

**THE RELATIONSHIP BETWEEN CORPORATE GOVERNANCE
AND FINANCIAL PERFORMANCE OF STOCK BROKERAGE
FIRMS AND INVESTMENT BANKS IN KENYA**

BY

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DECLARATION



This research project is my original work and has not been presented for the award of a degree in any University.

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

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DEDICATION

Dedicated to my parents who have seen me this far in my academic journey.

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ABSTRACT

Corporate governance is an area that has grown rapidly in the recent years due to the global corporate scandals and collapse of big companies. The purpose of this paper is to empirically investigate the impact of corporate governance aspects (board size, board composition, separation of role of chairman and Chief Executive Officer, ownership structure (insider ownership), information disclosure and frequency of board meetings on financial performance of firms. The objective of the study is to determine the relationship between corporate governance and financial performance of stock brokerage firms and investment banks in Kenya. Return of Assets (ROA) was used as a measure of financial performance.

The study used a causal design where primary data was collected from all the 19 stock brokerage firms and investment banks (members of Nairobi Securities Exchange) in Kenya using a questionnaire. The data was analyzed using statistical tools.

The study found out that there exists a relationship between different aspects of corporate governance and firm's financial performance. Board size had significant positive relationship on financial performance. Firms with bigger boards reported better results than those with smaller boards. Board composition had significant but negative relationship with financial performance. Firms with a higher proportion of non-executive directors performed worse than those with a smaller proportion. The study revealed no significant relationship between ownership structure (insider ownership), information disclosure and frequency of meetings with financial performance of firms.

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ABBREVIATIONS

CaIPERS	-	California Public Employees' Retirement System
CEO	-	Chief Executive Officer
CMA	-	Capital Markets Authority
IAS	-	International Accounting Standards
ICPAK	-	Institute of Certified Public Accountants of Kenya
ICPSK -	-	Institute of Certified Public Secretaries of Kenya
JSE	-	Johannesburg Securities Exchange
NSE	-	Nairobi Securities Exchange
NZSE	-	New Zealand Securities Exchange
OECD	-	Organization of Economic Cooperation and Development
OLS	-	Ordinary Least Squares
RDT	-	Resource Dependency Theory
ROA	-	Return on Assets
ROCE	-	Return on Capital
ROE	-	Return on Equity
SOX	-	Sarbanes – Oxley
TCE	-	Transaction Cost Theory

CHAPTER ONE

INTRODUCTION

1.1 Background to the Study

This chapter provides background information to the study. It provides the definitions of corporate governance, financial performance, corporate governance and financial performance and stock brokerage firms and investment banks. The chapter further gives a perspective of stock brokerage firms and investment banks in the Kenyan context. Finally, it gives the problem statement, the objectives and the importance of the study.

1.1.1 Corporate Governance

Corporate Governance is the system by which companies are directed and controlled (Cadbury's, 1992). It involves regulatory and market mechanisms, the roles and relationships between a company's management, its board, shareholders and other stakeholders and the goals for which the corporation is governed (Organization of Economic Cooperation and Development [OECD], 2004). Corporate Governance is concerned with the institutions that influence how business corporations allocate resources and returns. O'Sullivan (2000) argued that a system of corporate governance shapes who makes investment decisions in corporations, what types of investments they make and how returns from the investments are distributed.

Capital Markets Authority in its handbook defines corporate governance as the manner in which the power of a corporation is exercised in the running of the corporation's total portfolio of assets and resources with the objective of maintaining and increasing

shareholders' long-term value while taking into account the interest of other stakeholders.

Corporate governance seeks to ensure that leaders act in the best interests of the corporation and its stakeholders.

Corporate governance is concerned with ways in which all parties interested in the well-being of the firm (the stakeholders) attempt to ensure that managers and other insiders take measures or adopt mechanisms that safeguard the interests of the stakeholders. Such measures are necessitated by the separation of ownership from management, thus giving rise to the agency problem. An agency relationship arises whenever someone called a principal hires someone else called an agent to perform some service and the principal delegates decision making authority to the agent (Brigham & Daves, 2010). The stockholders own the firm and officers (or executives) control the firm (Kim & Nofsinger, 2007). Thus, corporate governance mechanisms try to address the concern that managers and other corporate insiders may pursue their personal goals that compete with the interests of stakeholders. Stakeholders include shareholders, creditors, employees and the society in general. Kim and Nofsinger (2007) grouped the solutions to agency problem into 2 categories, incentives and monitoring.

Kim and Nofsinger (2007) defined incentives as the solutions that tie the executive's wealth to the wealth of shareholders so that everyone shares the same goal. They try to align the incentives with shareholders desires in an attempt to influence managers to act in ways that also benefit the shareholder. These include paying managers a basic salary plus a bonus based on performance and stock options which are rights to buy the

company's shares in future at a pre-determined prices. This is expected to encourage managers to steer companies towards good performance so that they can benefit from performance bonuses once targets are met and by selling the options at higher prices and thereby aligning stakeholder goals to managers' goals.

Kim and Nofsinger (2007), defined monitoring mechanisms as those that are carried out by the board of directors, accountants, internal and external auditors, investment banks, analysts, creditors, credit rating agencies shareholders corporate take-overs and regulators. Managers are expected to act in the interests of shareholders for fear of being exposed by these monitoring bodies.

1.1.2 Financial Performance

Financial performance is a measure of the overall financial health of a corporation over a given period of time. It is a subjective measure of how well a firm can use assets from its primary mode of business and generate revenues. Performance can take many forms depending on the user of the information. Investors are interested in viability, growth in profitability, market share and turnover while environmental and social groups are interested in social corporate responsibility (Brown & Marches, 2003). Governments and development organizations on the other hand are interested in social and economic benefits to the society such as employment. Thus corporate financial performance measures can be financial or non-financial depending on the information needs of the user. However, most measures make use of financial statements. Reily and Brown (1997)

argued that analysis of financial statements seeks to assess performance of management in various areas including profitability, efficiency and risk.

Brealey Myers (2003) identified five main categories of financial measures; Leverage ratios that measure how much the company has borrowed (debt ratio, debt equity ratio and times interest earned), liquidity ratios which measure the company's ability to easily raise cash if needed to meet its obligations as they fall due (current ratio, quick ratio), efficiency ratios which measure how productively and efficiently the company is using its assets (sales to assets ratios, sales to net working capital, debtors turnover, inventory turnover), profitability ratios which measure how profitable the company is (net profit margin, return on assets, return on equity, dividend payout ratio) and finally market volume ratios which measure how highly the firm is valued by investors (price – earnings ratio, dividend yield and market to book ratio). The resulting ratios have to be compared with past performance, targets for the same company from year to year and with other similar companies. Comparison can also be made against internationally established benchmarks.

1.1.3 Stock Brokerage Firms and Investment Banks

Stock brokerage is defined as dealing with the exchange of shares of publicly quoted companies, government, corporate and municipal bonds among other instruments for money (Gillan, 2006). Stock brokerage firms are the companies that deal with buying and selling of shares on behalf of investors. Investment banks are banks that sell newly created securities. They design and sell new stocks for the investing public (Kim and

Nofsinger, 2007). Stock brokerage firms and investment banks act as intermediaries between sellers and buyers (investors) of shares and other investment instruments.

1.1.4 Corporate Governance and Financial Performance

The relationship between Corporate Governance and the financial performance of a company is generally expected to be positive. Companies that have good corporate governance systems are expected to perform better than those with poor corporate governance mechanisms. Whereas there have been many studies carried out to determine whether there is a link between corporate governance and corporate performance, the evidence appears to be fairly mixed (Mallin, 2010). Nesbitt (1994) reported that there is a positive relationship between long-term stock price returns and firms targeted by California Public Employees' Retirement System (CalPERS) suggesting that there is positive relationship between firm performance and corporate governance. Hermes (2005) stated that 'we consider that there is sufficient evidence in support of our view that good corporate governance improves the long term performance of companies. Millstein and MacAvoy (1998) stated that corporations with active and independent boards appear to perform much better than those with passive, non-independent boards. McKinsey (2002) found that a majority of investors are prepared to pay a premium to invest in a company with good corporate governance. Whereas a lot of people support the view that there is a positive relationship between corporate governance and financial performance, there are nevertheless differing opinions. Patterson (2000) stated that his survey did not present conclusive evidence of such a link. Dalton Daily, Eustrand and Johnson (1998) showed that board composition had virtually no effect on firm

performance. They also found no relationship between leadership structure (CEO) Chairman and firm performance.

1.1.5 Stock Brokerage Firms and Investment Banks in Kenya

In Kenya, dealing in shares started in the 1920's. Stock brokerage firms and investment banks in Kenya are member firms of the NSE. They are licensed to buy and sell securities listed on the NSE after fulfilling general licensing requirements as required by the CMA. There are currently 19 stock brokerage firms and investment banks, members in the NSE (NSE Website, 27th July, 2012).

In order to address these problems, CMA through Finance bill 2008/2009 spelt measures to guide the operations and running of stockbrokers and investment banks. The new measures require investment banks and stock brokerage firms to increase their share capital and to publish their financial statements semi-annually and annually, have a designated a compliance officer whose powers can even override that of the owner and the director, take up of professional indemnity that is not less than 5 times their daily average turnover and seek regulatory approval before changes in shareholders, directors, chief executive and key personnel (Mwangi, 2009).

In October 1999, Kenya adopted a national code of best practice for corporate governance at a corporate sector seminar organized by the private sector initiative for corporate governance. A report done by Private Sector Corporate Governance Trust (2009), gave guidelines on the principles of effective boards. According to the guidelines,

a good board should have balanced membership between executive and non-executive members (at least one third should be non-executive), the roles of Chairperson of the Board and Chief Executive Officers should be separate, there should be sub- committees of the board with defined terms of reference and a qualified, competent company secretary to ensure compliance.

1.2 Research Problem

Corporate governance is an area that has grown rapidly in the last few years, (Mallin, 2009). The global financial crisis, corporate scandals and collapse of big corporations such as Enron which was ranked in USA's Fortune top ten list of companies, Royal Ahold, a Dutch group with international interests and ranked third largest food retailer in the world, Parmalat of Italy, China Oil Aviation, Satyam Computer Services and Royal Bank of Scotland have all contributed to the explosion of interest in this area. As businesses become bigger and individual ownership gets replaced by corporate ownership with time, the role of corporate governance as a tool for ensuring financial health of companies has become increasingly important and cannot be under estimated.

Stock brokerage firms and investment banks play a key role in the financial market and thus growth of the economy. Stock brokerage firms link the buyers and sellers of stocks while investment banks offer financial advisory services to their clients. Stock brokerage firms and investment banks hold a lot of information and therefore they have the opportunity to pursue their own interests to the disadvantage of the principals if not checked.

In the last decade, Kenya has witnessed the collapse of a number of stock brokerage firms namely Francis Thuo & Partners (2007), Nyaga Stock Brokers (2008) and Discount Securities (2009). In 2010, Ngenye Kariuki & Co Ltd was put under statutory management by CMA. According to a forensic audit done by PricewaterhouseCoopers (PwC) on Nyagah Stockbrokers, there was diversion of funds by management, fraud by the staff, occurrences of collusion by other stock brokers in the NSE, and even the office of the regulator (Bonyop, 2009). The collapse of stockbrokers has, over the years resulted in lack of confidence with NSE.

A number of studies have been carried on corporate governance and financial performance of companies listed in the NSE. For instance Oyoga, (2010), Ongw'en (2010), Mutisya (2006), Kibuchi (2010) and Kerich (2006) carried out studies on the relationship between Corporate Governance and Financial performance, case for firms listed in NSE in general. Other studies on corporate governance in performance have been in specific industries. Nyaga (2007) studied corporate governance structures and manufacturing firms listed in NSE, Wanjau (2007) Micro Finance institutions while Materigo (2008) related corporate governance with performance in banking industry in Kenya. A few studies have been done in the area of corporate governance in stock brokerage firms. Kuria (2009) studied corporate governance practices in stock brokerage firms in Kenya while K'Odera (2010) studied the relationship between corporate governance and client base in investment banks and stock brokerage firms in Kenya. It is clear that no study has been carried out on corporate governance mechanisms and financial performance in stock brokerage firms and investment banks in Kenya. This study aims to fill the research gap by testing relationship between corporate governance

and financial performance in stock brokerage firms and investment banks between 2006 and 2010.

This study is aimed at answering the following question: Is there a relationship between corporate governance and financial performance of stock brokerage firms and investment banks in Kenya?

1.3 Objectives of the Study

The overall objective of the study was to determine the relationship between corporate governance and financial performance of stock brokerage firms and investment banks in Kenya. In line with this overall objective, the specific objectives of the study were:

- (i) To determine the relationship between board size and financial performance
- (ii) To determine the relationship between board composition and financial performance
- (iii) To determine the relationship between CEO/Chair duality (separation of the role of chairman from the role of CEO) and financial performance
- (iv) To determine the relationship between ownership structure (insider ownership and financial performance
- (v) To determine the relationship between information disclosure and financial performance
- (vi) To determine the relationship between frequency of board meetings and financial performance.

1.4 Importance of the Study

The study is expected to provide useful information to different users in general and in particular following groups:

Academicians

The study will add evidence to the existing body of empirical literature from a developing stock exchange such as that of Kenya. Hence, the study is expected to contribute to the existing body of knowledge on good corporate governance and also make recommendations arising from its findings for further research on this or other related areas of study.

Shareholders

The study will sensitize shareholders on the importance of ensuring that the board practices good corporate governance for the sake of maximizing their share value. It will also enlighten them as to whether stock brokerage firms and investment banks comply with corporate governance guidelines, whether such compliance has an effect on the financial performance of firms. Such information will help shareholders make informed decisions as to whether they can place reliance on corporate governance mechanisms to safeguard their interests.

Board of Directors

This study is intended to make the board more effective and efficient in their activities that lead to the achievement of its objectives such as to deliver value to the customers and returns to the shareholders' investment. The board will become more aware of how its activities affect the return on shareholders' value.

Capital Markets Authority and Other Policy Makers

Evidence from the study will serve as important quantitative information for purposes of policy formulation by to CMA, NSE and other policy makers concerned with corporate governance. The study will confirm to them whether or not corporate governance has any effect on the performance of stock brokerage firms and investment banks. This will help them evaluate whether or not to continue enforcing corporate governance measures on stock brokerage firms and investment banks, whether to enhance them, scrap them or change their tactic all together.

Stock Brokerage Firms and Investment banks

The study will help them to see their level of compliance first with set regulations and secondly compared with each other. It will also help them relate the level of compliance with financial performance. This is expected to enhance the level of compliance going forward.



CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter discusses the various theories on corporate governance, an overview of CMA guidelines on corporate governance, previous research on the relationship between corporate governance and firm performance locally and globally, and finally the knowledge gap that it seeks to fill.

2.2 Theoretical Framework of the Study

A number of theories have been advanced to try to explain corporate governance. Mallin (2010) identified four theories associated with the development of corporate governance namely: agency theory, transactions cost theory, stakeholder theory and stewardship theory.

2.2.1 Agency Theory

Managers of companies may pursue their self interests or may become opportunists. As agents, they may not act in the best interests of the principal or may only act partially in the interests of the principal. For instance, managers may misuse their power by creating empires and may also fail to take appropriate risks in pursuance of the principals interest if they (agents) view those risks as not being appropriate. Agency theory views corporate governance mechanisms especially board of directors as an essential monitoring device to try to ensure that any problems that may be brought about by the principal-agent relationship are minimized.

Blair (1996) states that managers are supposed to be the 'agents' of a corporation's 'owners'. He further adds that managers must be monitored and institutional arrangements must provide some checks and balances to make sure that they (directors) do not abuse their power.

Fama and Jensen (1983) argue that the separation of the decision making and risk bearing functions observed in large corporations is common to other organizations such as professional partnership and non-profits. They contend that the separation of decision-making and risk bearing functions survives in these organizations in part because of the benefits of specialization of management and risk bearing but also because of an effective common approach to controlling the separation of decision making and risk bearing functions. Smith (1838) states that directors of companies where there is separation of ownership and control, being the managers of other people's money rather than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance as if it were their own. According to Berle and Means (1932) agents are the managers and the principals are the shareholders. They highlighted that as countries industrialized and developed their markets, the ownership and control of corporations became separated.

2.2.2 Transaction Cost Economies

Transaction cost economics theory views the firm as a governance structure whereas the agency theory views the firm as a nexus of contracts. Nexus of contracts means that there is a connected group or series of contracts amongst various players arising because it is

seemingly impossible to have a contract that perfectly aligns the interests of principal and agent in a corporate control situation.

Stiles and Taylor (2001) point out that both theories (TCE and agency) are concerned with management discretion; and both assume that managers are given to opportunism (self interest seeking) and moral hazard, that managers are bound to operate under bounded rationality, managers will tend to sacrifice rather than maximize profit which is not being in the best interest of shareholders. Both agency and TCE theories regard the board of directors as an instrument of control.

Coase (1937) stated that “the operation of a market costs something and by forming an organization and allowing some authority (an ‘entrepreneur’) to direct the resources, certain costs are saved. The entrepreneur has to carry out his function at a less cost, taking into account the fact that he may get factors of production at a lower price than the market transactions which he supersedes”. This means that there are economic benefits that accrue to a firm from undertaking transactions internally rather than externally. However, as firms expand in size, it gets to a point where it becomes more cheaper or more efficient for transactions to be undertaken externally. Coase (1937) therefore concluded that firms may become less efficient the larger they become. Williamson (1984) states that the cost of any misaligned actions may be reduced by ‘judicious choice of governance structure rather than merely aligning incentives and pricing them out’.

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Hart (1995) states that there are a number of costs of writing contracts between principal and agent including cost of thinking about and providing for all eventualities that may occur during the course of the contract, the cost of negotiation with others, cost of writing the contract appropriately to ensure it is legally enforceable etc. These costs imply that contracts will always be incomplete in some way and always have omissions. He states that 'in a world of incomplete contracts (where agency problems are also present) governance structure does have a role. Governance structure can be seen as a mechanism for making decisions that have not been specified in the initial contract'.

2.2.3 Stakeholder Theory

Stakeholder theory takes into account a wider group of constituents rather than focusing on shareholders. It identifies stakeholders as people or groups with legitimate interests in various aspects of the company's activities. Stakeholders include the shareholders, employees, providers of credit, customers, suppliers, the government and local community as a whole. Stakeholder theory deviates from the agency theory which focuses on shareholder wealth maximization. Although the shareholder value maximization has been viewed as less self-evident, it can be argued that the shareholders as the recipients of the residual free cash flow (i.e profits remaining once other stakeholders such as creditors and employees have been paid) have a vested interest in trying to ensure that resources are used to maximum effect, which in turn should be to the benefit of society as a whole.

Jensen (2001) states that a traditional stakeholder theory argues that managers of a firm should take account of the interests of all stakeholders in a firm but because the theorists

refuse to say how the trade-offs against the interests of each of these stakeholder groups might be made, there are no defined measurable objectives and this leaves managers unaccountable for their actions. Jensen (2001) therefore advocated 'enlightened value maximization' which in his view was identical to 'enlightened stakeholder theory'. Enlightened stakeholder theory utilized much of the structure of stakeholder theory but accepts maximization of the long-run value of the firm as the citation for making the requisite trade-offs among its stakeholders. It therefore solves the problems that arise from multiple objectives that accompany traditional stakeholder theory. A stakeholder view of the firm places its executives at the centre of managing relationships with each stakeholder group.

2.2.4 Stewardship Theory

Donald and Davis (1991) cautioned against accepting agency theory as given. They introduced an alternative approach, stewardship theory. Stewardship theory stresses the beneficial consequences on shareholder returns of facilitative authority structures which unify command by having the roles of CEO and chair held by the same person. According to them, safeguarding of shareholder returns along the track lay on not placing management under great control of the owners but in empowering managers to take autonomous executive action.

Stewardship theory holds that managers are good stewards of corporations. Given that a corporation is a legal entity in which directors have a fiduciary duty to the shareholders, the stewardship theory argues that managers just like stewards will act in the

shareholders' best interests and will diligently work towards attaining a high level of corporate profit and shareholder returns. According to the theory, managers have more at stake, not just pursuit of self interest in a corporation. Managers work for among other things achievement, success, recognition, social status, respect within the society, the pleasure and self satisfaction that comes with success etc. The supporters of this theory argue that separation of ownership from control does not inherently lead to conflict between shareholders' and managers' goals and interests. On the contrary, separation actually promotes the development of managerial skills which is beneficial for corporate performance and shareholder wealth maximization.

2.2.5 Resource Dependency Theory

Resource Dependency Theory (RDT) was introduced by (Pfeffer & Salancik, 1978). The theory is built around the central hypothesis that organizations are constrained by external pressures and demands. Consequently, "the key to organizational survival is the ability to acquire and maintain resources" (Pfeffer & Salancik, 1978). RDT views the corporation as an open system that is dependent on contingencies in the external environment (Pfeffer & Salancik, 1978). Pfeffer (1987) argues that organizations are not autonomous, but rather are affected by a network of interdependencies with other organizations which creates interdependence between the organizations. The interdependence, coupled with uncertainty about the actions that the other organizations are likely to lead to uncertainty on the continued success. Organizations therefore take actions to manage external interdependencies. Pfeffer and Salancik (1978) proposed five options which firms can implement in order to minimize environmental dependences. These include mergers and

vertical integration, Joint ventures and other interorganizational relationships, boards of directors, political action and executive succession. However, such actions are not always completely successful and produce new patterns of dependence and interdependence. This in turn results in interorganizational and intraorganizational power. RDT describes organizational success as the ability to maximize power by accessing scarce and essential resources (Pfeffer, 1972) & (Ulrich & Barney, 1984). Thus financial performance of a company is dependent on its ability to access scarce resources.

2.3 Capital Markets Authority Guidelines on Corporate Governance

The Capital Markets Authority (CMA), set up in 1989 through an Act of Parliament Cap. 485A Laws of Kenya is a body corporate and a statutory agency charged with the prime responsibility of regulating the development of orderly, fair and efficient capital markets in Kenya. It licenses and supervises market intermediaries, conducts on-site and off-site market surveillance and enforces compliance, and promotes market integrity and investor confidence. One of the roles of CMA is to create, maintain and regulate a market in which securities can be issued and traded in an orderly, fair, and efficient manner, through the implementation of a system in which the market participants regulate themselves to the maximum practicable extent and to protect investor interests. Capital Markets Act (Cap 485A) guidelines on corporate governance as published in Gazette Notice No. 3362 (2002) give specific guidelines on corporate governance. The objective behind the guidelines is to strengthen corporate governance practices by public listed companies in Kenya and to promote the standards of self regulation so as to bring the level of governance in line with international trends. The guidelines cover areas such as

the role of board, board composition, role of Chairman and CEO, board balance and size, appointment and responsibilities of board, disclosure requirements, rights of shareholders and accountability and audit.

According to the CMA guidelines, each public listed company should disclose the extent of compliance or non compliance with the corporate governance providing guidelines in the corporate annual reports. This is done by way of a statement of the directors and should form part of the annual report.

Each public listed company is to be headed by an effective board and should have sub-committees to deal with certain areas. As a minimum, each board must establish an audit and a nominating committee. The board, on an annual basis should disclose its policies for remuneration including incentives for the board and senior management categorized into executive directors fee, executive directors emoluments, non-executive directors fee, and non- executive directors emoluments. The board should also disclose the top ten major shareholders of the company, share options and other forms of executive compensation that may have been made in the course of financial year.

The board should compose of a balance between executive and non executive directors.

The guidelines state that non-executive directors should comprise at least one third of the board members should be non-executive. The directors should also have diverse skills and expertise to ensure that no individual or small group of individuals can dominate the board decision making processes. The act further provides guidelines on how directors

shall be appointed, re-elected and how to handle cases of multiple directorship and resignation of directors.

The guidelines provide that there should be a clear separation of the role and responsibilities of the chairman and chief executive officer to provide a balance of power of authority and provide checks and balances such that no one individual has unfettered powers of decision making. The guidelines cap the number of public listed companies that an individual can chair to not more than two at any one time. This is to ensure effective participation in the board.

The guidelines empower the shareholders of a company to participate in major decisions of the company such as major disposal of company's assets, restructuring, take overs, mergers, acquisitions and re-organizations. Shareholders exercise their power through voting during the annual general meetings.

Further, the guidelines require the board to present an objective and understandable assessment of the company's operating position and prospects and to also ensure that the accounts are presented in line with International Accounting Standards (IAS). The board should maintain a sound system of internal controls to safeguard the shareholders investments and assets. The board is further expected to establish a formal and transparent arrangement for shareholders to appoint independent auditors. The board is also charged with the responsibility of ensuring that a formal and transparent arrangement for maintaining a professional relationship with the company's auditors is maintained.

Finally, the Act requires disclosure of any management or business agreements entered into between the company and related companies which may result in a conflict of interest. It also requires that Chief Finance Officers of public listed companies be members of the Institute of Certified Public Accountants (ICPAK), that company secretaries be members of the Institute of Certified Public Secretariats of Kenya (ICPSK) and auditors be members of ICPAK.

2.4 Empirical Studies

Several studies have been carried out on the subject of corporate governance and financial performance both globally and locally.

2.4.1 Global Empirical Studies

Manaseer, Hindawi, Dahiyat and Sartaw (2012) studied the relationship between corporate governance and performance in Jordanian banks. They used four performance measures: return on equity, return on assets, profit margin, and earnings per share against four corporate governance mechanisms (board size, board composition, chief executive status and foreign ownership). The results of the study were mixed. On one hand, the study revealed a positive relationship between the number of outside board members and the foreign ownership and Jordanian banks' performance. On the other hand, the study found a negative relationship between the board size and the separation of the role of CEO and chairman with the banks' performance implying that the combination of chairperson and CEO helps in avoiding ambiguity in responsibilities thereby leading to better financial performance.

Bhagat and Bolton (2008) studied the relationship between corporate governance and performance and found that better governance is significantly positively correlated with better contemporaneous and subsequent operating performance. They however found that board independence is negatively correlated with performance.

Abdo and Fisher (2011) studied the relationship between governance disclosure and corporate performance of companies listed in the Johannesburg Securities Exchange (JSE), South Africa. The study revealed a striking relationship between corporate governance and performance. Corporate governance was positively correlated with share price returns during the period reviewed suggesting that investors place a premium on (valued highly) South African companies with good governance. They said that the evidence was sufficient to conclude that corporate governance is a component of equity risk and that there is a positive relationship between the level of disclosure and corporate performance. They stated that their findings had significant implications for companies neglecting corporate governance disclosures.

Khan, Nemati and Iftikhar (2007) examined the effect of corporate governance on a firm's performance in the Tobacco industry of Pakistan. The study focused on three aspects of corporate governance namely: ownership concentration, CEO duality and Board's Independence. They measured firm's performance through Return on Equity (ROE) & Return on Assets (ROA). They found out that corporate governance had a strong and positive impact on a firm's performance. They argued that the presence of more independent directors on the board will make the board more independent. An

independent board will be better placed to make independent decisions and hence safeguard the interests of all the stake holders, particularly the rights of minority shareholders.

Kajola (2008) examined the relationship that exists between firm performance as measured using (ROE and profit Margin) and four corporate governance mechanisms (board size, board composition, chief executive status and audit committee and found mixed results depending on the measure of performance. Whereas there was a positive and significant relationship between ROE and board size, ROE and chief executive status, there was no significant relationship between ROE, board composition and audit committee. Likewise, the study did find no significant relationship between profit Margin and board size, board composition and audit committee but found a positive and significant relationship between profit Margin and chief executive status.

Gurbuz, Aybars and Kutlu (2010) studied the relationship between corporate governance and financial performance with a perspective on institutional ownership in Turkey. The results of their study revealed that the existence of institutional investors improves firm financial performance. They found that ROA of the firms listed on the corporate governance index is more than those not listed on the index. The study supports the view that corporate governance practices enhance firm financial performance. Institutional investors have been found to improve the financial performance of all firms. This is because they have a lot of stake and they have the interest and resources to monitor the performance of firms. The study also found that good corporate governance can improve

decision making process, access to capital and lead to better risk management. All these lead to improvements in the generation of added value to all the stakeholders.

Krishna (2010) studied the relationship between corporate governance practices and financial performance and found that compliance with New Zealand Stock Exchange (NZSE) recommendations had a positive effect on financial performance on companies with large capitalization. However, companies with small capitalisation and public sector corporate entities showed negative relationship between financial performance and compliance with NZSE recommendations. The study also revealed mixed results when the relationship between performance and governance was compared between different industries.

Ness, Miesing and Kang (2010) examined the influence of corporate boards on firm financial performance in the new era of Sarbanes-Oxley (SOX). The results of their study were mixed. Contrary to results of previous findings that boards with a greater number of outside directors have a positive influence on performance, they found no such relationship. Similarly, they did not find any significance of age or gender of board directors on performance. However, they found significant positive relationship between financial performance on one hand and duality, occupational expertise, board size, and board tenure on the other hand. The study showed that duality (the role of CEO and Chairman played by the same person) had a positive influence on growth in ROA may be due to more harmony between corporate boards and executive management. The study also found a relationship between board composition in terms of expertise and

performance. Boards with educators had negative influences on revenue growth maybe because of limited exposure to the business transactions. Contrary to expectation, boards with a high ratio of directors with finance expertise showed a decrease in revenue growth. They also found out that boards with directors with high average tenure is positively related to ROA because of their experience suggesting that low turnover of board directors is good for the financial performance of the company.

Yermack (1996) studied higher market valuation of companies with a small board of directors and found out that company performance was more related to company size, industry membership, inside stock ownership, growth opportunities, and alternative corporate governance structures. He also found that companies with small boards reported better performance as measured using financial ratios, and provide stronger CEO performance. These findings support the study by (Jensen, 1993). Jensen criticized the performance of large boards, citing problems of poor communication and decision-making which overwhelm the effectiveness of such groups. He argued that large boards are less effective compared to small boards and thus board size has a negative impact on firm performance. This is attributable to the challenges of coordinating a large group of people and reaching decisions. In some cases, the decisions end up being compromises and not necessarily the most optimal. In large boards, some members may also become joy riders who do not contribute ideas towards the decisions of the company.

2.4.2 Local Empirical Studies

Oyoga (2010) examined corporate governance and firm performance of financial institutions listed in Nairobi Stock Exchange and established that there is a positive relationship between firm performance and board composition, shareholding and compensation, shareholder rights and board governance disclosure issues. The study found out that financial institutions that exhibit higher corporate governance standards will perform better than their peers in the same industry. Empirical evidence gathered from the study however gave mixed and little evidence for the shape of an optimal governance structure.

Lang'at (2006) conducted a study on corporate governance structures and performance in firms quoted in the NSE and found out there is a positive relationship between a firm's performance and the frequency of board meetings, the ratio of outside directors to the total directors, percentage of insider share ownership and executive compensation. However, like Oyoga (2010) he did not find conclusive evidence for the shape of an optimal governance structure.

Kihara (2006) studied the relationship between ownership structure, governance structure and performance of firms listed in the Nairobi Stock Exchange and found no significant relationship between ownership and firm performance. However, the study found a significant positive relationship between foreign share ownership and firm performance.

Mutisya (2006) studied the relationship between corporate governance and financial performance of companies listed in the NSE and found out that 4.3% of the changes in profitability when measured using ROI were accounted for by aspects of corporate governance. She further found out that board size and number of meetings and the proportion of shares held by the top directors were the most significant variables.

Nyaga (2008) studied the control and enforcement of corporate governance by the Capital Markets Authority and found out that the authority has put in place various measures and reporting requirements for listed companies and these act as a guideline. Fines and penalties are applied as some of the mechanisms for controlling and enforcing the guidelines. The study found that there are varying levels of control and enforcement of the guidelines against the prescribed measures.

Kiamba (2008) studied the effect of corporate governance in local authorities in Kenya and found out that financial performance of local authorities in Kenya is largely influenced by the political composition of the respective councils, the manner in which internal audits are conducted and the managerial approaches applied by the chief officers. The study attributed poor performance by councils to their failure to conduct regular assessment of their performance, poor co-ordination between the internal and external providers of assurance, high staff turnover and transfers.

Wanjau (2007) carried out a survey of the relationship between corporate governance and performance of microfinance institutions in Kenya and found out that there exists a

relationship between different aspects of corporate governance and firm performance. The size of the board was found to be positively correlated with turnover and disbursements.

Ngugi (2007) studied the relationship between corporate governance structures and performance of insurance companies in Kenya and concluded that the size of the board and insider holding have an association with performance of insurance companies. However, the study found no evidence that external board, individual holding and institutional holding have any influence on performance of insurance companies.

Manyuru (2005) studied corporate governance and organizational performance; the case of companies quoted in the Nairobi Stock Exchange and found out that performance of companies correlated with the extent of corporate governance. The study also found out that the correlation was stronger in some sectors than others with the Agricultural sector having the highest correlation followed by Industrial and Allied sector with alternative investment market segment showing the weakest relationship.

Kibuchi (2010) studied the relationship between corporate governance and financial performance; a case of companies listed in the Nairobi Stock Exchange. The results of the study were mixed with some aspects of corporate governance showing a positive relationship while others showed negative correlation. Overall conclusion was that corporate governance mechanisms do affect company performance as measured by Return on Equity (ROE).

2.5 Conclusions from Literature Review

There are varied views about the relationship of corporate governance and financial performance. Empirical evidence from some studies has revealed mixed results on whether corporate governance or some of its aspects do actually influence financial performance. Whereas a lot of the studies on the subject have shown positive and significant relationship between corporate governance and financial performance, other studies have found negative relationship between the two. Yermack (1996) found out that small boards are more effective and that a negative relationship exists between board structure and turnover. Kajola (2008) found no significant relationship between ROE, board composition and audit committee or between profit margin and board size, board composition and audit committee. The relationship between corporate governance and financial performance remains unclear. Thus there is need for further research in this area to clear highlighted contradictions. This study differs from previous studies in that previous studies have focused on corporate governance and financial performance in general while others have focused on banks, insurance companies, government corporations and micro finance institutions. No study has been carried out on the relationship between corporate governance and financial performance of stock brokerage firms and investment banks in Kenya.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

Research is a structured enquiry that uses acceptable scientific methodology to solve problems and create new knowledge that is generally acceptable. Research helps to prove a hypothesis or answer specific questions. It involves the definition of a problem, formulation of possible solutions, data collection, analysis and evaluation. Research methodology is a way to systematically solve the research problem. Research methodology specifies the research design used, type of data whether primary or secondary, target population, sample size and selection criteria, data collection method(s) and instruments, data analysis and interpretation. This chapter outlines the general methodology used to carry out the study.

3.2 Research Design

This study used a causal research design. A causal research design investigates the cause and effect relationship between two or more variables. It is used to assess the impact a change in one variable will have on another and helps to predict the hypothetical scenarios that a researcher may be interested in. Causal design was preferred for this study because it explores the effect of one or a group of variables on another in this case the effect of corporate governance on the financial performance of stock brokerage firms and investment banks in Kenya. Since the study sought to find out the cause-and-effect

relationship between corporate governance and financial performance, a causal research design was considered appropriate.

3.3 Population

The study targeted all the stock brokerage firms and investment banks who were members of the Nairobi Stock Exchange. The list of member firms was downloaded from the Nairobi Stock Exchange website (www.nse.or.ke) as at 27th July 2012 (Appendix I). The population size as per the list was 19 firms of which 2 were under statutory management.

Given the small size of the population, the study targeted a census survey of all the firms excluding the firms under statutory management. Firms under statutory management do not have the normal operational governance systems and so would bias the study if included. One firm which is not a member of NSE but trades through NSE through its sister company (which is member of NSE) was considered as part of the population as it qualifies in all material respects. For this reason, only 18 firms therefore qualified to be included in the study.

3.4 Data Collection Method

The study used primary data. The data was collected using questionnaires targeted at all the stock brokerage firms and investment banks in the population. In order to capture both quantitative and qualitative data, the questionnaire was designed with both open-ended and closed questions. The drop and pick method was used. Follow up was made through telephone calls, e-mails and where necessary personal visits to ensure the questionnaires

were received and completed. Performance was measured using ROA. ROA is a measure of how effectively the assets of a company are used to generate a return. It is calculated as a percentage of income over total assets.

3.5 Data Analysis

Data was analyzed using multiple regression equation. The method of estimation was Ordinary Least Squares (OLS) in order to establish the relationship between corporate governance and financial performance. Table 3.1 below summarizes operational definitions applied in the study.

Table 3.1 Operational Definitions of Variables

Variable	Definitions
Independent variables	
Board Size (BRD SIZE)	Total number of directors in the board
Board composition (BRD COMP)	Director Proportion of independent non-executive directors
CEO/Chair duality(Separation of the role of the Chairman from the role of the CEO)	Dummy variable – 1 if the Chairman of the Board is also the Chief Executive Officer or the Managing Director
Ownership structure (insider ownership)	Percentage of control rights (both direct and indirect) held by the managers (and family members)
Information Disclosure	Compliance with minimum CMA disclosure requirements
Frequency of board meetings	Number of board meetings in a year
Dependent Variable	
Financial Performance	As measured by Return on Assets (ROA)

3.6 The Model Specification

The study used multiple regressions with return on assets as the dependent variable and corporate governance as the independent variable. The objective of the model was to test whether indeed a relationship exists between corporate governance and earnings of a firm as measured by ROA. The model can thus be illustrated as a multiple regression equation with ROA as the dependent variable and the selected corporate governance measures as the independent variables.

Financial performance was expressed using the following equation:

Financial Performance = $\alpha + \beta_1$ (Board Size) + β_2 (Board Composition + β_3 (CEO/Chair Duality) + β_4 (Ownership structure) + β_5 (Information Disclosure) + β_6 (Frequency of Board Meetings) + ϵ_i where:

α – Constant

$\beta_1 \dots \beta_6$ = Corporate Governance Measures (partial regression coefficients) that was used to measure the change in financial performance per unit change in the respective corporate governance measures (X_i 's).

ϵ_i . Error term which accounts for all the other factors/variables that were not considered in developing the above regression model about financial performance.

Partial correlation coefficients (a correlation matrix) was computed to determine the relative importance of the different explanatory variables (corporate governance measures). The explanatory variable with the highest partial correlation coefficient with respect to the dependent variable contributes most to the explanatory power of the model.

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The enter all method of multiple regression analysis was used. Correlation at a value of 0.5 was used to deal with the problem of multicollinearity. P-Values were computed to establish the statistical significance of the parameter estimates. The coefficient of multiple determination, R^2 , was computed to determine the proportion of the total variation in financial performance (Y) 'explained' by the multiple regression of Y on the X_i 's (corporate governance measures). The overall significance of the regression was tested at 95% confidence level using the P-Values. The analysis was done using the SPSS version 18.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

The research objective was to determine the relationship between corporate governance and financial performance of stock brokerage firms and investment banks in Kenya. The data was collected from 19 brokerage firms and Investments banks. This chapter presents the results of the analysis and the interpretation of the research findings. The results of the tests carried out are presented below.

4.2 Correlation Analysis

A correlation matrix was generated using SPSS package to examine the strength of the relationships between the various aspects of corporate governance and firm performance. As a rule of the thumb, r-squared greater than 0.5 is considered a strong relationship. As indicated in the Pearson coefficient correlation coefficient table, Frequency of board meetings is correlated (correlation coefficient > 0.5) to both Board Size (BRD SIZE) and Ownership structure (insider ownership) while the rest of the variables are not correlated. Therefore one of them should be dropped from the model. Information Disclosure, Ownership structure (insider ownership), Board Size (BRD SIZE) could be used to predict Financial Performance since the correlation coefficients between them were all less than 0.5

Table 4.1 Coefficient Correlations^a

Model		Frequency of board meetings	Information Disclosure	Board composition (BRD COMP)	Board Size (BRD SIZE)	Ownership structure (insider ownership)
1	Correlations	Frequency of board meetings	1.000			
		Information Disclosure	.142	1.000		
		Board composition (BRD COMP)	.293	-.078	1.000	
		Board Size (BRD SIZE)	-.509	-.158	.292	1.000
		Ownership structure (insider ownership)	-.677	.114	-.376	.399

a. Dependent Variable: Financial Performance

4.3 Test of Goodness of Fit

The study further used Coefficient of determination (the percentage variation in the dependent variable being explained by the changes in the independent variables) and P-value to check on the overall significance of the model. The coefficient of determination of 0.98 shows that 98 percent of the variation in firm's financial performance could be explained by the changes in Frequency of board meetings, Board composition (BRD COMP), Information Disclosure, Ownership structure (insider ownership), Board Size (BRD SIZE) leaving only 2 percent unexplained. The P- values =0.049 > 0.05) which shows that the model of return on assets (ROA) is significant at the 5 percent significance.

Table 4.2 Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
dimension0 1	.990 ^a	.980	.931	2.69466	.980	19.839	5	2	.049

a. Predictors: (Constant), Frequency of board meetings, Information Disclosure, Board composition (BRD COMP), Board Size (BRD SIZE), Ownership structure (insider ownership)

4.4 ANOVA Test

ANOVA findings (P- value of $0.049 < 0.05$) in table 4.21 shows that there is correlation between the predictors variables (Frequency of board meetings, Board composition (BRD COMP), Information Disclosure, Ownership structure (insider ownership), Board Size (BRD SIZE)) and response variable (Financial Performance)

Table 4.3 ANOVA^b

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	720.263	5	144.053	19.839	.049 ^a
	Residual	14.522	2	7.261		
	Total	734.785	7			

Predictors: (Constant), Frequency of board meetings, Information Disclosure, Board composition (BRD COMP), Board Size (BRD SIZE), Ownership structure (insider ownership)

b. Dependent Variable: Financial Performance

4.5 Regression Analysis

A regression analysis was further carried out in order to establish corporate governance had an impact on the financial performance of stock brokerage firms and investment banks in Kenya during the period 2006 and 2010. As shown in Table 4.4 below, the variables that were used in the model were (Board Size (BRD SIZE), Board Composition (BRD COMP), Ownership Structure (insider ownership), Information Disclosure and Frequency of board meetings. All the variables requested were entered. However, separation of the role of CEO and chairperson was rejected by the model and was thus excluded. This can be explained by the fact that all the respondents returned a uniform response that the two roles are separate in their firms.

Table 4.4 Variables Entered

Variables Entered	Variables Removed	Method
Board Size (BRD SIZE) Board composition (BRD COMP), Ownership structure (insider ownership), Information Disclosure and Frequency of board meetings	Separation of the role of Chairman from CEO	Enter

All requested variables entered.

Dependent Variable: Financial Performance

The model expressing the relationship between Board Size (BRD SIZE) Board composition (BRD COMP), Ownership structure (insider ownership), Information Disclosure and Frequency of board meetings, and Financial Performance was written

using the unstandardized Coefficients to allow for forecasting purposes. The model was as follows:

$$\text{Financial Performance (Y)} = 2.347 + 5.507X_1 - 24.887X_2 + 5.592X_3 - 3.049X_4 - 1.246X_5$$

Where

$X_1 = 5.507$, shows that one unit change in Board Size (BRD SIZE) results in 5.507units increase in Financial Performance other variables held constant

$X_2 = -24.887$, shows that one unit change in Board composition (BRD COMP) results in 24.887units decrease in Financial Performance other variables held constant

$X_3 = 5.592$, shows that one unit change in Ownership structure (insider ownership) results in 5.592 units increase in Financial Performance other variables held constant

$X_4 = -3.049$, shows that one unit change in Information Disclosure results in 3.049 units decrease in Financial Performance other variables held constant

$X_5 = -1.246$, shows that one unit change in Frequency of board meetings results in 1.246 units decrease in Financial Performance other variables held constant

Table 4.5 Regression Coefficient

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	2.347	7.046		.333	.771
	Board Size (BRD SIZE)	X_1 5.507	1.144	.689	4.814	.041
	Board composition (BRD COMP)	X_2 -24.887	4.813	-.681	-5.171	.035
	Ownership structure (insider ownership)	X_3 5.592	3.747	.226	1.492	.274
	Information Disclosure	X_4 -3.049	2.342	-.138	-1.302	.323
	Frequency of board meetings	X_5 -1.246	.388	-.499	-3.214	.085

a. Dependent Variable: Financial Performance

In terms of magnitude, the findings indicated that Board composition (BRD COMP) had the highest influence on Financial Performance, followed by Ownership structure (insider ownership), Board Size (BRD SIZE), Information Disclosure, and Frequency of board meetings. The P-Values also indicated that only Board Size (BRD SIZE) and Board composition (BRD COMP) are significant in the firm's financial performance, while Ownership structure (insider ownership), Information Disclosure, and Frequency of board meetings are not significant or linearly related to the firm's financial performance.

Board Size (BRD SIZE), the number of board directors ranged from 3 to 7. Firms with larger number of board members performed better than those with smaller boards. This can be explained by the fact that bigger boards bring in diversity of ideas and experiences which positively contribute to financial performance. However, there is caution on the size of the board. Very big boards can also be a problem in terms of reaching quality decisions. Some of the decisions end up being compromises and some board members may also become joy riders.

Board composition (BRD COMP), the percentage of non-executive directors had significant but negative effect on financial performance. Firms with boards with a higher percentage of non-executive directors performed poorly compared to those with a smaller proportion. This could be interpreted to mean that the non-executive directors had negative influence or interfered with running of the firms such that they returned poor performance compared those with smaller percentages of non-executive directors. This could be the reason why CMA's recommendation is one third of the board members as

non-executive directors. Firms need to strike a balance between advantages of independence brought by non-executive directors and the disadvantage of interference. It could also imply that it is not just the proportions in terms of numbers but other factors like the expertise the non-executive directors bring into the firm matters.

Ownership structure (insider ownership) had a positive but insignificant relationship with financial performance. Firms with more insider ownership performed better than their counterparts. However, the relationship was insignificant meaning that how a firm is owned does not seem to influence financial performance of firms. However, the results could have been influenced by the respondents who found the question sensitive.

Information disclosure had a negative but insignificant effect on financial performance. This could be explained by the fact disclosure is regulated in terms of what information is to be disclosed, at what frequencies, timing and mode of communication. For this reason, all firms reported high information disclosure but their financial results were varied meaning that information disclosure did not influence their financial performance.

Frequency of meetings had a negative but insignificant effect on financial performance. Firms performed well on meetings but still reported varied financial results meaning that frequency of meetings per se did not influence their financial performance. This could be interpreted to mean that it is not the number of meetings held but the quality of decisions that come out of the meetings. However, the results could have been influenced by the fact that there is some degree of regulation in that CMA regulations require the board to meet regularly.

CHAPTER FIVE

SUMMARY CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This section discusses the main findings, draw conclusions and make recommendations.

5.2 Summary of Findings

The objective of the study was to determine the relationship between corporate governance and financial performance of stock brokerage firms and investment banks in Kenya.

The study used regression analysis to find the relationship between Board Size (BRD SIZE), Board composition (BRD COMP), Ownership structure (insider ownership), Information Disclosure and Frequency of board meetings on one hand and Financial Performance on the other. Forecasting model was developed and tested for accuracy in obtaining predictions. The findings of the study indicated that the model was significant. This is demonstrated in the part of the analysis where R^2 for the association was 98%. All the predictor variables were also linearly related with the dependent variable thus a model of five predictor variables could be used in predicting financial performance.

On board size, the study found that there is a significant positive correlation between board size and financial performance. This means that firms with bigger boards had reported better performance over the period under study. This is consistent with the

findings of Kajola (2008) who found a positive and significant relationship between board size and return on equity. However, the findings are inconsistent with those of Ness et.al. (2010) who found no relationship between board size and financial performance. They also contrast those of Yermack (1996) who found that companies with small boards reported better financial performance as measured using financial ratios.

With respect to board composition, the study found a significant negative correlation between board composition (the proportion of non-executive directors in the board) and financial performance. This means that firms with a smaller percentage on non-executive directors are likely to perform better financially than those with a greater proportion of non-executive directors. The findings contrast those of Khan et al (2007) who found that companies with a higher percentage of non-executive directors reported better financial performance.

On ownership structure, the study found a positive but insignificant correlation between insider ownership and financial performance. This means that insider ownership has little effect on the financial performance of a firm. These findings are inconsistent with those of Khan et al. (2007) whose study revealed a positive relationship between ownership concentration and a firm's financial performance

The study found a insignificant negative relationship between information disclosure and financial performance. This means that financial performance of a firm is not significantly affected by its level of information disclosure. These findings contrast those

of Oyoga (2010) whose study revealed a positive relationship between financial performance and board governance disclosure. However, the findings of this study could have been affected by respondent's desire to appear to conform to expectation when filling out the questionnaire.

According to the findings of the study, the frequency of board meetings had negative but insignificant effect on financial performance. This may be interpreted to mean that it is the quality of the discussions in the meetings and not necessarily the number of meetings itself that matters. These findings contract those of Mutisya (2006) and Langat (2006) whose studies revealed a positive relationship between frequency of board meetings and financial performance.

5.3 Conclusion

This study sought to test the effect of firm specific corporate governance variables on financial performance of stock brokerage firms and investment banks in Kenya. The results of study are mixed with some variables board size and board composition indicating significant positive relationship, ownership structure revealing a positive but insignificant relationship while information disclosure and frequency of board meetings revealed negative but insignificant relationship with financial performance. The study therefore concludes that only board size and board composition have an influence financial performance. Ownership structure, information disclosure and frequency of meetings do not significantly affect financial performance. This means that firms should only consider board size and board composition in making decisions about their board structures as these are the two variables that significantly affect financial performance.

However, there may be other significant factors that affect financial performance besides those used in the model.

5.4 Recommendations

The following recommendations are given to both the policy makers and researchers;

5.4.1 Recommendations on Policy

The research findings revealed that some firms who are members of NSE have not fully embraced corporate governance practices and these should be prevailed upon to ensure they fully comply with corporate governance guidelines. Although there is no empirical evidence to suggest that embracing corporate governance will itself improve financial performance, it is expected to combine with other factors to enhance a firms financial performance in the long run.

The study also revealed a major gender imbalance. Only a few firms had women directors in their boards. Although there is no empirical evidence from the study that inclusion of women directors in the board improves financial performance, in future, there may be need for affirmative action to correct this position in line with the current Kenyan constitution.

5.4.2 Recommendations for Further Research

This study was conducted using primary data and relied on information provided by the respondents. The same study could be conducted using secondary data for comparison

purposes to find out whether the findings would be consistent. The study also used ROA as the financial performance measure. The same study could be conducted using other financial performance measures like Return on Capital Employed (ROCE) and Return on Equity (ROE). Further, the scope of the study could be expanded to include in the target population those other firms that trade in the NSE through NSE member firms but are not themselves stock brokerage firms. Since corporate governance is a relatively new field of study, this same study could be repeated in future years to check the impact of new regulations that are continuously being introduced by CMA to govern the operations of stock brokerage and investment banks in Kenya. This study was based on six aspects of corporate governance namely board size, board composition, Chair duality, ownership structure (insider ownership) and frequency of board meetings. Further study may be carried out including more corporate governance aspects in the model for a more complete picture of the effect of all corporate governance aspects on a firm's financial performance.

5.5 Limitations of the Study

The study suffered a number of limitations the major one being unwillingness by respondents to fill in the questionnaire as they considered the data requested sensitive. It took several days and persuasion to obtain data from some of the firms.

Secondly, the study relied on primary data provided by the respondents. Given that some of the issues under review are compliance issues, there is a chance that some firms could

have given positive responses even where the responses should have actually been negative. The study did not verify the authenticity of data provided.

The study centered on the extent to which corporate governance affects financial performance. However, financial performance of a firm is affected by many other factors including political, social, economic and technological factors. These other factors that were not considered could have had an effect on the performance of the firms, which effect was not considered in the study.

The study considered only 6 corporate governance parameters but there are many more others which equally affect financial performance. For instance, the study looked at mere numbers of board members but not their expertise in terms professional and educational backgrounds and experience. Ness et al (2010), in their study found a negative relationship between financial performance and boards with educators maybe because of limited exposure. They also found financial performance of firms whose boards have more finance people to perform poorly financially contrary to expectation. Tenure in the board was also ignored yet it was found to have a positive relationship with financial performance, Ness et al. (2010).

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APPENDICES

Appendix 1: List of Stock Brokerage Firms and Investment Banks in Kenya

1. Dyer & Blair Investment Bank Ltd
2. Francis Drummond & Company Limited
3. Ngenye Kariuki & Co. Ltd. (Under Statutory Management)
4. Suntra Investment Bank Ltd
5. Old Mutual Securities Ltd
6. CFC Stanbic Financial Services
7. Kingdom Securities Ltd
8. Afrika Investment Bank Ltd
9. ABC Capital Ltd
10. Sterling Capital Ltd
11. Apex Africa Capital Ltd
12. Faida Investment Bank Ltd
13. NIC Securities Limited
14. Standard Investment Bank Ltd
15. Kestrel Capital (EA) Limited
16. Discount Securities Ltd. (Under Statutory management)
17. African Alliance Kenya Investment Bank Ltd
18. Renaissance Capital (Kenya) Ltd
19. Genghis Capital Ltd

Source: NSE website-27th July 2012

Appendix 2: List of Stock Brokerage Firms and Investment Banks who responded to the questionnaire and data used for regression analysis

No.	Name Of Firm	Type of firm	Corporate Governance Variables						Financial Performance (Average ROA)
			Board Size (BRD SIZE)	Board composition (BRD COMP)	CEO/Chair duality(Separation of the role of the Chairman from the role of the CEO)	Ownership structure (insider ownership)	Information Disclosure	Frequency of board meetings	
1	Apex Africa Capital	SB	5	0.33	1	0.52	0	12	9.67
2	Faida Investment Bank	SB	6	0.8	1	0.6	1	12	4
3	ABC capital	SB	3	1	1	0	0	2	-0.12
4	African Alliance	SB	3	0.67	1	0	1	4	-0.84
5	Sterling Capital	SB	4	0	1	1	1	2	0.15
6	Stanbic Investment Bank	IB	7	0.14	1	0	1	4	29.73
7	Suntra Investment Bank	IB	5	0.8	1	0.12	1	4	-0.03
8	Dyer and Blair	SB/IB	5	0	1	0.2	1	4	8.04
9	African Investment Bank	SB	4	1	1		0	2	1.6
10	Kestrel Capital East Africa	SB	4	0.75	1	0.5	1	4	0.1
11	Old Mutual	SB	5	0.6	1		1	4	0.01
12	NIC Capital	IB	4	0.75	1	0	1	2	1.83
13	NIC Securities	SB	4	0.5	1		1	2	-0.1
14	Kingdom Securities	SB	6	0.67	1		1	4	0.07

IS: Stock Brokerage

IB: Investment Bank

Appendix 3: Questionnaire

TITLE: A Questionnaire on the Relationship between Corporate Governance and Financial Performance of Stock Brokerage Firms and Investment Banks in Kenya

The information provided will be used solely for academic purposes and will be treated with the highest level of confidentiality.

INSTRUCTIONS

The questionnaire has five sections. Please answer all the questions in each section. If a question is not applicable, pls mark 'N/A'. If you simply do not have an answer or the knowledge, please mark 'NK'.

Please write as legibly as possible

SECTION A: GENERAL INFORMATION

1. Name of the firm (**Optional**)
2. What is the nature of the firm's business? (Tick)
 - Stock Brokerage
 - Investment Banking
 - Stock Brokerage and Investment Banking
 - Any other (please specify).....
3. When was the firm established in Kenya? (Tick)
 - Below 1975
 - Between 1976-1980
 - Between 1981-1985
 - Between 1986-1990
 - Between 1991-1996

Between 1995-2010

From 2011 onwards

4. How many staff does the firm have in its establishment?

20 and Below

Between 21-40

Between 61-80

Between 81-100

Above 100

SECTION B: BOARD SIZE AND COMPOSITION

1. Does the firm have an explicit statement of commitment to Corporate Governance?

Exists Does not exist

Comments-----

2. Does the firm have specific Corporate Governance policies and guidelines disclosed?

Specific guidelines disclosed Only general guidelines disclosed Only general guidelines disclosed

Comments-----

3. Number of board members of the organization.....

4. Number of Executive Directors-----

5. Number of Non-Executive Directors-----

6. Number of women directors in the board-----

7. Is there as separation of the post of the CEO and the Chairman? Yes [] No []

8. Are the roles of the CEO and the Chairman clearly documented? Yes [] No []

9. How often does the full board meet?

Weekly Fortnightly Monthly Quarterly Half yearly Annually Adhoc

Other (please comment)-----

10. Which of the following Committees of the Board have been established?

Audit Committee

Staff Committee

Appointments committee

Planning/Strategy Committee

Others (please specify)-----

11. How often do the various committees of the Board meet?

11.1 Audit Committee

Weekly Fortnightly Monthly Quarterly Half yearly Annually Adhoc

Other (Comments) -----

11.2 Staff Committee

Weekly Fortnightly Monthly Quarterly Half yearly Annually Adhoc

Other (Comments) -----

11.3 Appointments Committee

Weekly Fortnightly Monthly Quarterly Half yearly Annually Adhoc

Other (Comments) -----

11.4 Planning/Strategy Committee

Weekly Fortnightly Monthly Quarterly Half yearly Annually Adhoc

Other (Comments) -----

11.4 Other Committee(s)

Weekly Fortnightly Monthly Quarterly Half yearly Annually Adhoc

Other (Comments) -----

12. Are the responsibilities of the board committees clearly documented?

Documented Not documented

Comments-----

SECTION C: OWNERSHIP STRUCTURE

1. Number of shares (issued) of the firm -----

2. Indicate the shareholding composition

1) Local Individual(s) 2) Foreign Individual(s).....

3) Local firm(s) 4) Foreign firms.....

3. Number of Shares share owned by the CEO of the firm

4. Number of Shares share owned by the Chairman of the firm

5. Number of shares owned by Executive directors-----

6. Number of shares owned by No- executive directors-----

SECTION D: INFORMATION DISCLOSURE

1. What returns does the company submit to make to the CMA?

2. What is the frequency of reporting to the CMA?

Monthly () Quarterly () Half Yearly () Yearly ()

3. What returns does the company make to the NSE? Please specify.

4. What is the frequency of reporting to NSE?

Monthly () Quarterly () Half Yearly () Yearly ()

5. How often do you communicate the financial results to your shareholders?

Quarterly () Half Yearly () Annually () Others ()

6. When announcing your financial results, how do you communicate to shareholders?

- a) Investors breakfast briefing
- b) News release
- c) News conference
- d) Post on the company website
- e) A combination of the above
- f) Any other (please specify) -----

7. Are the qualifications and experience of each member of the board disclosed?

Disclosed Not disclosed

Comments-----

8. Is individualised directors remuneration is disclosed?

Disclosed Not disclosed

Comments-----

9. Is the aggregate remuneration for all directors for the full year disclosed?

Disclosed Not disclosed

Comments-----

10. Is the interest of each director in the company disclosed?

Disclosed Not disclosed

Comments-----

11. Is the distribution of the company's shareholding disclosed?

Disclosed Not disclosed

Comments-----

12. Does the firm have a compliance officer?

Yes [] No []

SECTION E: FINANCIAL INFORMATION DATA

Performance Measure	YEAR ENDING				
	2006 KShs	2007 KShs	2008 KShs	2009 KShs	2010 KShs
Turnover					
Profit Before Tax					
Profit After Tax					
Total Assets					
Net Assets (Total assets less total liabilities)					
Return on Assets (ROA)					