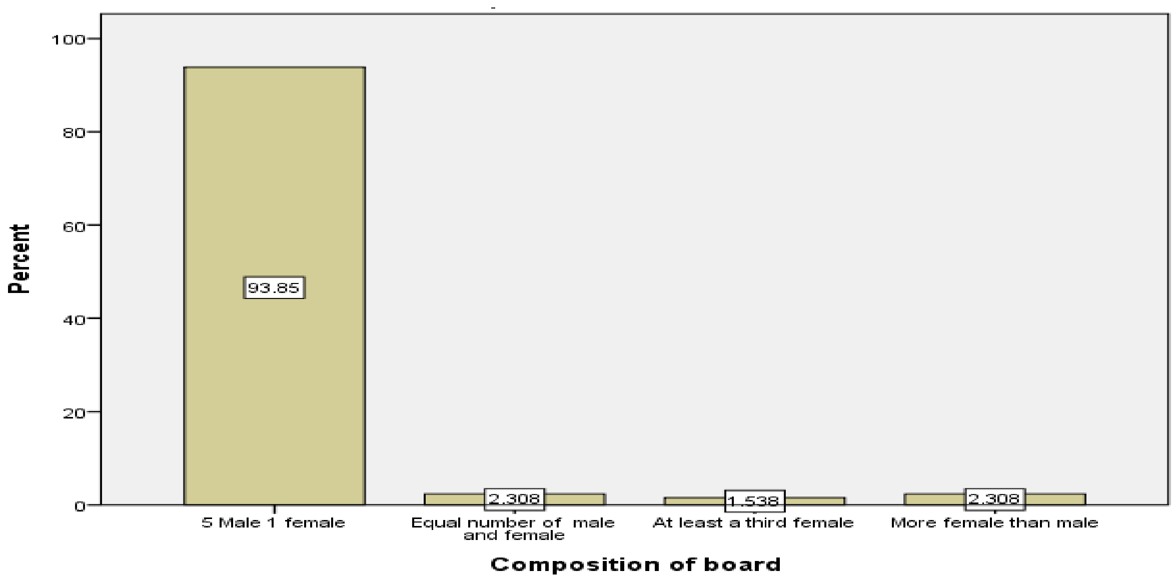


Figure 4.3: Trend in the composition of board of directors

For most of the factories participating in this study, it is notable 93.85% were 6 male and one female. There is an indication that the board of directors for most of the KTDA managed factories are male. This is an indication that the organization has to comply with Kenya's affirmative action of ensuring 30% women representation.

4.2.1.4 Highest Level of Educational Qualification

The study examined different levels of educational qualifications from their employees. The findings were indicated below.

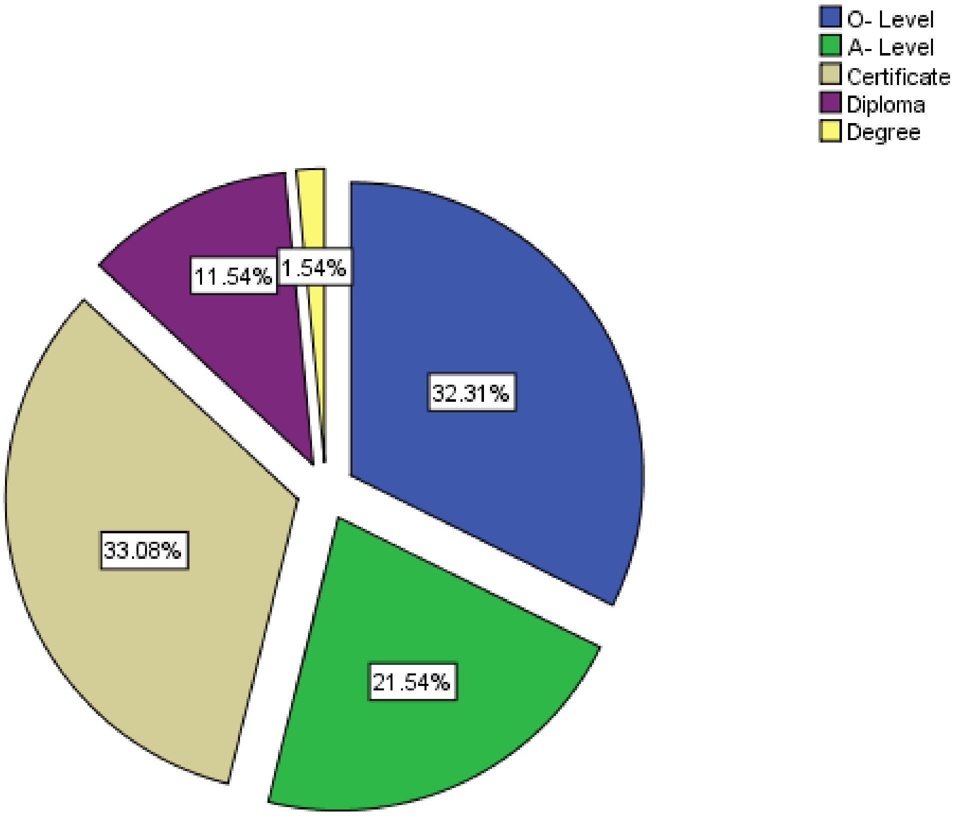


Figure 4.4: Highest level of educational qualifications

From the study findings on figure 4.4, most of the respondents had either or O- level certificates or certificates as their highest level of educational qualifications. This was as indicated by 33.1% and 32.3% of the respondents respectively. An observable percentage (21.5%) had A level certificates while 11.5% had diplomas, with 1.54% having degrees.

4.2.1.5 Governance Practices

Various governance practices were examined in this study. The practices examined were based on the indicators of good governance as measured or observed by ; the number of times the audit committee met, the reporting relationship with the audit committee, the independence of the audit committee, the level of disclosure and transparency during reporting and the communication channels used. The findings are as indicated below.

4.2.1.6 Meeting Times for the Audit Committee

In the standard governance practice, the audit committee should meet on quarterly basis, or as often as possible. This study established the frequency of meetings for the audit committee in the quest to examine how often the committee met. The findings was as indicated on table 4.1

Table 4.1 Frequency of Meetings of the Audit Committee

	Frequency	Percent	Mean	Std. deviation	Variance
Monthly	4	3.1	4.3	1.1	1.2
Quarterly	8	6.2			
Semi- Annually	17	13.1			
Annually	11	8.5			
They do not meet at all	90	69.2			
Total	130	100.0			

The findings on table 4.1 display dismal practice as far as the meetings of the audit committee is concerned. Majority (69.2%) of the respondents indicated that the audit committee did not meet at all, with a few (3.1%), (6.2%), (13.1%) and (8.5%) indicating that the audit committee met monthly, annually and semi – annually respectively. A mean of 4.3, a standard deviation of 1.1 while a variance of 1.2 was obtained. The findings of mean indicate that many of factories would fall between non-compliance with the standard with regards to the meetings of the audit committee.

4.2.1.7 Reporting relationship of the internal auditor and the audit committee

Ideally the independence of the internal auditor should be assured by ensuring that he or she reports to the chairman of the audit committee. In order to establish whether the independence of the auditor was assured, the study established the reporting pattern. The findings are as indicated on table 4.2.

Table 4.2: Reporting relationship of the Audit committee

Where the internal auditor reports to	Frequency	Percent	Mean	Std. Deviation	Variance
Chairman of the audit committee	9	6.9	2.8	0.5	0.3
Any Member of the Audit committee	8	6.2			
The CEO	113	86.9			
Total	**130**	**100.0**			

From the study findings, it is notable that majority of the respondents (86.9%) indicated that the internal auditor for their factories reported to the CEO. 6.9% indicated that the internal auditor reported to its chairman while 6.2% indicated that the internal auditor reported to any member of the committee. The study findings indicate noncompliance with governance procedures when with regards to the reporting of the internal auditor.

4.2.1.8 Independence of the Internal Auditor

In order to be objective with regards to company performance and governance practices, the internal auditor should be independent. The study established the extent to which the internal auditor was independent based on their observations. The findings on the independence of the audit auditor is as indicated on table 4.3.

Table 4.3: Rating on independence of the Internal Auditor

	Frequency	Percent	Mean	Std. Deviation	Variance
Very Independent	12	9.2	3.5	0.98	0.98
Independent	11	8.5			
Moderately independent	4	3.1			
Not Independent	103	79.2			
Total	**130**	**100.0**			

Based on the opinion of majority (79.2%) of the respondents, the internal auditor is not independent. Few respondents however, considered the internal auditor as independent. 9.2% indicated that the internal auditor was very independent, 8.5% indicated that he was independent while 3.1 % indicated that the internal auditor was moderately independent. The findings indicate that low level of compliance with governance practices as far as the independence of the internal auditor is concerned.

4.2.1.9 Disclosure and Transparency

Under disclosure and transparency, standards governance practices posit that organizations disclose every activity including Corporate Social responsibility activity that is a cost to the organization. This study examined the extent to which this was carried out at KTDA managed factories. Respondents were asked to indicate whether their factories reported beyond the compulsory requirements. The finding were as indicated on figure 4.5.

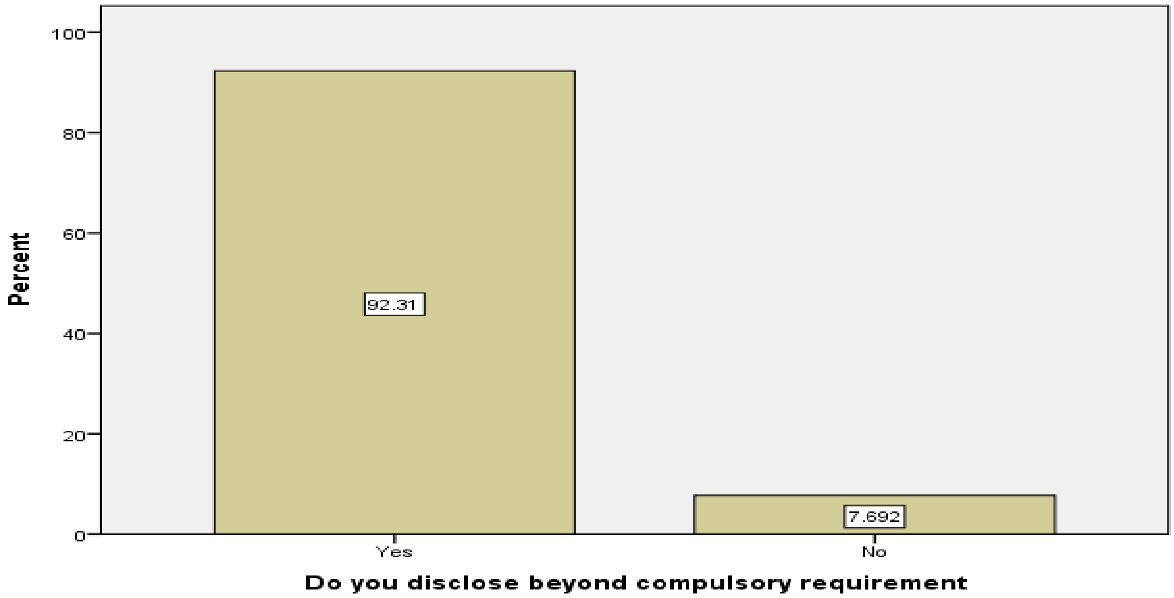


Figure 4.5: Disclosure beyond the Compulsory Requirements

From the study findings, it is notable that 92.31% of KTDA managed factories will disclose beyond their compulsory requirements. This means that on disclosure and transparency, the factories were considered compliant with standard governance procedures.

4.2.1.10 Forms of Disclosures beyond the Compulsory Requirements

For those who revealed that their factories, disclosed information beyond the compulsory requirements, the study further established the forms of disclosures common among those factories. The findings were as indicated on figure 4.7.

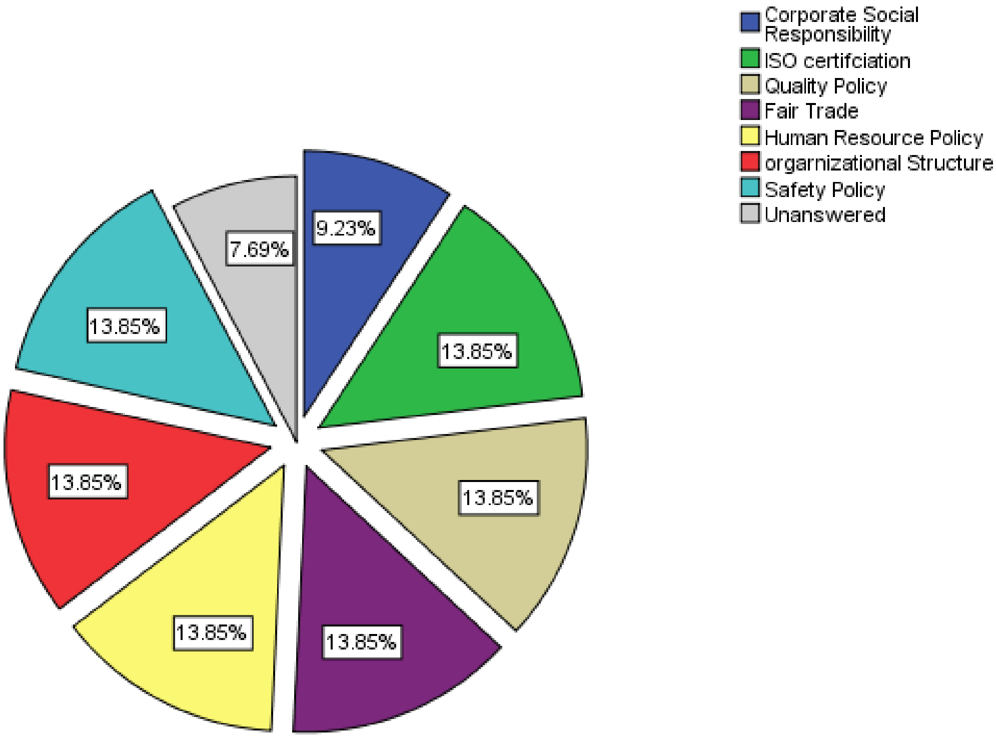


Figure 4.6: Disclosure beyond compulsory requirements

From the study findings, it is notable that more or less equal proportions of disclosure was made for various organizational activities and programmes. Of the activities reportedly disclosed included; corporate social responsibility, ISO certification, quality policy, Fair Trade, Human Resource Policy, organizational structure and safety policy.

4.2.1.11 Modes of Communication

Information sharing is in line with governance practices, which indicates that information should be designated to shareholders in whichever mean. Respondents were asked to indicate common forms of communication that their organization used in dissemination information. The findings on the modes of information distribution at different KDTA managed factors is as indicated on figure 4.8.

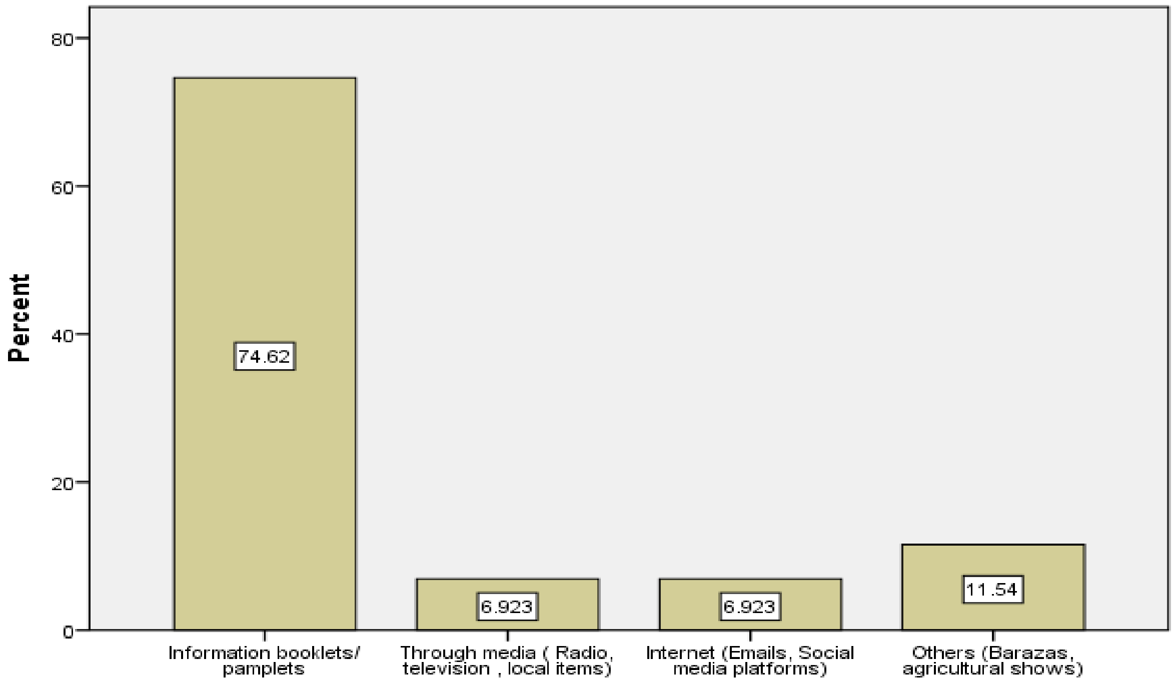
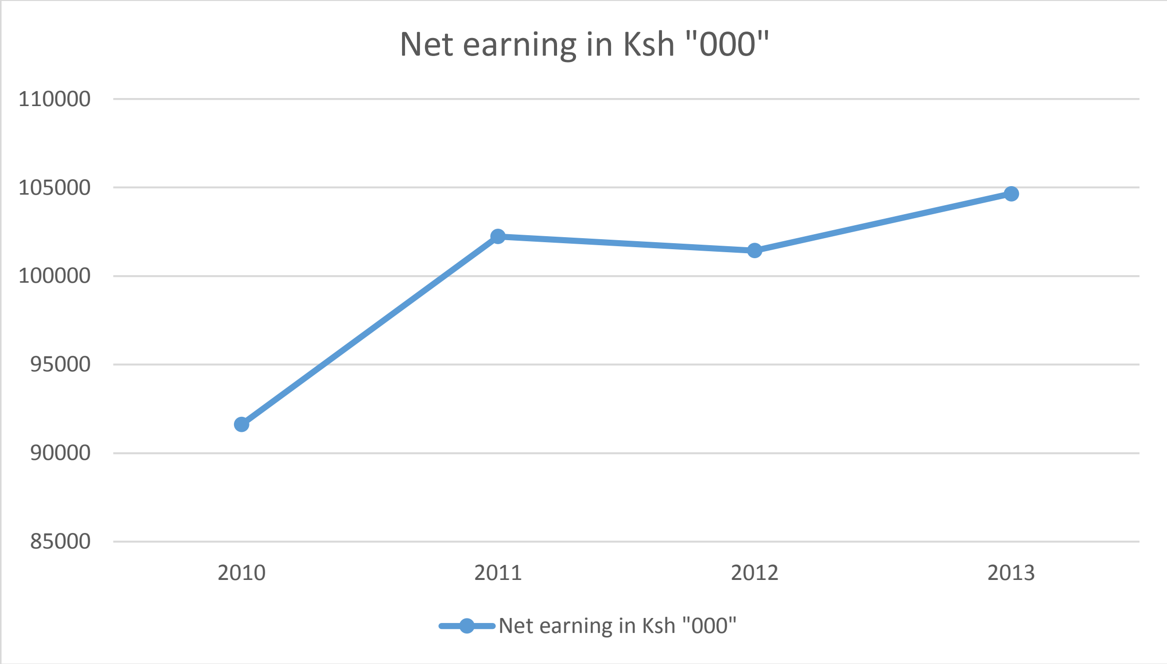


Figure 4.7: Different Modes of Communication

Respondents indicated that there was different modes of communication through which information was relayed to shareholders. The most common mode as per majority (74.62% of the respondents was through information booklets or pamphlets. Others included; through media (6.9%), internet (6.9%) and barazas, agricultural shows and trade fairs (11.54%).

4.2.1.12 Financial Performance Trend for KTDA Managed Factories

The financial performance for KTDA managed factories was examined through a description of net earnings (profits) from the year 2009 -2013. The findings indicating the trend in the profits within this period has been indicated



Source KNBS: (2014)

Fig 4.8: Trend in net earnings of tea

4.3 Regression Analysis

In examining the relationship between corporate governance practices and financial performance. A regression analysis was undertaken between financial performance trend and corporate governance practices. The results were presented below.

Table 4.4: Model Summary

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.704[a]	.495	.479	.84929
a. Predictors: (Constant), Profession of Board of directors, Presence of Internal Audit committee , Independence of the Audit committee, Disclosure and transparency				

From the summary of the model on table 4.4, the adjusted R is the coefficient of determination which tells the variation in the dependent variable due to changes in the independent variable. The R square value for this study was 0495. An indication that there was 49.5% variation in financial performance for KTDA managed factories due to changes in governance practices that included the profession of the board of directors, presence of internal Audit Committee, independence of the Audit committee and disclosure and transparency at 95% level of confidence. The value of R 0.704, is the coefficient which shows the relationship between study variable. In the case of this study, moderately strong correlation of the study variables.

Table 4.5: Anova

ANOVA[a]						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	88.370	4	22.092	30.629	.000[b]
	Residual	90.161	125	.721		
	Total	178.531	129			

a. Dependent Variable: Financial Performance

b. Predictors: (Constant), Profession of Board of directors, Presence of Internal Audit committee , Independence of the Audit committee, Disclosure and transparency

From the Anova Statistics in table above, the processed data which is the population parameter , had a significance level of 0.00 which shows that the data is ideal for making a conclusion on the population parameters as the value of significance (value) is less than 5% **.**

Table 4.6: Regression Coefficients

Coefficients [a]						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.503	.687		.731	.466
	Presence of Internal Audit committee	.170	.081	.161	2.102	.001
	Independence of Internal Audit Committee	.033	.080	.027	.409	.002
	Disclosure and Transparency	-1.337	.390	-.304	-3.432	.001
	Profession of board of directors	1.536	.156	.944	9.827	.000

a. Dependent Variable: Financial Performance

The established regression equation was $Y = 0.503 + 0.161 X_1 + 0.027 X_2 - 0.304 X_3 + 0.944 X_4$.

The above regression equation reveals that financial performance of KTDA managed factories would stand at 0.503 at a constant zero. Availability of internal audit committee lead to an increase in financial performance by a factor of 0.161, independence of the internal audit committee. Disclosure and transparency will decrease financial performance of KTDA managed factories by a factor of -0.304, while professions of the board of directors will increase financial performance of KTDA managed factories by a factor of 0.944. All the P- value for all independent variable was found to be less than 0.05 indicating that they are statistically significant.

4.4 Correlation Analysis

A correlation analysis was carried out to examine to establish the nature and the direction of relationship between corporate governance practices and financial performance. The findings were as indicated.

Table 4.7 Correlation Analysis

		Correlations 1	2	3	4	5
1. Financial Performance	Pearson Correlation	1				
	Sig. (2-tailed)					
	N	124				
2. Profession of board of directors	Pearson Correlation	.605**	1			
	Sig. (2-tailed)	.000				
	N	124	130			
3. Presence of internal audit committee	Pearson Correlation	.138**	-.480**	1		
	Sig. (2-tailed)	.126	.000			
	N	130	130	130		
4. Independence of the audit committee	Pearson Correlation	.351**	-.442**	.114	1	
	Sig. (2-tailed)	.000	.000	.195		
	N	124	130	130	130	
5. Disclosure and transparency	Pearson Correlation	.073**	.004	-.286**	.380**	1
	Sig. (2-tailed)	.422	.960	.001	.000	
	N	130	130	130	130	130

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

The correlation results indicated that financial performance for KTDA managed factories had a moderately strong but positive correlation with the profession of the board of directors at a coefficient of 0.605, The presence of internal audit committee positively correlated with financial performance at a correlation coefficient of 0.138, the independence of the audit committee had a weak correlation with financial performance at a coeffient of 0.351, while disclosure and transparency showed a weak positive correlation with financial performance at a correlation coefficient value of 0.073.

4.5 Interpretation and Discussions

The study sought to examine the effect of corporate governance practices on financial performance for KTDA managed factories in Kenya. This comes at the wake of renewed reformation in the way corporate governance has been carried out in the sector Based on corporate governance parameters that is professional composition, board of directors' presence of audit committee, independence of audit committee, as well as disclosure and transparency. Based on the trend in the composition of board of directors, it is notable that majority of the board of directors are male while minority are female. The level of education of the board of directors could be said as reasonable given that high proportion of them have post-secondary school levels of education. Governance as a practice in KTDA managed factories is a multifaceted issue. The professional composition of the board of directors as well as gender vary.

The recommended governance practices are hardly carried out in KTDA managed factories. As such there are few cases (30.9%) of the respondents who indicate that their factories have audit committee meetings. The independence of the audit committee is seen to be compromised with 86.9% indicating that the audit committee reports to the CEO while 79.2% indicate that the independence of the audit committee is not independent at all. The regression results indicate that the financial performance varies by 49.5% as a result of changes in corporate governance practices, there is also a moderately strong positive correlation of 0.704 on the study variables. Based on this observation, it can be said that governance policies practices have a major role to play for KTDA managed factories.

The established regression equation was $Y = 0.503 + 0.161\ X_1 +0.027\ X_2 – 0.304\ X_3+0.944\ X_4$.

The above regression equation reveals that financial performance of KTDA managed factories would stand at 0.503 at a constant zero. Availability of internal audit committee lead to an increase in financial performance by a factor of 0.161, independence of the internal audit committee. Disclosure and transparency will decrease financial performance of KTDA managed factories by a factor of -0.304, while professions of the board of directors will increase financial performance of KTDA managed factories by a factor of 0.944. All the P- value for all independent variable was found to be less than 0.05 indicating that they are statistically significant. The variables examined show a positive correlation between corporate governance practices and financial performance. The profession of the board of directors particularly exhibited a strong positive correlation in relation to financial performance of the KTDA managed factories.

The findings of the current study concur with various observation in the literature. Within the literature, corporate governance has been viewed as a multifaceted issue with various impacts on firm’s performance. In particular, corporate governance in relation to financial performance has indicated many dimension in which governance could be viewed. There has been evidence linking large shareholders with positive effect on performance of a firm (Wiwattanakantang, 2009). Ownership concentration as measured by the percentage of shares owned by a firm was found to have significant effect on financial performance.

In line with current study, it has been evidently documented that board of directors play an important role in maintaining effective corporate governance (Baghat, 2009), this however was discussed in the context of agency problem and the associated problems, particularly for publicly held corporations. Various parameters of corporate governance affect different sectors of the economy differently. For instance, empirical evidence from this study indicate that board size, board composition, CEO duality and leverage strong relates with financial performance for listed insurance firms in Kenya (Wanyama, 2012).

Further, a significant relationship has been established between financial reporting structures and financial performance for savings and credit cooperation's. The study findings concur with Bhagat (2009) observations that the management of a firm is responsible for implementing major policies. The study concur with Wanyama (2012), study that found a positive relationship between corporate governance practices and financial performance. According to Wanyama's observations, the most critical aspect of board composition was identified as experience, skills and expertise of the board members.

CHAPTER FIVE

SUMMARY, CONLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter provides summary of the findings and conclusion to the study; the effect of corporate governance on financial performance of KTDA factories in Kenya. The summary of the findings have been provided with reference to corporate governance for KTDA managed factories, trends in financial performance, and the relationship between corporate governance practices and financial performance.

5.2 Summary of the Findings

The response rate for the study was 92.8% which was judged as very good for analysis and reporting. There was high proportion of male compared to female respondents who participated in the study. For most of the factories the ratio of female to male board of directors was 1:6.The factories have therefore not complied with Kenya's directive on the affirmative action for 30% women representation. Most of the board of directors for KTDA managed factories have Certificate, A- level and O level highest qualifications for their education and are either farmers or teachers in their profession.

For most of the factories, there is no audit committee and in cases where the audit committee is present, the committee hardly meets, although very few factories indicated that they met monthly quarterly, semi-annually and annually. For most of the factories (86.9%) the audit committee reports to the chief Executive officer instead of reporting the chairman of the committee. The independence of the internal auditor seems compromised with 79.2% of the factories indicating that the internal auditor is not independent. Most of the factories have demonstrated recommendable practice with regards to disclosure and transparency. 92.3% indicate that they disclose beyond the compulsory requirements.

Various forms of disclosure include; corporate social responsibility activities, ISO certification, quality policy, fair trade, human resource policy, organizational structure, and safety policies. Most (74.6%) of the KTDA managed factories use information booklets and pamphlets to disburse information to shareholders. Other forms of communication include Barraza's, agricultural shows local media.

There trend in financial performance for KTDA managed factories in the year indicate increasing, constant and a slowed pace of growth with reference to financial performance. Financial performance varies at 49.5% for KTDA managed factories. The study variable interrelate at a correlation coefficient of 0.704. There is a relationship between corporate governance practices and financial performance for KTDA managed factories as expressed in the equation $Y = 0.503 + 0.161 X_1 + 0.027 X_2 – 0.304 X_3 + 0.944 X_4$.

5.3 Conclusion

The study sought to examine the effect of corporate governance practices on financial performance for KTDA managed factories in Kenya. Based on the study findings it is notable that KTDA managed factories are yet to comply with most corporate governance practices and thus, this explains why most of the variables have a low correlation coefficient with financial performance.

There is a significance relationship between corporate governance practices and financial performance for KTDA managed factories. According to the study findings, financial performance for KTDA managed factories trend 2011-2013 indicate an increase in the increment of profitability for tea factories though at a slow pace. This could be an important indicator that corporate governance practices shape the direction of performance for KTDA managed factories. Weak but positive correlation coefficient between corporate governance practice and financial performance could be an indicator that enhancing governance practices among KTDA managed factories could increase the financial performance. A negative correlation coefficient value between disclosure activities and financial performance could be an indicator that disclosure of activities reveal the true financial status for these factories and therefore could be a significant indicator in shaping cost policy for the organizations.

The study findings are consistent with the literature reviewed in the sense that corporate governance has been considered as a multifaceted issue with various governance parameters affecting financial performance. While empirical evidence reveal a significant relationship between board of directors policy, board size, board composition and CEO duality with financial performance (Wanyama, 2012, Bhagat, 2009). A similar observation is made for KTDA managed factories with regards to the profession of the board of directors, presence of internal audit committee, independence of the audit committee and disclosure and transparency.

5.4 Limitation of the Study

The researcher was faced by a number of limitation that were outside his control during the time of data collection. The data used in this study particularly for the secondary data for collection of financial performance information. As such, the researcher was not in control of the financial data collected and the processes used to collect the data.

The information provided in the primary data was limited to the extent of knowledge and understanding of interviewees as far as corporate governance practices was concerned. Further, the study limited itself to the extent of willingness among the interviewee to provide information.

In the analytical model, the researcher used a multiple regression model. In, multiple regressions, it is possible that some multiple regressions and multiple correlations variables are correlated rather than uncorrelated, this the standard error associated with each partial regression coefficient might have been understated.

The research was to be conducted within a specific time period as envisaged in the researcher's academic schedule. This study was therefore limited to the availability of time as required by his academic schedule.

The study sample was collected from KTDA managed factories which are spread in various places over the country. The researcher was therefore limited to 30% sample size to the cost and time required to collected data for a larger sample.

5.5 Recommendations for Policy practice

The study made the following recommendations

5.5.1 Policy Recommendations

Based on the study findings, the study provides the following recommendations.

In order to enhance the level of financial performance among KTDA managed factories, it is important for the management of these factories to adopt the acceptable Kenyan standards of corporate governance. Gender inequality is eminent among KTDA managed factories. In order to comply with Kenya's requirement on gender, it is important that KTDA managed factories increase the number of women in leadership. This could be achieved through providing equal opportunities for both men and women during elections as well as having clauses that encourage women to be actively involved in leadership positions.

5.5.2 Suggestions for Further Research

From the study findings, it can be noted that corporate governance practices are unique to different organizations. As such, it is important to establish the extent to which corporate governance practices affect other areas of production such as sugar and coffee production.

Most of the factories examined in this study did not have internal audit committee. A further study should therefore be undertaken to examine the factors affecting the involvement of audit committee among KTDA managed factories in Kenya.

The professionalism of board of directors was found to strongly correlate with financial performance for KTDA factories examined. It is therefore important to carry out a study on the factors affecting professional selection of board of directors in the management of KDTA managed factories.

In other previous studies, various corporate governance practices such as shareholder composition, the size of board and CEO duality was found to affect firm's financial performance. It is therefore important to examine whether a similar scenario exists for KTDA managed factories by undertaking a study to examine the effect of board size, shareholder' concentration and CEO duality on financial performance for KTDA managed factories.

Disclosure and transparency within the tea sector has been on the increase. It was however notable from the study findings that reporting beyond the compulsory disclosure was popularly adopted corporate governance practice compared to other practices, a further study should therefore be undertaken to examine factors affecting adoption of best practice governance practices among KTDA managed factories.

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APPENDICES

Appendix 1: Interview Guide

Dear respondent,

This study seeks to examine the effect of corporate governance on financial performance of KTDA factories in Kenya. Am kindly requesting you to assist in the provision of information required to complete this study? The information you provide will be used for accomplishing academic purposes.

PART A: BACKGROUND INFORMATION

1. Kindly indicate your sex?
   a. Male ☐
   b. Female ☐
2. What is the sex composition in your board of directors
   a. The number of male board members …………………………………
   b. The Number of female board members ………………………………
3. Kindly indicate your profession?

   …………………………………………………………………………………….
4. What is your highest level of educational qualifications?
   a. O- Level ☐
   b. A- Level ☐
   c. Certificate ☐
   d. Diploma ☐
   e. Degree ☐
   f. Post graduate qualifications ☐

   Kindly specify………………………………………………………….......

PART B: GOVERNANCE PRACTICES

5. How many times does the audit committee meet in a financial years?
   a. Monthly ☐
   b. Quarterly ☐
   c. Semi – Annually ☐
   d. Annually ☐
6. What is the reporting relationship of the internal auditor with the audit committee?

a. Reports to the chairman of the audit committee ☐
b. Reports to any member of the audit committee ☐
c. Reports to the CEO ☐

Kindly comment on 5 above ……………………………………………........

7. How would you rate the independence of the internal auditor?
   a. Very Independent ☐
   b. Independent ☐
   c. Moderately Independent ☐
   d. Not independent ☐

   Kindly explain …………………………………………………………………

8. Under disclosure and transparency, do you report beyond the compulsory requirements? Yes ☐ No ☐
9. If yes, in 8 above, please indicate the disclosures you make?
   a. Corporate Social Responsibility ☐
   b. ISO certification ☐
   c. RA certification ☐
   d. Fair Trade ☐
   e. Quality Policy ☐
   f. Mission and vision statements ☐
   g. Human Resource policy ☐
   h. Organizational Structure ☐
   i. Safety Policy ☐
   j. Governance Charter ☐

   (Tick the appropriate box as per the practice in your factory)

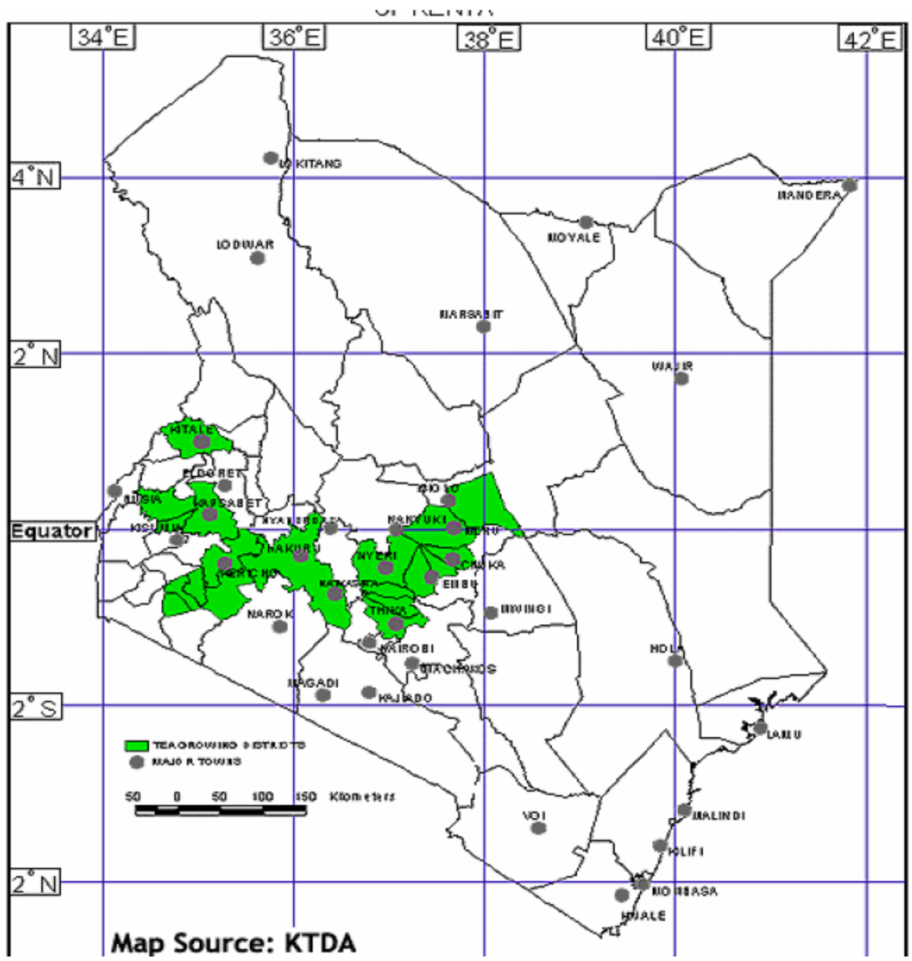
10. Communication channel: How is your firm's information disseminated to stakeholders?
    a. Information booklets /pamphlets ☐
    b. Through the media (Radio, television , local dailies) ☐
    c. Internet (Emails, social media platforms) ☐
    d. Others please specify ………………………………………………..

End: Thank You for Participating In This Interview

Appendix ii: List of KTDA Managed Factories

1. Kagwe
2. Kambaa
3. Theta
4. Ndarugu
5. Mataara
6. Gachege
7. Njunu
8. Ngere
9. Makomboki
10. Ikumbi
11. Gacharage
12. Nduti
13. Githambo
14. Kanyenya-ini
15. Gatunguru
16. Kiru
17. Chinga
18. Iriani
19. Gitugi
20. Gathuthi
21. Ragati
22. Ndima
23. Mununga
24. Kangaita
25. Kimunye
26. Thumaita
27. Mungania
28. Rukuriri
29. Kathangariri
30. Githongo
31. Kinoro
32. Imenti
33. Michi mikuru
34. Kiegoi
35. Weru
36. Kionyo
37. Ingembe
38. Litein
39. Chelal
40. Tegat
41. Kapkatet
42. Momul
43. Kapkoros
44. Mogogosieki
45. Kobel
46. Kapset
47. Tirgaga
48. Rorok
49. Toror
50. Oleng
51. Nyansiongo
52. Kebirigo
53. Sanganyi
54. Tombe
55. Nyankoba
56. Kiamokama
57. Rianyamwamu
58. Nyamache
59. Ogembo
60. Itumbe
61. Eberege
62. Chebut
63. Kaptumo
64. Mudete
65. Kapsara
66. Nduti

Appendix iii: Tea growing Areas in Kenya

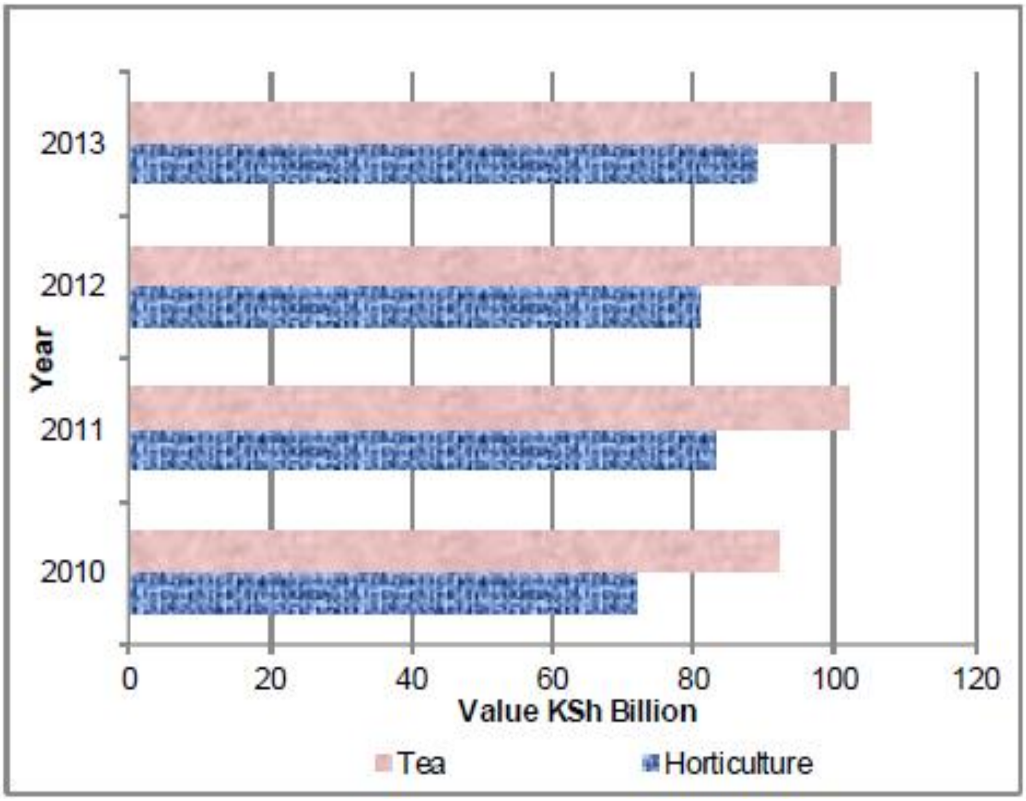


Source (KTDA, 2006).

Appendix iv: Trend in Net earnings from Tea

Source: Kenya National Bureau of Statistics (2014)

Appendix V: Trend in Net earnings from Tea



Source: Kenya National Bureau of Statistics (2014)