# THE EFFECT OF CORPORATE GOVERNANCE ON THE FINANCIAL PERFORMANCE OF STATE OWNED ENTERPRISES (SOEs) IN KENYA

**BY:**

**KIBE HILTON MAINA**

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## DECLARATION

I declare that this project is my original work and has not been submitted to any other university for assessment or award of degree.

Signature…………………………………. Date…………………………

**Kibe Hilton Maina**

**D61/61203/2013**

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

Signed………………………………. Date………………………..

**Dr Duncan EllyOchieng (Ph.D, CFA)**

Lecturer, Department of finance and accounting

School of Business University of Nairobi

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## DEDICATION

I dedicate this work to my family for every support they have given me. To my supervisor for helping me get out the best of what the intention of this research was. To all my friends, who gave their all in ensuring the best of this research is achieved. For your support and contribution, my mind and soul was enriched during the discussions and the impact of each of you was felt and will always be felt forever.

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## ABSTRACT

Recent events leading to the collapse of high profile corporation in the global arena has led to increased advocacy for corporate governance practice across the world. Specifically, failure by State owned Enterprises in many developed and developing nations has prompted concerted efforts towards corporate governance in the public sector. This study informed by this problem studied the corporate governance attributes verses financial performance of SOEs in Kenya. The guiding objectives were; to determine the corporate governance attributes amongst the SOEs in Kenya, to investigate the trends of performance of SOEs in Kenya and to find out the effect of corporate governance attributes on performance of SOEs in Kenya. The study used correlation research design to achieve these objectives. The population of this study comprised the SOEs as defined in the State Corporations Act. The researcher opted to limit the scope of the study to Nairobi where there are 70 SOEs and narrowed to those that are commercial. Out of these 43 were commercial SOEs. For each of the commercial SOEs, one respondent was covered. The respondents included heads of SOEs and chief financial officers. Correlation and regression analysis approaches were used to analyze the data. From the analysis, the study established that the findings from this study were in line with the relevant literature with all the variables showing positive relationship with financial performance. This was shown by the fact that all the study variables which were ownership structure, board independence, board size and board composition had positive relationship with the independent variable (ROA) which measured financial performance. Based on these findings, the study conclusion was that ROA is a good aspect for measuring financial performance. The study also concluded that there is a positive and significant relationship between, board independence, ownership structure, board size and board composition with financial performance in terms of ROA. Therefore if SOEs in Kenya are to improve their performance they should direct their efforts towards these variables.The study recommended that the treasury should have a seat in the boards of SOEs in Kenya and that the board size of individual SOEs should be pegged on the organization's size.

## ABREVIATIONS& ACCRONYMS

| | |
|---|---|
| CBK | Central Bank of Kenya |
| CCG | Centre for Corporate Governance |
| CEO | Chief Executive Officer |
| NSE | Nairobi Securities Exchange |
| OAG | Office of Auditor Generall |
| OECD | Organization for Economic Cooperation and Development |
| ROA | Return on Asset |
| ROE | Return on Equity |
| SOEs | State Owned Enterprises |
| UK | United Kingdom |

# CHAPTER ONE

# INTRODUCTION

## 1.1 Background to the Study

Corporate governance is defined by Organization for Economic Cooperation and Development OECD (2005) as the structure guiding how business entities are to be controlled and directed away from the top management. In this regard, the structure is supposed to give guidelines in terms of how the rights of the duty bearers and their responsibilities are to be distributed. As such, the corporate governance structure sets outs guidelines for operationalization of corporate activities. This ensures that an organization has a proper structure upon which its mission is attained as well as procedures for measuring outcomes are set.

Shleifer and Vishny (1997), posits that corporate governance is focused on issues to do with shareholders are assured of their interests in terms of getting ROI. This refers to systems ensuring that managers are accountable for the resources provided for the organization's operations and that the resources are put to profitable use. This attitude has been adopted by other scholars and policy makers across the globe case in point being the CII report of India in which corporate governance practice is defined in well outlined legislative framework to be used both the private and public sectors. Therefore, the global common goal of corporate governance is maximization of shareholder value.

In recent times, there has been increasing corporate collapses which has led to emergence of good corporate governance as a global issue. The scholars and players have however, not identified a single universal model of good corporate governance (ASX, 2003; OECD, 2004).McKinsey (2002), however suggested that "good" governance is characterized by; a transparent ownership, an accountable board, a majority of outside independent directors with no ties to management and the use of internationally recognized accounting standards for both annual and quarterly reporting. Waweru (2011) compared developing and developed countries context in regard to corporate governance practice, where she established linkages in the realm of economic, cultural and political nexus in the way corporate governance was practiced in different countries. They noted that unlike developed countries, low skills and few available

human resources affected corporate governance practices in the developing countries. In Africa, corporate governance practice is quite recent due to the colonial upheavals which made the governments in post-colonial era play industry leader role through SOEs.

### 1.1.1 Corporate Governance

Corporate Governance can be described as a set of procedures, practices, policies, laws and institutions guiding how a corporation is run, managed or controlled, with the main purpose to directly or indirectly influence how an organization handles stakeholder issues (Dignam and Lowry, 2014). It is also the relationships among many players (stakeholders) Oman *et al.* (2013). Accordingly, the sets of regulations and guidelines outlining how various stakeholders in an organization are linked in terms of responsibilities are the essence of Corporate Governance concept (OECD, 2012).

Gompers (2012) asserts that for an organization to reap the benefits of corporate governance of increased value of the firm and sustainable growth there must be set legislative framework for setting standards. Claessens (2012) also maintains that such frameworks enable firms to access external finance at lower costs while enhancing good treatment of stakeholders and hence better firm performance. The main objective of good governance framework is to maximize contributions of firms to the overall economy including other stakeholders (Claessens, 2003).

with the driving force behind success being though not limited to: private market investment based activities that are anchored on innovative advancement, easy access to external finance, and attaining free trade among other areas of operational reforms in a corporation. This is because long outstanding institutions on corporate governance arrangements have been characterized by inconsistencies and gaps hence necessitating the need for good corporate governance that would help create decision structures that can prevent the agent from engaging in activities that expose the principal to higher risk than desired.

### 1.1.2 Financial Performance

Riahi-Belkaoui (2013) asserts that firm performance is the total return of a firm before it is distributed to stakeholders. Firm performance according to Barney (2012) is the ability of a firm use its primary assets and resources to generate income. Weldeghiorgis (2004) observed financial performance in the line of investment management where it is considered in an

organization's total performance management. Weldeghiorgis (2004) also quotes Zairi (1996) that measuring firm performance enables firm managers in planning and decision making.

Some of the measures for firm performance include Return on Assets, Return on Equity, profitability, Earning Per Share, amount of dividend issued, and Tobin's Q which is a stock market based mechanism for measuring the value of the firm. Measuring firms performance using accounting ratio is common in the corporate governance literature as per Demaetz and Lehn, (1985), Ang*et al*. (2000), where focus is on capital return, ROA, which in this study was the dependent variable as a measure of SOEs financial performance.

However, as Ang (2000) argued for financial performance measurement to be effective financial record keeping and analysis need to be well outlined and maintained which also enhances decision making. Problem identification and response to the problems as well as utilization of opportunities for increased corporate growth are goals for improved analysis of financial performance. Some of the most useful sources of information in conducting financial performance measurement according to Zairi (1996) are cash flow statement reports and income statement reports.

### 1.1.3 Corporate Governance and Financial Performance

Studies by Bebchuk, Cohen and Ferrell (2004) have determined the nexus between corporate governance relative to firm performance. In their study, Bebchuk, Cohen and Ferrell (2004) established that firms with good governance structures perform better than those with weaker governance structures. However, Agrawal and Millstein (2012) investigated the whether there is a relationship between the two variables (CG and FP) where they showed mixed results without a clear cut relationship. From a traditional view of Corporate Governance, the main objective of the practice is to address the agent-principal conflict in a firm (Muelbert, 2009).

Maher and Anderson (1999) on their part established firms' ownership and control as the main difference across countries in terms of established corporate governance structures. Maher and Anderson (1999) determined that one way to distinguish the various corporate governance structures is by looking at the degree of control and ownership as well as the type of systems in which shareholders are defined under corporate controls.

Agency theory in this regard is supported by these studies showing positive influence of corporate governance on financial performance as well as on the value of the firm (Bhagat and Bolton, 2008).

Braga-Alves and Shastri (2011) in their study on Brazilian firms established that firms that voluntarily implemented CG practices had higher valuation than those without CP practices. This was more interesting finding as Brazilian laws and regulations do not provide proper environment for the practice of corporate governance. This observation is consistent with the findings of other country specific studies (Black *et al*., 2006; Balasubramanian*et al*., 2011; Price *et al*., 2011) that focused on emerging economies like Korea, Mexico and India with an aim of examining the effect of corporate governance practice on the value of the firm. Claessens (2003) on his part established that corporate governance enhances performance through enhancing efficient management approaches, strategic resource allocation, improved stakeholder engagement as well as general improvement of quality assurance mechanisms.

### 1.1.4 State Owned Enterprises in Kenya

Commercial state corporations in Kenya have for a long time been performing dismally experiencing high financial losses and losses in terms of opportunity costs which have had far reaching effects on the economy. We posit that the main reason why these corporations underperform is because of the requirement to comply with a myriad of governance instruments and Statutes at a considerable expense. These requirements not only limit the exercise of discretion by business managers but also create risk averseness among them. The fear of contravening these laws is as a result of the ensuing criminal sanctions. Kenya like many other countries in the world has not been let off the hook from corporate collapses over the past years. The worst experience of corporate collapse in Kenya can be traced to the 1980s when most state owned enterprises collapsed involving some parastatals such as National Housing Corporation (NHC) and Kenya Co-operative Creameries (KCC) among others collapsed (Mwendwa, 2011).

The Centre for Corporate Governance (CCG) (2013) posed that in the light of these collapse of major state owned enterprises with the dire economic consequences involved, formed a wake-up call for the need to adopt corporate governance became a major policy priority. CCG (2013) further argued that the media and the Kenyan public were instrumental in the interrogation and oversight of the SOEs. Due to increased push from the public, media, government oversight

organs and scholars, CCG in 2002unlike in previous years when corporate governance was basically a the private sector initiative laid way forward for public institutions to adopt CG practices in Kenya. From a regulatory framework, commercially oriented parastatals in Kenya according to the Companies Act 1948 c.486 these corporations are supposed to abide by the provisions of the act. However, when it comes to commercial regulatory bodies, there exist specific regulations as per set structure in the legislation frameworks set by the government (Kiarie, 2009).

State Corporation Act of (SCA of c. 446 1986 is the one governing how SOEs are regulated and how relevant guidelines are drafted. According to the act, SOEs are established as either companies or statutory bodies. In the case of parastatals they are governed under the companies act while state corporations are distinguished and are identified as an natural person subject to the State Corporation Act (Mwaura, 2010). The Act, gives the executive significant powers especially at the presidency. In the arrangement of the SOEs, each ministry has portfolio SOEs upon which the ministry can issue directives on how the running of the SOEs should be done (UNCTAD, 2003). However, the SCA has been criticized in several for a as well as the companies act and calls for their improvement have been highlighted. Other bodies that have helped in implementing the practice of corporate governance has been the professional associations which have helped ensure that members adhere to professional standards. This they do by inculcation of high standardsand professional knowledge to their members. By so doing these associations help in enhancing uniform practice within various sectors of the economy (Institute of Certified Public Secretaries of Kenya(ICPSK) (2014).

### 1.2 Research Problem

Corporate governance practice has been ignited after the insolvencies of major corporations in the US and Europe due to managerial malpractices by the top management of the firms in question. The insolvencies has made the practice of corporate governance become a wide spread practice across the globe with policy makers and economists citing the macro-economic benefits of the practice of good corporate governance (Claessens, 2013). Intermittent turmoil in the business environment, market failures, willful misrepresentation of material facts and financial crises owing largely to governance issues, coupled with changing circumstances in the business

environment continue to necessitate the drive for more research in corporate governance (Muthukumar, 2009).

These changes required that corporate governance practices will continue to evolve as on-going development in global business also continues to change. There is no one size fits all model of good corporate governance that leads to higher firm performance. In fact, despite the numerous studies conducted on this topic, there has not been an all inclusive single finding agreed to by the various researchers. Various scholars have established varied findings regarding establishing the relationship between corporate governance practice and firm performance. However, a common aspect of the studies is that the firm structure actually determines how a firm responds to external factors that determine the firm performance (Berglof and Von Thadden, 1999, Bebchuk, Cohen & Ferrell, 2004).

The system for corporate governance in Kenya has been criticized by some scholars including Stewart, Kent, Okibo (2009) for being ineffective in undertaking their key mandate of monitoring risk profile for most public corporations. The inefficiency of the public sector corporate governance practices and procedures has led to increased cases of failures by state corporations highly linked to mismanagement. This highlights the need for effective corporate governance practices in the public sector (Kamau, 2012). It is in this aspect that the Office of the Auditor General (OAG) (2014) suggested that establishment and implementation of good corporate governance frameworks improves corporate financial risks and hence better financial performance for SOEs. However, researchers have found that despite elaborate corporate governance guidelines, accountable financial management has been elusive in most of the SOEs in Kenya (OAG, 2010). In order to realize a more accountable public sector in Kenya, mechanisms of corporate governance in the public sector institutions require an environment of transparency and information flow among stakeholders especially for matters of finance management. Hence, the public sector requires robust corporate governance practices supported by effective internal audit and assurance arrangements.

Recent findings in studies on the relationship between corporate governance and firm performance for firms in different parts of the world are inconclusive or even contradictory. Love and Rachinsky, (2007) in their study on Indian firms established that there is a negative relationship between corporate governance and firm performance. However, the study was

mainly based on the Indian context with no ground for generalization. Ashenafi (2013) conducted a study on relationship between corporate governance and financial performance for SOEs in Ethiopia in which they established a positive relationship but exposed a gap in that they relied on government guidelines instead of international standards of corporate governance. Coskun and Sayilir (2012) in their study targeting Turkish companies differed with the common hypothesis that corporate governance leads to better firm performance.

Among the Kenyan studies Kiruri, (2013) finds that ownership concentration and state ownership in SOEs lead to lower profitability while higher foreign and domestic ownership lead to higher profitability, Nyarige, (2012), finds that board size affects market performance of commercial banks listed at the NSE negatively whereas board independence affects market performance of these banks positively, Mangu'nyi, (2011) found no significant relationship between the ownership structure and banks' financial performance for banks with adopted CG practices. These contradictions in findings could create aspersions as to whether corporate governance impacts on financial performance of SOEs in Kenya. Prowse (1997) finds that research on corporate governance as applied to public institutions and intermediaries especially banks, are scarce. This necessitated this study which sought to assess the impact of corporate governance on financial performance of SOEs in Kenya.

## 1.3 General Objective

The general objective of this study was to find out the effect of corporate governance on financial performance of SOEs in Kenya.

### 1.3.1 Specific Objectives

The study was based on the following specific objectives

(a) To determine the corporate governance practices amongst the SOEs in Kenya.

(b) To investigate the trends of performance of SOEs in Kenya.

(c) To find out the influence of corporate governance practices on performance of SOEs in Kenya.

## 1.4Value of the Study

**Scholars and Academicians**: The study was of great importance to scholars and academicians by adding to the body of existing knowledge on corporate governance. The study also gave recommendation for further researchable areas that was useful in furthering the understanding of financial performance and corporate governance.

**Management:** It is expected that the findings of this study were of interest to the management of SOEs who were able to determine the effects of corporate governance on the value of their institutions and make prudent decisions on governance improvement.

**Investors**: The study was expected to provide valued information that investors can use to make investment decisions.

**Policy Makers**: For the policy makers, this study enabled them to borrow knowledge from the study findings on firm dynamics on proper corporate governance practices and situations under which they enhance firm performance; the study therefore was a guiding document in designing appropriate regulations and policies of governance structure for board of directors for SOEs in Kenya.

# CHAPTER TWO

# LITERATURE REVIEW

## 2.1 Introduction

In this section, theoretical framework is discussed as well as the empirical literature review. It also gives a summary of literature reviewed and point out the research gaps. The chapter ends with a conceptual framework showing the operationalization of the study variables.

## 2.2 Theoretical Framework

Specific theories that relate to corporate governance provided the theoretical backing for this study. This section reviews significant theories in corporate governance. The theories that guided this study were the agency theory, the second one was the stewardship theory, and the third theory was the stakeholder theory. These theories try to inform the theoretical backing for the objectives of the study. Each theory is discussed with relevance to how the specific theory applies to the proposed study.

### 2.2.1 Agency Theory

One of the dominant theories of corporate governance is agency theory since it tries to explain the role of the directors in relation to management. The theory was identified by Berle and Means in 1932 and it owes its development to research conducted by Alchian and Demsetz (1972). Specifically, the theory considers the firm as a useful function and synchronized operation through the transactions in the market, upon which the firm's production is a negotiated contract among individuals with aim of maximizing their own interests (Learmount, 2002). Therefore, the theory gives exclusive insights into corporate systems, outputs, incentives, and risks Eisenhardt (1989) and is highly prevalent in the theoretical understanding of corporate governance.

The core of agency theory is the agency relationship, which refer to contracts where an agent is approached to transact business on behalf of the principal(s) (Jensen &Meckling, 1976). Specifically, the shareholders invest funds for productive use and then engage the managers to generate return on the funds in the company. Thus, the relationship between shareholders and

mangers is coordinated by the contract to determine rights of the managers and allocation of return within the firm.

The essence of agency theory rests upon resolving two main problems which are basically due to agency relationships. The first agency problem is one due to conflict in interest between the principal and the agent and the other is when the principal is the exact role of the agent. The other problem emanates from the need to share risk which derives from different attitudes toward risk between principals and agents, and causes the principals and agents to have different proposals for risk mitigation (Eisenhardt, 1989). Therefore, agency costs will be generated when the principals encourage managers to maximize the principals' wealth rather than act in the managers' own self-interests. Specifically, the principal can establish incentives mechanisms to limit aberrant activities by incurring monitoring costs. Meanwhile, agents will also incur bonding costs to guarantee that they will not take action harming the interests of the principals. When there is discrepancy of the decision between agents and principals, it results in residual loss which means there is a reduction in the wealth of the principals. In this case, agency cost is realized in the form of; principals' monitoring expenditure, expenditure on agents' and the residual loss (Jensen &Meckling, 1976). Therefore, agency theory focuses on design of initiatives by an on how the principals can design incentives and monitoring mechanisms to influence the agents' behaviour as well as minimize the agency costs.

### 2.2.2 Stewardship Theory

Contrary to the concepts of agency theory, Donaldson (1990) and Davis (1991) derived the stewardship theory which focuses on maximizing shareholder wealth through firm performance. Abdullah and Valentine (2009) described stewardship theory in the perspectives borrowed from psychology and sociology. It is usually applied in business in cases relating to family business interests in what scholars refer to as 'family firm' in which the firm has both family shareholders as well as family managers Braun *et al.*(2011); Le Breton-Miller *et al.*(2011); Renato, (2010); Braun and Latham (2009); Miller and Le Breton-Miller (2006).

Contrary to agency theory that concentrates on the monitoring role of the outside director over management and executive directors (in their capacity as managers), stewardship theory holds that there is no conflict between inside/executive directors and outside directors. Both categories of directors have an alignment of objectives, or motivation, in terms of working together to grow

and sustain a company's wellbeing. To this end, given common and aligned motivations and within an environment of trust, both the outside and executive director input may also be considered a 'resource' to the company (Nicholson and Kiel, 2004)). From this perspective, it is easy to see how Abdullah and Valentine (2009) in their literature review of the range of corporate governance theories could expand from agency theory to stewardship theory and then on to resource dependency theory. Abdullah and Valentine (2009) develop even further their view of governance theory evolvement, with descriptions of transaction cost theory, political theory and various ethics related theories. However, for the purpose of this thesis, theories beyond resource dependency are not considered as they go beyond the role of the board and directors into the wider organizational structure and economic transacting within the firm, and/or the political and idealistic goals of its stakeholders. Stewardship theory's relevance to this study is on the basis that a firm performance is may not be affected by differences in the roles of the directors both inside and outside and hence in such a case, stewardship theory comes into force.

### 2.2.3 Stakeholder Theory

Stakeholder theory owes its development to Freeman's (1984). Freeman's study defined both concept of stakeholder and provided explanation for corporate responsibilities to its stakeholders. The essence of stakeholder theory is the assumption that the firm is a system composed of stakeholders who operate within a larger system where various stakeholders and the society at large provide needed legal and market infrastructure that enable the companies' activities as well as the companies' ability to generate wealth and value for its shareholders (Clarkson, 1994).

Stakeholder theory involves three aspects which in essence explains and guides the structure of the corporation. One of the aspects is the descriptive aspect which describes the specific uniqueness and behavior of the corporation. The second is the instrumental aspect which identifies the linkages between management, stakeholders and organizational achievement of goals. The third is the normative aspect which focuses on the definition of the corporation function like moral guidelines for the corporation's operation and management (Donaldson & Preston, 1995).

In Kenya, many scholars and policy makers have shown interest in analyzing stakeholder as theory. Li (2002) suggested for corporate governance to consist of both formal and informal institutions to enable the setting up of proper corporate governance mechanisms touching on all

the stakeholders. By so doing, firms will enhance proper decision making processes that protect the interests of stakeholders. Li (2011) added that the stakeholders in corporate governance have the potential to enhance the stability and development of the firm. Yang (2011) emphasized that a firm attains stability if the interests of both internal and external stakeholders through proper stakeholder engagement mechanisms.

### 2.3 Determinants of Firm Performance

A number of corporate governance mechanisms have been proposed by various studies to improve the principal-agent relationships between management and shareholders in organizations with a view of improving financial performance. Employing these mechanisms would make managers to better align their interests with those of the shareholders, hence reducing the level of agency problems. The corporate governance mechanisms as identified in the conceptual framework figure 2.2 are therefore discussed in details as follows:

#### 2.3.1 Capitalization Structure

Good corporate governance in a company depends on a combination of two factors namely: how investors‟ rights are protected and ownership concentration (Shleifer&Vishny 1997). The ownership structure of the firm is an outcome of shareholders decisions (Demstez, 1983). To maximize the value of the firm may require either concentrated or diffuse ownership structure. This is determined by the trading pattern of shares on the stock exchange or security exchange that may reflect the desire of existing shareholders or potential owners to change their ownership stakes. Block holder refers to owners of a large volume of a company's shares or bonds who are able to influence the company’s decisions by virtue of the voting rights awarded to them. Berle and Means (1932) suggested that there is a positive correlation between block ownership and firm performance. However, some studies have not observed any relationship between the two variables at all. Findings from related studies indicate that, there is positive market reaction to block purchases of companies‟ shares; however if the acquirer fails to initiate corporate restructuring process this reactions may be short lived a situation profound where the acquisition is for their own value destroying purposes leading to reduction in liquidity of stock and supply of information to the market (Denis, 2001).The more dispersed the ownership structure of a firm, the higher the agency costs (Jensen &Meckling, 1976). This is because ordinary shareholders may not have time and relevant skills required to monitor the activities of the company’s

management. In view of this, the high presence of small ownership in a company may give rise to free rider problems (McColgan, 2001). However, this problem can be neutralized by the presence of block holders in the company's ownership structure. In an agency framework, higher block ownership facilitates more active monitoring of management activities and can help mitigate agency costs (Gilan& Starks 2003).

### 2.3.2 The board of Directors' Composition

Dean and Sharfman (2016) describe board of directors' composition as key in strategy formulation. The boards of directors are responsible for choosing company's direction in regard to achievement of defined goals. This process provides a framework for achievement of anticipated goals and is therefore essential to SOEs. The boards' main role is that of oversight of strategy formulation and execution which a major interest to shareholders is. Strategy formulation forces SOE to carefully look at the changing environment and to be prepared for the possible changes that may occur (Stahl and Grigsby, 2012).The composition of the board also enhances SOEs to carefully evaluate their resources, strategically allocate budgets, and determine appropriate plan for maximizing return on investment. Since the board of directors sets the strategic decisions either formal or informal they play a major role in enhancing the interaction between an organization and its environment (Ginsberg, 2012). The board composition if properly done enables organizations to deal with risks that threaten the survival of the firm. This therefore as Golden and Zajac (2011) argued require that the board be composed in a manner that ensures proper balance of power such that no one individual or block of individuals can determine finality in decision making. For instance, non-executive directors should posses right experience in the sector the SOE operates, have necessary skill, be independent, and bring right judgment to the organization's decision making.

### 2.3.3 Board Independence

Board independence as an aspect of corporate governance refers to the board's ability to influence the direction taken by top management of an organization. In most cases independent directors act in shareholders' interest in a better way compared to insider directors; for they do not have an incentive to collude with internal managers to expropriate shareholders wealth (Monks & Nell, 2004). A more independent board is crucial in improving the general management approaches and the general control of an organization by properly informing the top

management and giving facts on proper actions taken during a crisis. Based on a wide range of positive findings on the board independence and its effect on financial performance CBK recommends that non-executive directors should not be less than 3/5 of board size in order to enhance accountability in the banking sector (CBK, 2013).Agency theory recommends the need to involve independent directors in the company's board to monitor any self-interested actions by managers with a view of minimizing agency costs (Williams *et al*. 2006).

### 2.3.4 Board Size

Size of the board can be determined by the number of directors forming the board of governance of an organization. This variable of corporate governance has attracted various researchers such as Morten *et. Al*(2006) who have tried to determine its significance in a firm's performance. It is argued by Sanda *et al.* (2011) that a larger board, makes it more effective in its mandate of monitoring the management. While there may be no specific recommended board size board size Yermack, (1996) recommended for a board of 8-10 is often recommended while Sanda (2005) is consistent with recommendation of a company board size to be ten. In theory, size of the board remains one of the corporate governance attributes that guarantees the interest of the shareholders in the company (Allen & Gale, 2000). Its task is to monitor, discipline and remove ineffective management teams (Bein er *et al.* 2003).

## 2.5 Empirical Revie

Many hypothetical and experiential studies have indicated influence of corporate governance attributes on financial performance (Morck et al., 1989); while others like Lehmann & Weigand(2000) have shown negative relationship as others likeDemsetz & Lehn, (1985); Burkart et. al., (1997) have argued there is no relationship. According to Pandey (2010), there are several financial measures to determine financial performance. They include return on assets (ROA) which is measured by dividing profit after tax by book value of total assets (BVTA); return on investment (ROI) which is found by dividing earnings before interest and tax by total asset; return on equity found by dividing net profit by shareholders equity, and the Tobin Q which is the market value of equity by book value of total assets. The financial performance measure selected for this study is the return on assets.

However, Opanga (2013) established that the board meetings, board meeting frequency, number of resolutions passed in an AGM and number of board directors is all positively correlated with

financial performance. He suggests that each of these variables of corporate governance influenced financial performance for insurance companies in Kenya. However, the weakness of the study was in the ability to acquire the number of meetings as the data was not out rightly available posing a weakness to the study.

Kiruri (2013) sought to investigate the effects of ownership structure on bank profitability in Kenya. Primary data was obtained through questionnaire administration. The study used annual reports that were available from commercial banks websites and Central bank of Kenya website. Commercial banks profits were adopted as a dependent variable, whereas ownership concentration, state ownership, foreign ownership and domestic ownership were adopted as independent variables. The findings were that, in cases where ownership concentration is in favor of the state ownership there was negative influence on financial performance while foreign and domestic ownership settings had positive influence on organizational performance in general. The study concluded that higher concentration on state ownership lowers the firms' profitability and hence financial performance. Kiruri (2013) in his study used profitability as a measure of performance. However, use of profit as a measure of performance is limited by the fact that profit alone is not enough measure for financial performance. These setbacks definitely had some effects on the findings.

Ashenafi*et al.* (2013) examined corporate governance characteristics and their impact on performance of commercial SOEs in an environment lacking standard regulations from the state in Ethiopia. The study analyzed the relationship between selected internal corporate governance characteristics (board of directors' structure, board size, audit existence, bank size, and ownership type) and external corporate governance mechanism (government regulation and supervision, capital adequacy ratio, loan loss provision allowance) that were adopted as independent variables. ROA and ROE (dependent variables) were adopted as performance measures. Data on the organizations' performance was collected from annual audited financial statements for the period 2005 to 2011 that were at the National Bank of Ethiopia whereas data on board characteristic was obtained from individual organizations. The study was undertaken on nine commercial banks of which two were state owned and seven were privately owned. Data was analyzed using both qualitative and quantitative methods. The findings of the study indicated that: board size and composition of the board had positive significant effect on

performance (ROA and ROE). However, they failed to understand that in absence of national standards on corporate governance, auditing and accounting standards, SOEs in Ethiopia could have relied on international auditing and accounting standards as well as international corporate governance standards as provided by the OECD and the Basel committee on banking and supervision.

Nyarige, (2012), sought to analyze how corporate governance structures of commercial banks in Kenya affect their financial performance. The focus of the study was on the nine commercial banks listed oat the NSE between 2005 and 2010. Board size, board meetings, board independence and executive compensation were adopted as independent variables while Tobin q ratio was adopted as proxy for financial performance (dependent variable). The research was conducted using a Cross-sectional survey that sought to identify differences in corporate governance's structures between listed banks facing a decline in values, those facing appreciating values and those with stable value on calendar years 2005 to 2010. The findings of the study indicated that board size negatively affects the banks' market performance while board independence affects the banks' market performance positively. However, they failed to consider Tobin's q as a market measure of performance that is critical in any study on corporate governance as per the findings of Bocean and Barbu (2005) that this study adopted. On the same note, they shouldn't have adopted bank size as a corporate governance variable but as either a control variable or moderating variable.

Coskun and Sayilir (2012) in their study of Turkish companies deviated from the link of better corporate governance leading to higher corporate growth. The non-relationship is explained as due to bias in financial accounting and reporting which highly misleads investors with low awareness of corporate accountability of the top management.

Opondo (2012) in his study on influence of CG practice on organizational performance for financial institutions in Kenya established that none of the unlisted firms had achieved 100% compliance with the governance mechanisms. He found out that the attributes of corporate governance had no significant influence on the value of the firm as well as financial performance.

Areba (2011) concludes that if proper mechanisms of separating firm's principals and agents are ensured through good corporate governance practices, a firm is ensured of better performance. He recommended for the establishment that both size and composition of the board as well as having a well specified role distribution is required. Other recommendations revolved around having both internal and external independent directors with proper participation as this influences financial performance. Langat (2013) proposed that corporate governance is important and impacts financial performance.

## 2.5Research Conceptual Framework

**Independent Variables** **Dependent Variable**

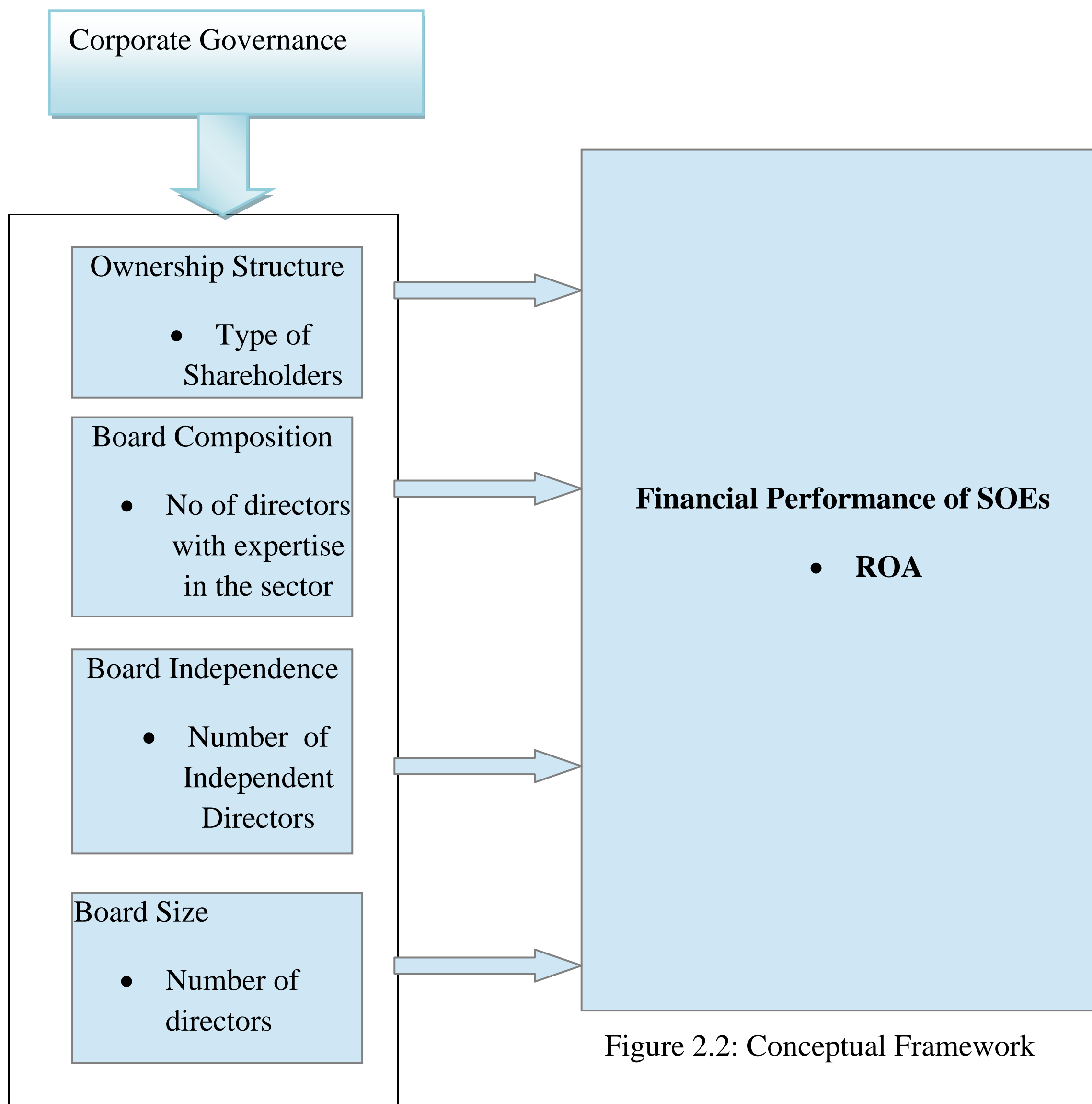



Figure 2.2: Conceptual Framework

*Source: Author, 2017*

Independent variables are those related to agency theory and corporate governance as presented in the conceptual framework (figure 2.2) that will be measured as follows: ownership structure will be computed as the total firm's outstanding shares owned by different shareholders, defined as the sum of the three largest stakes in the SOE's equity (Stepanova & Ivantsova, 2012), Board composition is the manner in which the board is composed; whether it is composed in line with the set regulations and guidelines. Board independence was calculated as the ratio of non executive directors to total board size, board size was measured by the logarithm of the number of board members. Financial performance measures as spelt out in the conceptual framework figure 2.2 was measured as follows: return on asset was measured by the ratio of profit before tax to total assets of the corporation; return on equity will be measured by the ratio of net income (profit after tax) to shareholders equity of the bank.

## 2.6 Summary of Literature

The Kenyan economy has been negatively affected by the dismal performance of most of the country's SOEs. This has led to budgetary burdens in the form of debt buy out by the government on behalf of the various SOEs. In this regard, SOEs have failed to achieve the initial role of fostering regional development and improvement on self-sufficiency in various sectors. This has been blamed on weak governance structures characterized by opaque board nomination processes, fraudulent transactions, poor remuneration and overlapping regulations which have led to inefficiencies in the operations of the SOEs leading to poor financial performance. This calls for ratification of the regulations governing SOEs and enhancement of proper corporate governance structures. In the government's pursuits to find solutions, the study will seek to highlight the fact that the much sought after privatization will not necessarily bring efficiency gains unless governance problems are addressed before hand. This study will seek to analyze the effect of corporate governance practices on the financial performance of the SOEs in Kenya.

**Table 2.1: Research and Knowledge Gaps**

| RESEARCHER(s) | FOCUS AND METHODOLOGY | FINDINGS | RESEARCH GAPS |
|---|---|---|---|
| Opanga (2013) (Study done in Kenya) | Focused on effect of board committees, board meeting frequency, number of resolutions passed in an AGM and number of board directors on firm performance. Methodology – Descriptive research design | Positive influence exists | Recommended further research on joint effect of corporate governance and firm factors like organizational culture on performance of private corporations. |
| Kiruri (2013) | Effects of ownership structure on bank profitability in Kenya. Methodology – Descriptive research design | Positive influence exists | Recommended study on how director' education background could influence firm performance |
| Ashenafi*et al.* (2013) | Examined corporate governance mechanisms and their impact on performance of SOEs in Ethiopia | Positive influence exists | Proposed a study on role of international standards on corporate governance adoption on performance of commercial public organizations |
| Nyarige (2012) | Analyze how corporate governance structures of commercial banks in Kenya affect their financial performance Methodology – Descriptive research design | Board size negatively affects firms' market performance while board independence affects market performance positively. | No findings with respect to the effect of corporate governance structure on financial performance. |
| Coskun and Sayilir (2012) | corporate governance and firm performance a case study of listed firms at Karachi stock market Methodology: Case study. | Study indicated that leverage positively and significantly impacts on Tobin's q and return on asset and leverage positively and significantly influenced return on equity. | The study did not outline consistency in findings since it was case study. |

# CHAPTER THREE

# METHODOLOGY

## 3.1 Introduction

In this chapter, the research methodology is discussed from the perspective of the research design which was used, the population targeted, sample design and the methods for collection of both primary and secondary data. Finally the chapter discusses the approaches for data analysis.

## 3.2 Research Design

A research design refers to the general plan detailing how researchers indent to achieve research objectives (Saunders, Lewis and Thornhill, 2009). As argued by Cooper and Schlinder (2011), research design refers to the procedures for conducting the entire research involving data collection, measurement and analysis. In this study correlation research design was applied. Albright (2011) describes this as a process where scores on study variables are compared, without manipulating the variables, with an aim of determining whether a relationship exists. To determine the interrelationships between the various variables of the study, cross sectional study approach was applied among the different SOEs in Kenya. From this, the researcher made statistical inferences with the aim of achieving targeted generalizations to attain research objectives.

## 3.3 Population

Population has been defined by Gupta(2010) refer to the large pool of subjects from where a sample is obtained. Neuman (2010) reinforces this definition by defining population as a large group of subjects with common characteristics ("N" represent the size of population). The population of this study comprised of the SOEs as defined in the State Corporations Act. The total number of SOEs currently operating in Kenya is 187. The entire 187 formed the target population for this study. It is from the 187 that the researcher sampled the ones that were considered for the study.

## 3.4 Sample

Since the population is small and as Gupta (2010) suggested, small population require a census approach, the study sought to study all of the SOEs. However due to time and resource constrains, the researcher opted to limit the scope of the study to Nairobi where there are 70

SOEs. Out of these 43 are commercial SOEs. For each of the commercial SOE, one respondent was covered. The respondents included heads of SOEs and chief financial officers.

### 3.5 Data Collection

Both qualitative and quantitative primary and secondary data was used for the study. Primary data refers to the data obtained directly from the respondents (Kothari, 1990). The primary data was obtained by use of a questionnaire closed questions using the Linkert Scale. The questionnaire as distributed to respondents for filling and then later picked by data collection clerks. The questionnaire contained five sections. First four sections were relevant in collecting relevant information on the four corporate governance attributes significant to the study, whereas as the last section is relevant in obtaining financial information relevant to financial performance in consonance with the objective of the study. The secondary data included annual reports of the SOEs including financial statements. Secondary data required covered the period from January 2012 to December 2016.

### 3.6 Data Validity and Reliability

Validity of a sample refers to the sample's ability to represent the content and enable testing of parameters it is designed to measure (Kothari, 2004). In doing validation for research instruments, a researcher conducts tests to assess and ascertain the validity of a research tool. Some of the measures that were used to achieve the validity in this study were pilot testing and reliability test. To attain generality, external validity was measured. Content validity was used in ascertaining the appropriateness of the contents in the research instrument that is: whether the questionnaire was able to achieve the study objectives. The reliability was measured by Cronbach's alpha; a measure of the internal consistency of the questionnaire instrument.

### 3.7 Data Analysis

The analysis approaches used involved the use of multivariate regression approach which determined the relationship between the dependent and the independent variables. The dependent variable in the study was the ROA, which was obtained by computing net company income/total assets while the independent variables was ;Ownership structure, corporate governance practices, board composition, board independence and board size. Data was analyzed using statistical package for social sciences (SPSS).

### 3.7.1 Model Specification

The data analysis techniques used in this study for the purpose of establishing the relationships among the variables as moderated by Corporate Governance which was a dummy variable. ANOVA statistical technique was applied to determine the model significance. The output of the results in this regard was presented in tables where inferential findings can be picked out for interpretation purposes. The study's regression model is as follows;

$y = a + \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_3 + \beta_4 x_4$

Where;

y= Return on Assets- Net Income divided by total assets

a= Constant

$x_1$= Ownership structure – Type of shareholders

$x_2$= Board composition – No of directors with expertise in the sector

$x_3$ = Board Independence–Number of independent directors.

$x_4$= Board size- Number of directors in the board.

Financial performance was measured by Return on assets (ROA) and return on equity as described in the conceptual framework. This is in line with Tangen (2013) who suggested that ROA is one of the best measures of firm performance.

### 3.8 Tests of Significance

Statistical Package for Social Science (SPSS) was used to measure the relationship between the variables which were; corporate governance aspects as relates to financial performance of the SOEs. The Tests of Significance used were Regression Analysis based on Coefficient of Determination ($R^2$), while the variances were measured using correlation analysis and P values. Inferential Statistical techniques were done at 95% Confidence Level ($\alpha = 0.05$).

# CHAPTER FOUR

# DATA ANALYSIS, RESULTS AND DISCUSSIONS

## 4.1 Introduction

In this chapter presents the study findings and discusses the inferential and empirical findings in relation to the study overall objective which was to establish the link between corporate governance attributes and fiscal performance of SOEs in Kenya. The analysis is also done as per the study objectives which were; to determine the corporate governance attributes amongst the SOEs in Kenya, to investigate the trends of performance of SOEs in Kenya as well as effect of corporate governance attributes on performance of SOEs in Kenya. The analysis followed the approaches and techniques as outlined in chapter three.

## 4.2 Response Rate

The study covered 43 SOEs that were operating in Nairobi. Of the 43 commercial SOEs, questionnaires were distributed to each of the 43 SOEs (See appendix V). However, not all the respondents chosen successfully returned filled questionnaire. The researcher was however able to collect 33 questionnaires which were returned by respondents. This represented a 76.7% response rate. As recommended by Mugenda and Mugenda (2003) the response rate was above 50% response which was an adequate response rate for any survey. Using these arguments by the stated researchers, the response rate was rated as enough. This meant that the data was good to make proper generalization and conclusions.

## 4.3 Reliability Tests

From the data collected, the researcher subjected the entire data collected using questionnaire to reliability test. In this study, the instrument reliability was determined using the Cronbach's alpha coefficient which measured the internal consistency of the questionnaire. The higher this coefficient, the more reliable is the test. According to Zinbarg (2005) for a data to have a acceptable consistencies, it must attain an alpha value of 0.70 and above. Such a data is assumed to have good internal consistency which makes it reliable in research generalization as it is representative of the target population. The test results are as presented in the table 4.1 below.

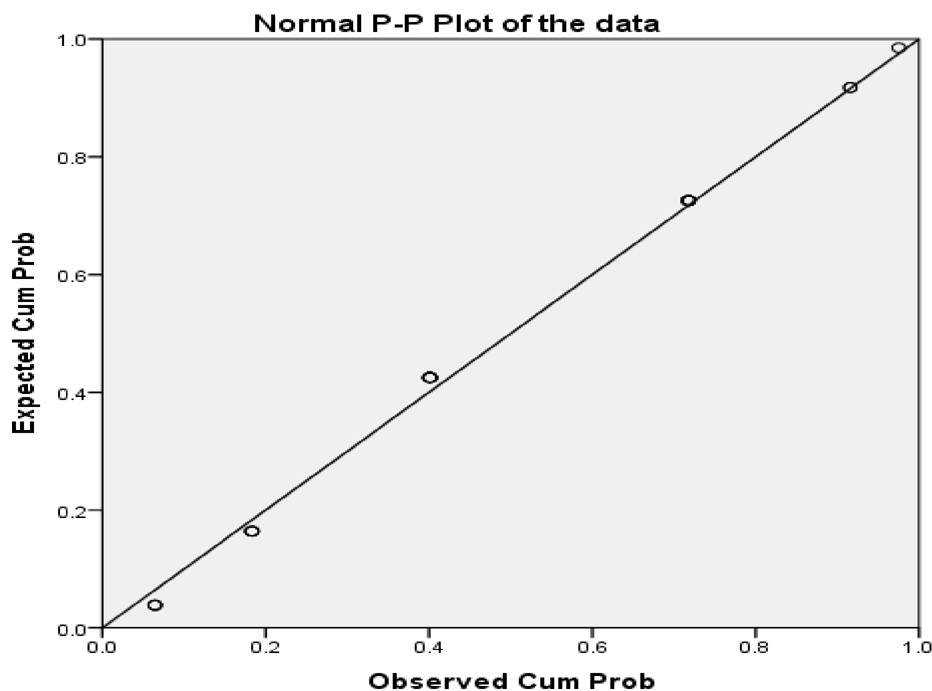
**Table 4.1 Reliability and Validity**

| Variable/Construct description | Item Means | Item Standard deviations | Coefficient Alpha Reliability |
|---|---|---|---|
| Ownership structure | 6.9 | 6.1 | 0.789 |
| Board size | 5.2 | 2.4 | 0.796 |
| Board Independence | 5.9 | 2.9 | 0.774 |
| Board composition | 4.9 | 2.0 | 0.766 |

Source: Field Data (2017)

As shown in the table 4.1 the Cronbach's alpha for ownership structure was 0.789, for board size was 0.796, for board independence was 0.774 and for board composition the coefficient was 0.766. The Cronbach's reliability test for all the variables was above 0.7 and therefore surpassed the recommended levels of reliability.

**Figure 4.1: Data distribution**



As can be seen from the P-P plot, the circles all lie quite close to the line; this shows that since the circles are close enough the study data can therefore be termed to come from a normal distribution.

## 4.4 Attributes of corporate governance and financial performance

Various aspects of corporate governance were assessed in regard to how they influence financial performance of SOEs in Kenya. Various items were used to measure the extent to which they affected financial performance of the SOEs as organized according to the study variables. The main study variables under study were; ownership structure, board size, board independence and board composition. These four variables had various items for assessment designed in a likert scale format. Factor analysis was used to determine how each of the variables affected financial performance of the SOEs as per the opinion of the respondents.

### 4.4.1 Factor Analysis

According to Tabachnick & Fidell, (2007) for any data to be subjected to for factor analysis, its variables must have factor loadings of above 0.40. The researcher therefore ran the data to test the factor loadings of the variables in which items measuring board independence were confirmed to have factor loading above 0.40 and hence were appropriate for further analysis.

Kaiser-Meyer-Olkin (K.M.O) measure was used in testing the adequacy of the data collected to be run for principal component analysis using the factor analysis technique. From the study results which were determined using the Kaiser-Meyer-Olkin measure the data was found to have sampling adequacy .601, which was adequate. The Bartlett's test of sphericity was found to be significant at ($\chi^2$ (190) = 434.512, $p$ <.05). This is shown in table 4.2.

**Table 4.2 KMO and Bartlett's Test**

| Kaiser-Meyer-Olkin Measure of Sampling Adequacy. | | 0.601 |
|---|---|---|
| | Approx. Chi-Square | 434.512 |
| Bartlett's Test of Sphericity | df | 0.190 |
| | Sig. | 0.000 |

From the results as obtained in the table 4.2, the correlation matrix on the diagonals were all over .5, which led to the researcher's decision to include all the items in the factor analysis. On generating communalities, all items had communalities of above .3 (see Table 4.3), which confirmed that all items shared some common variance. Based on these measurements, all items measuring board independence were included in the factor analysis.

**Table 4.3 Factor Communalities for Board Independence**

| Board Independence factors | Initial | Extraction |
|---|---|---|
| Whether the board members are effectively appointed by the CEO | 1.000 | .716 |
| Whether relationships that are personal among directors raise major concerns | 1.000 | .569 |
| Whether objection to the agenda by management is judged as defiance | 1.000 | .648 |
| Whether decisions that are wrong draw blame in the future. | 1.000 | .792 |
| Whether the being informed on various matters is key element for the CEO and management team. | 1.000 | .611 |
| Whether the selection, replacement and monitoring of the CEO is a role of the board | 1.000 | .577 |
| Whether the board takes active role and revises key executive and director remuneration | 1.000 | .740 |
| Whether the there is active contribution by the board to: stakeholder interests | 1.000 | .709 |
| Whether it is the role of the board to contribute to integrity in the financial reporting. | 1.000 | .545 |
| Whether it is the responsibility of the board to ensure proper disclosure and communication to stakeholders | 1.000 | .774 |

Extraction Method: Principal Component Analysis.

From the factor analysis the study identified the most prominent items of board independence affecting financial performance. The initial communality indicated that the highest factor measured 55.37% of the variance, the second item 11% in variance. From the factor analysis, only two of the ten original constructs were significant in the analysis. This was further supported by a break after the second item as illustrated by the scree plot.

**Figure 4.2: Scree Plot**

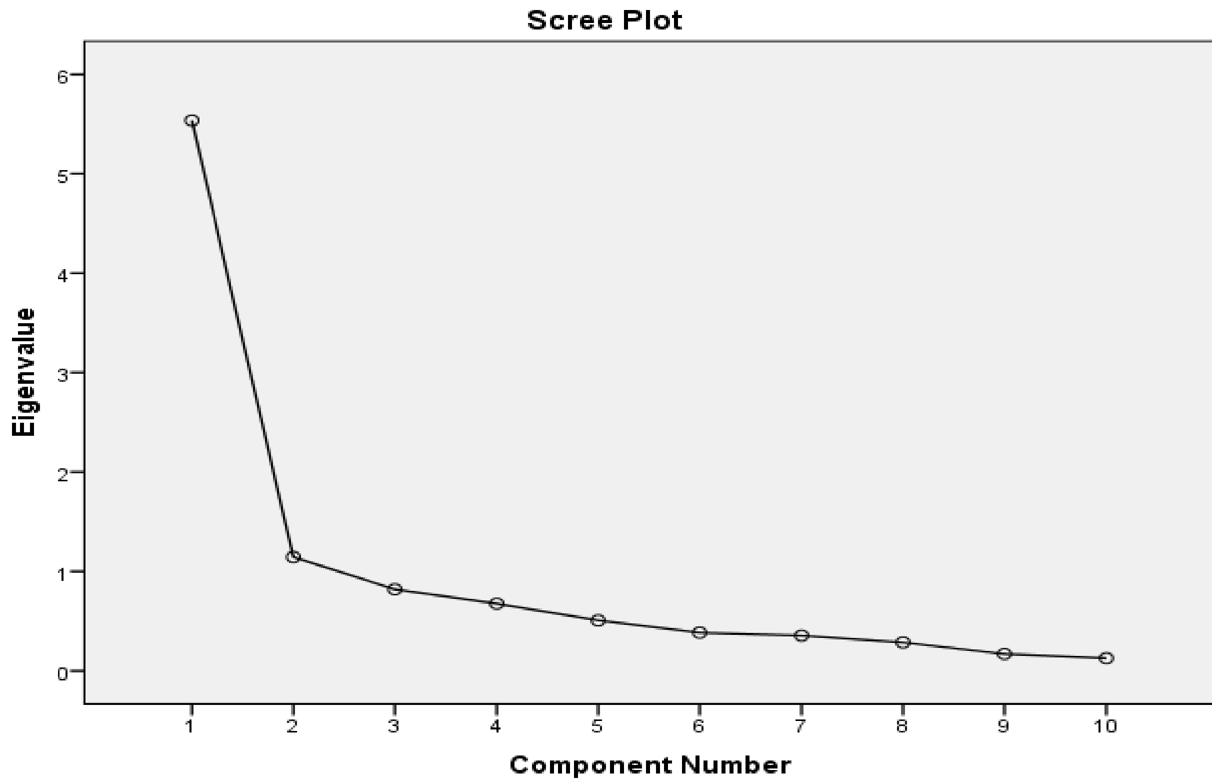



**Table 4.4 Component Matrix**

| Board independence factors | Component 1 | Component 2 |
|---|---|---|
| Whether the board members are effectively appointed by the CEO | .840 | -.102 |
| Whether the board members are effectively appointed by the CEO | .809 | -.291 |
| Whether relationships that are personal among directors raise major concerns | .783 | .422 |
| Whether objection to the agenda by management is judged as defiance | .781 | .196 |
| Whether decisions that are wrong draw blame in the future. | .767 | -.153 |
| Whether the being informed on various matters is key element for the CEO and management team. | .759 | .006 |
| Whether the selection, replacement and monitoring of the CEO is a role of the board | .746 | .110 |
| Whether the board takes active role and revises key executive and director remuneration | .696 | -.248 |
| Whether the there is active contribution by the board to: stakeholder interests | .470 | .744 |
| Whether it is the role of the board to contribute to integrity in the financial reporting. | -.726 | .427 |

Whether it is the responsibility of the board to ensure proper disclosure and communication to stakeholders
a. 2 components extracted.

A component matrix showed that the most prominent factors depicting board independence were; whether the CEO has effectively selected the Board members and whether the board revises key executive and director remuneration with coefficients of .840 and .809 respectively. The higher the coefficient, the more the factor is significant in depicting board independence. The total variance for the items was also computed to determine the percentages at which the two most prominent factors of board independence were rated. The table 4.5 below shows the findings in this regard.

**Table 4.5 Total variance**

**Total Variance Explained**

| Item | Initial Eigenvalues | | | Abstraction of Loadings | | |
|---|---|---|---|---|---|---|
| | Total | % of Variance | Cumulative % | Total | % of Variance | Cumulative % |
| 1 | 5.537 | 55.372 | 55.372 | 5.537 | 55.372 | 55.372 |
| 2 | 1.144 | 11.442 | 66.813 | 1.144 | 11.442 | 66.813 |
| 3 | .819 | 8.191 | 75.005 | | | |
| 4 | .675 | 6.754 | 81.759 | | | |
| 5 | .506 | 5.064 | 86.823 | | | |
| 6 | .383 | 3.833 | 90.656 | | | |
| 7 | .354 | 3.544 | 94.200 | | | |
| 8 | .285 | 2.852 | 97.052 | | | |
| 9 | .168 | 1.685 | 98.737 | | | |
| 10 | .126 | 1.263 | 100.000 | | | |

Extraction Method: Principal Component Analysis.

It can therefore be concluded that the two prominent factors which were; whether the CEO has effectively selected the board members and whether the board revises key executive and director remuneration with coefficients had variances of 55.37% and 11% respectively. This means that according to the study findings, selection of board members informs board independence at 55.37% while revision of key executive and director remuneration informs board independence by 11%.

### 4.5 Descriptive statistics

The analysis of the study variables was done according to the responses obtained from the research as per the questionnaire. The variables were assessed based on a likert scale analysis which rated each of the statement based on the level at which the respondents agreed with it. 1 = strongly agree, 2 = agree, 3 = neutral, 4 = disagree and 5 = strongly disagree. Descriptive statistics were used in analyzing the findings in this regard.

#### 4.5.1 Ownership Structure

The first variable of the study was to determine the ownership structure of the SOEs. The study also sought to determine whether the ownership structure of the SOEs affected decision making processes within the institutions. The first question asked the respondents to state whether the larger shareholders had more voting rights and hence controlled the decisions of the management. The table 4.6 below describes the descriptive statistics for the findings.

**Table 4.6 Descriptive statistics for Ownership structure**

| Ownership | N | Mean | Std. Deviation |
|---|---|---|---|
| The largest shareholder has a substantial voting right including that of organization he controls and effectively controls the organization | 33 | 1.1212 | .92728 |
| Two or more large shareholders collectively control the organization | 33 | 2.2424 | .86712 |
| Organization mainly owned by government | 33 | 1.3636 | 1.05529 |
| Organization mainly owned by investors/financial institutions | 33 | 4.0909 | 1.01130 |
| The organization is substantially owned and controlled by the government | 33 | 1.1515 | .83371 |
| The organization is owned and substantially controlled by foreign financial institutions | 33 | 4.0606 | 1.02894 |

The study established that in majority of the SOEs the largest shareholder has a substantial voting right including that of organization he controls and effectively controls the organization. This was indicated by a mean of 1.1212 and a standard deviation of 0.9272 which indicated that majority of the respondents strongly agreed with this. This consequently implied that most SOEs have the government as the largest shareholder and hence has substantial voting rights. The study

too established that some of the SOEs had two or more shareholders with substantial voting rights. In which case, the government was one of the larger shareholders. This was reported by respondents averagely rating this at a rate of 2.2424 and a SD of .86712. Few SOEs had financial institutions that had substantial share though majority did not agree with this aspect as shown by an average ranking of 4.0909 and a SD of 1.01130 which showed that majority strongly disagreed. The last item asked whether the organization were owned by foreign entities. The findings indicated that few SOEs had investment from foreign entities as shown by a an average ranking of 4.0606 and a SD of 1.0289 which indicated that majority of the respondents strongly disagreed. Overall it can be argued that block holding is dominant in SOEs with the government as the highest shareholder in almost all of them.

Regarding the role played by institutional investors who own quite substantial shares in the companies, the study sought to determine whether these institutional investors affect the decision making processes in the SOEs. The descriptive statistics in this regard are as outlined in the table 4.7 below.

**Table 4.7 Descriptive statistics for influence of institutional investors**

| | N | Mean | Std Dev. |
|---|---|---|---|
| There is a requirement for institutional investors to disclose their voting policies with respect to their investment in the organization | 33 | 3.1212 | .89294 |
| The institutional investors are required to disclose their governance policies with respect to their investment | 33 | 3.0303 | .84723 |
| The institutional investors rarely use their vote | 33 | 1.9697 | .80951 |
| The institutional investors are required to revealmodalities of their conflict resolution among stakeholders | 33 | 1.8485 | .66714 |
| The institutional investors are coalesce on share ownership | 33 | 1.8182 | .72692 |
| The institutional investors engagement in the organization is beyond just voting | 33 | 1.6667 | .69222 |

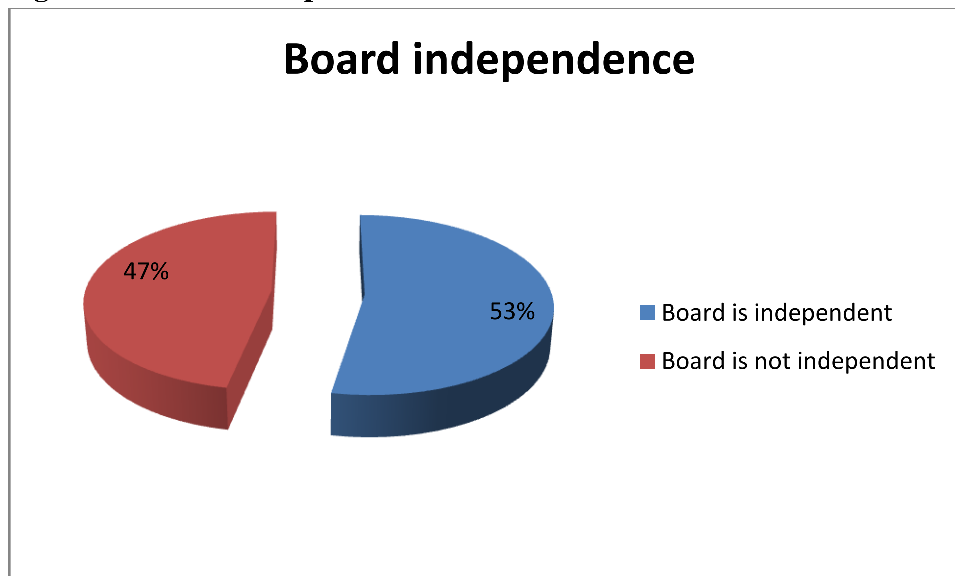
From the study findings, it was established that institutional investors it was established that institutional requirement to disclose their voting policies with respect to their investment in the organization is moderately practiced by the SOEs as was indicated by a an average ranking of 3.1212 with a SD of 0.8929. Regarding whether the institutional investors are required to disclose their governance policies with respect to their investment, the study found out that study

it was also moderately practiced as indicated by an average ranking of 3.0303 and SD of 0.84723. On whether the institutional investors use their vote, the study established that, these investors rarely use their vote as was shown by an average ranking of 1.9697 and SD of 0.80951 indicating that many respondents agreed with the statement. However, it was established that the institutional investors are required to revealtheir conflict management procedures and performance rights by the SOEs as indicated by an average ranking of 1.8485 and SD of 0.66714. Similarly the institutional investors are allowed to coalesce on share ownership as shown by a mean of 1.8182 and standard deviation of .72692. The last item assessed whether institutional investors engagement in the organization is beyond just voting and the study findings were an average ranking of 1.6667 and SD of 0.69222 which meant that the engagement of the institutional investors with the SOEs, was beyond just voting. This can be explained by the fact that in all the SOEs the government is the majority shareholders and the vote by others don't matter a lot.

### 4.5.2 Board Independence

Cumulatively 69.7% of the respondents to a very large extent indicated that independent boards of directors in their organizations were truly independent while 30.3% indicated that they were not.

**Figure 4.3 Board independence**



Descriptive statistics were used to determine the levels of independence of the boards in the SOEs as reflected by various aspects. Ten items were used to assess the independence of the boards by using a likert scale. The findings are as outlined in the table 4.8 below.

**Table 4.8: Descriptive statistics for board independence**

| | N | Mean | Std. Deviation |
|---|---|---|---|
| The CEO has effectively selected the Board members | 33 | 1.879 | .8200 |
| Concern over personal relationships with other directors | 33 | 2.2424 | .70844 |
| Criticizing the management is not taken as defiance | 33 | 3.0102 | .61237 |
| No blame is put on board members in future over a past decision | 33 | 2.0606 | .70442 |
| CEO has better judgment and is more informed than the board | 33 | 1.5152 | .56575 |
| Board monitors and actively selects CEO | 33 | 2.0909 | .91391 |
| Revises key executive and director remuneration | 33 | 1.6364 | .69903 |
| Reviewing stakeholder interests and any misunderstanding | 33 | 3.1515 | .61853 |
| Ensures integrity of the organization's financial reporting | 33 | 2.0909 | 1.01130 |
| Ensures disclosures and enhances openness | 33 | 3.3333 | 0.46961 |
| Overall | 33 | 2.200 | 1.2123 |

To demonstrate how independent these directors were, an average ranking of 1.879 and standard deviation of .8200 was obtained indicating that most respondents were in agreement that the CEO has effectively selected the Board members. Majority of the respondents were also in agreement that there was concern over personal relationships with other directors as indicated by a mean of 2.2424 and standard deviation of .70844. Regarding whether openly objecting to the management agenda is viewed as a defiance that is contrary to the norm the respondents were indifferent on this matter as indicated by a mean of 3.0102. The study found that among the SOEs, there is issue of blame or responsibility over past decisions as indicated by an average ranking of 2.0606 and a SD of 0.70442. On whether CEO has better judgment and is more informed than the board, an average of1.5152 and a SD of 0.5657 was obtained indicating that much is expected from the management than the board thus casting doubt on the ability of the boards to be fully independent in decision making. It was found that the boards select and monitors the CEO shown by an average of 2.0909 and a SD of 0.91391. Majority of the

respondents were generally in agreement that the board revises key remuneration decisions in their organizations as shown by a mean of 1.6364 and a standard deviation of 0.69903. On whether the board played a major role in reviewing stakeholder interests an average of3.1515 was obtained showing that majority of the respondents were indifferent to this statement. It was however established that the boards ensures integrity of the organization's financial reporting as shown by a mean of 2.0909 and a standard deviation of 1.01130. this meant that though majority were in agreement, some few were in strong disagreement hence the huge deviation from the mean. On whether the boards in the SOEs enhance openness, majority of the respondents were indifferent in this regard showing a mean of 3.3333 and a standard deviation of 0.46961. Overall, board independence was rated at 2.200 as shown in the table 4.8. On whether it was a forum of serious discussion where major decisions that impact on performance were discussed; 66.7% of the respondents strongly indicated that the board was a forum of serious discussions where major decisions that impact on bank performance were discussed, 18.2% were merely in agreement, whereas 15.2% were indifferent. Cumulatively 84.9% of the respondents were in agreement that the board was a forum of serious discussions where major decisions that impact on commercial performance in commercial banks were discussed. The findings further demonstrated that the board ensures effectiveness of corporate governance in the Kenyan banking sector as indicated strongly by 33.3% of the respondents, 60.6% being agreement, whereas 6.1% being in disagreement. Cumulatively, 93.9% of the respondents indicated that the board ensures effectiveness of corporate governance in the banking sector. This was further affirmed by 90.9% of the respondents who were cumulatively in agreement that independent board of directors also ensured integrity in financial reporting in these banks.

### 4.5.4 Board Size

From the study findings, majority of the respondents amounting to 78.8% indicated that SOEs require bigger boards to cater for professional diversification in decision making, 12.1% were in agreement, 6% of the respondents could neither agree nor disagree, whereas 3% strongly disagreed with the presence of a bigger board. Cumulatively 90.9% of the respondents indicated that SOEs require bigger boards that will enable it draw diverse professional advice from.

### 4.5.5 Board Composition

The study sought to determine how the boards in the SOEs we composed by determining whether the board members had sector specific qualifications. From the study findings, it was established that

cumulatively, 54.5% of the SOEs had board members with sector specific qualifications. This meant that 45.5% of the SOEs board members had no sector specific qualifications. This would affect the independence of the boards since without proper understanding of crucial issues in the sector the boards might end up depending on advice from the management. This is as shown in the table 4.9.

**Table 4.9 Board composition based on sector expertise of board members**

| | | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|---|
| Valid | Strongly agree | 8 | 24.2 | 24.2 | 24.2 |
| | Agree | 10 | 30.3 | 30.3 | 54.5 |
| | Neutral | 5 | 15.2 | 15.2 | 69.7 |
| | Disagree | 10 | 30.3 | 30.3 | 100.0 |
| | Total | 33 | 100.0 | 100.0 | |

### 4.5.5 SOE performance

The respondents were asked to rate the extent to which they have achieved various levels of performance as highlighted in the study items. Table 4.10 presents the SOEs performance measurement scale.

**Table 4.10 Performance Indicators of SOEs**

| Descriptive Statistics | | | |
|---|---|---|---|
| Indicators | N | Mean | Std. Deviation |
| Your organization has good improvement of ROA in the last Five years | 33 | 2.8485 | .87039 |
| Your organization has better ROA than industry average | 33 | 3.4242 | 1.39262 |
| Your organization has a good improvement of ROE in the last five years | 33 | 2.4545 | 1.30122 |
| Your organization has better ROE than industry average | 33 | 2.9394 | 1.45644 |
| Your organization has a good improvement in Tobin's q in the last three years | 33 | 2.7273 | 1.64455 |
| Your organization has a better Tobin's q than industry average | 33 | 2.5455 | 1.25227 |
| Overall | 33 | 2.82323 | 1.31958 |

The study found out that a moderate number of the organizations had good improvement of ROA in the last five years as was indicated by a mean of 2.8485 and a standard deviation of .87039which showed a moderate agreement with the statement. It was also established that the SOEs were not performing well compared to industry average as was indicated by a mean of 3.4242. on whether the organizations had good improvement of ROE in the last five years the rating was indicated by a mean of 2.4545 and a standard deviation of 1.30122 showing that the improvement of ROE was moderate. On whether the organizations had a good improvement in Tobin's q in the last three years the assessment was also moderate scoring a mean of 2.7273 and a standard deviation of 1.64455. The rating of the Tobin’s q relative to industry average was also rated moderately at a mean of 2.5455. Overall, the rating of performance in terms of RoA, RoE and Tobin’s q was rated at a mean of 2.8232 as per the opinions of the respondents. This was a moderate rating as per the likert scale analysis. The study conducted further analysis of the secondary data to determine the relationships among the variables using secondary data on performance of the SOEs. Regression analysis techniques were used to achieve this objective.

### 4.6 Correlation Analysis

Table 4.11 presents descriptive statistics results on the relationship between the corporate governance mechanisms (ownership structure, board independence, Board size and board composition) as they relate to the performance of commercial banks in Kenya (ROA).

**Table 4.11: Relationships between variables**

| Variables | Observations-n | Minimum | Maximum | Mean | Standard deviation |
|---|---|---|---|---|---|
| ROA | 33 | -.13 | .37 | .0257 | .03829 |
| Ownership structure | 33 | .59 | 1.00 | .6814 | .21685 |
| Board independence | 33 | .17 | .92 | .6747 | .13890 |
| Board size | 33 | .60 | 1.18 | .8633 | .12959 |
| Board composition | 33 | 2.88 | 5.51 | 4.1179 | .60476 |

From the data received from 33 SOEs (Table 4.11), the findings indicate that SOEs in Kenya had an average board size of about 8 directors (antilog. of .8633), a maximum of 16 (antilog. of 1.18) and a minimum of 4 (antilog. of .60) directors, that deviated by 1 (antilog. of .12865) director on both sides of the mean. The findings further indicated that independent directors constituted of 67.47% of the board size, with a maximum of 92% and a minimum of 17% that were spread on either side of the mean by 13.89%.

On average institutional investors held 19.98% of equity stakes in these SOEs, with a maximum of 59% and a minimum of 0 that were spread on either side of the mean by 16.402%. Block holders on average owned 68.14% of equity stakes with a maximum of 100% and a minimum of 59% that were spread on both sides of the mean by 21.685%.

Using Return on asset as a measure of performance the findings indicate that SOEs in Kenya reported an average return on asset of 2.57% with the maximum of 37% and minimum of -13% that deviated by 3.829% on both sides of the mean. The standard deviation was relatively low 3.829%.

**Table 4.12 Relationship between variables and financial performance**

| | | Ownership structure | Board independence | Board size | Board composition | ROA |
|---|---|---|---|---|---|---|
| Ownership structure | Correlation | 1 | 0.858 | 0.639 | 0.537 | 0.578 |
| | Significance (2-tailed) | 0 | 0 | 0 | 0.001 | 0.07 |
| | df | 0 | 34 | 34 | 34 | 34 |
| Board independence | Correlation | 0.858 | 1 | 0.61 | 0.494 | 0.760 |
| | Significance (2-tailed) | 0 | 0 | 0 | 0.002 | 0.001 |
| | df | 34 | 0 | 34 | 34 | 34 |
| Board size | Correlation | 0.639 | 0.861 | 1 | 0.878 | 0.482 |
| | Significance (2-tailed) | 0 | 0 | 0 | 0 | 0.02 |
| | df | 34 | 34 | 0 | 34 | 34 |
| Board composition | Correlation | 0.537 | 0.494 | 0.878 | 1 | 0.321 |
| | Significance (2-tailed) | 0.001 | 0.002 | 0 | 0 | 0.002 |
| | df | 34 | 34 | 34 | 0 | 34 |

From the study findings, the following relationships were drawn through correlation analysis. Pearson's' Product moment correlation statistical technique was used to test the significance of the relationship between corporate governance factors and financial performance of SOEs.

The Pearson's Product Moment Correlation co-efficient for board independence showed a strong positive relationship with financial performance of SOEs ($r = .760$, $P < 0.01$). This relationship confirms other findings of similar studies by Cooper (2010) on public organizations in the USA where he argued that board independence has positive impact on financial performance of organizations.

Similarly the Pearson's Product Moment Correlation co-efficient for ownership structure showed a moderately positive relationship with financial Performance of SOEs ($r = 0.578$, $P < 0.05$). The Pearson's Product Moment Correlation co-efficient for board size showed a strong positive relationship between board size and performance of SOEs($r = 0.482$, $P < 0.01$).Lastly the

Pearson's Product Moment Correlation co-efficient for board composition showed a moderate positive relationship with the financial performance of SOEs ($r = 0.321$, $P < 0.01$).

### 4.7Regression Analysis

Hierarchical multiple regression was adopted in analyzing the relationship between corporate governance and performance of commercial banks in Kenya. Performance indicators were defined by: ROA and the proxies of corporate governance were: ownership structure, board independence, board size and board composition.

From empirical studies reviewed in this study, it was established that corporate governance practice leads to corporate well being and sustainable growth of a company. From the literature it was also learnt that corporate governance is the control system for any organization in the business world. Corporate governance provides an environment upon which board of directors and the management maximize corporate growth for all the stakeholders. It also provides proper guidance for the optimal utilization of available resources of the company. Parastatals practicing corporate governance tend to deliver better financial results against those parastatals with poor corporate governance mechanisms, thus attracting more and better publicity and both Government and Donor-funding.

Correlation analysis indicated that SOEs corporate governance had a positive correlation with its financial performance. The study was conducted to evaluate the effect of corporate governance on SOEs performance through examining the corporate governance parameters and financial performance of parastatals from 2012-2016 by applying linear regression through SPSS. The model was of the functional form:

$y=a + \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_3 + \beta_4 x_4$

Where;

$y$= Return on Assets- Net Income divided by total assets

$a$= Constant

$x_1$= Ownership structure – Type of shareholders

$x_2$= Board composition – No of directors with expertise in the sector

$x_3$ = Board Independence–Number of independent directors.

$x_4$= Board size- Number of directors in the board.

The data collected comprised of a five year period (2012-2016).The data was obtained from the financial reports of the SOEs selected for this study, Board size was equal to total number of directors in the SOE; Board independence indicated what percentage of non-executives was present in the board of directors. Ownership structure showed what part or authority the last five shareholders had among all the shares a SOE held. The table below summarizes the findings of the study.

**Table 4.13: Regression and Coefficient of Determination**

| Model | Unstandardized Coefficients | | Standardized Coefficients | | |
|---|---|---|---|---|---|
| | B | Std Error | Beta (β) | T statistic | P-value |
| (Constant) | 0.63 | 0.27 | 2.33 | 0.0117 | 0.021 |
| Board independence | 0.59 | 0.265 | 0.28 | 2.23 | 0.020 |
| Ownership structure | 0.64 | 0.23 | 0.33 | 2.67 | 0.002 |
| Board size | 0.57 | 0.12 | 0.04 | 4.75 | 0.004 |
| Board composition | 0.66 | 0.14 | 0.19 | 4.71 | 0.000 |

From table 4.13, the factors that were considered most significant had a significance of less than 0.05. It was established that all the variables were significant since they had p-values less than 0.05. These were; board independence (0.02), ownership structure (.005) board size (0.004) and board composition (0.000). Results reveal that these factors contributed to financial performance of the SOEs.

the study results shows that board composition amongst the four explanatory variables was more significant with a beta value of 0.66 while board independence, ownership structure and board size, had beta value of 0.59, 0.64, and 0.57 respectively.

The bigger the difference of *t*-calculated and *t*-critical (it can be either positive or negative), the bigger the evidence against the null hypothesis that there is no significant difference. The closer *t* is to 0, the more likely there isn't a significant difference. If the P-value is less than 0.05 ($p<0.05$), the decision rule is that we reject the null hypothesis since there are significant differences between the variables we are comparing.

All the p-values for the variables were less than 0.05 which indicates that they are statistically significant in explaining the financial performance of the SOEs.

$\boldsymbol{\beta_0}$is the autonomous components which are factors that are not influenced by the independent variables considered in the study. It also gives the Y intercept of our curve. From the table 4.19 on multiple linear regression, $\boldsymbol{\beta_0 = 0.63}$

$\boldsymbol{\beta_1}$ is the coefficient of proportionality which tells the variation to which board independence causes on financial performance of SOEs in Kenya. From the table 4.19 on multiple linear regression, $\boldsymbol{\beta_1 = 0.59}$

$\boldsymbol{\beta_2}$ is the coefficient of proportionality which tells the variation to which ownership structure causes on performance of SOEs in Kenya. From the table 4.19 on multiple linear regression, $\boldsymbol{\beta_2 = 0.64}$

$\boldsymbol{\beta_3}$ is the coefficient of proportionality which tells the variation to which board size causes on financial performance of SOEs in Kenya. From the table 4.19 on multiple linear regression, $\boldsymbol{\beta_3 = 0.57}$

$\boldsymbol{\beta_4}$ is the coefficient of proportionality which tells the variation to which board composition causes on financial performance of SOEs in Kenya. From the table 4.19 on multiple linear regression, $\boldsymbol{\beta_4 = 0.57}$

The model is then generated as follows;

**Y(Return on Assets) =** $\boldsymbol{0.63+0.59X_1 + 0.64\ X_2 + 0.57\ X_3 + 0.66\ X_4 +} e$

This means that a unit change in board independence informs financial performance at a rate of 0.59 per unit. Consequently, a unit change in ownership structure, board size and board composition would inform a change in financial performance by 0.64, 0.57 and 0.66 respectively per unit.

### 4.8 Interpretation of findings

The study found out that board independence greatly influences the financial performance of SOEs. These findings confirm Shleifer and Vishny (2013) assertions that board independence facilitate organizational financial performance. The study also reflects the conclusion by Grossman and Hart (2010) that attributes of corporate governance especially the independent directors are important for excellent business performance. The study has shown that, presence of independent directors promote corporate integrity and thus turn over which echoes the sentiments by Demsetz and Lehn(2015) that there is a strong correlation between board independence and financial performance.

The study has showed that ownership structure is critical to the organization's financial performance. Moreover, the study has indicated that ownership structure determines the organizational controls and thus determines the sources of influence that can spur the organization to further financial performance. For the largest shareholder has a substantial voting right including that of organization he controls and effectively controls the organization, the conduct of the main shareholder determines the outcome of the organization in terms of financial performance. For instance, the study found out that in most SOEs institutional investors are required to disclose their governance policies which may affect the performance of the SOEs. Such findings reinforce Lehn (2015) that ownership structure affects quality and governance modalities in an organization and thus affects the financial performance.

Board size as a variable was operationalized using the number of members of the board in the SOEs. According to the study, the smallest board size was composed of five members while the largest had 15 members. This had a mean size of the board as 7.6. The results from this study can be likened to similar findings by Brown and Caylor (2004), which recommended optimal board size to be not lower that six and not larger than 15. Another similar study by Jensen (1993) recommended for an average of 8 members, while Lipton and Lorsch (1992) recommend a board size of 8–9. Jensen and Ruback (1983) on their part argued that a lean board size of around 8

members is ideal for effective decision making. However, Tornyeva and Wereko(2012) argued that the appointment of directors need to be done based on the size of the organization and considering the required skills as well as the shareholding structure.

Board composition was measured by the proportion of non-executives appointed to the firm's board in SOEs in Kenya. Descriptive statistics for board composition composed of members with relevant expertise showed that in most of the boards the members have relevant expertise rated at a mean of 69.7%. Cadbury (1992) observed that non-executive directors are crucial in enhancing decision-making in organizations but that is determined by their backgrounds.

# CHAPTER FIVE

# SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

## 5.1 Introduction

The main objective of this chapter was to provide a summary, draw a conclusion and make necessary recommendations based on the qualitative and quantitative analysis presented in chapter four. The summary of the results are correlated with empirical and available theoretical literature. The conclusion relates directly to the specific objectives. Whereas the recommendations are deducted from the conclusion and discussion of the findings, the chapter is structured in three sections: summaries of findings, conclusion and recommendations of the study.

## 5.2 Summary of Findings

The study sought to investigate the relationship between corporate governance and financial performance of SOEs in Kenya. A pilot study was undertaken on one SOE to test the reliability and validity of the questionnaire. The results of the pilot study were used in improving the questionnaire instrument making data collected using it achieve a relatively high level of consistency and could be generalized to be representative of the target population and used for further analysis.

Factor analysis was used in the study to reduce the number of constructs/variables especially for board independence to fewer that could clearly explain board independence aspect in governance of SOEs in Kenya. From the factor analysis two underlying factors were found to predominantly affect financial performance of SOEs in Kenya. These were; the CEO has effectiveness in selection of board members and board role in revising key executive and director remuneration both factors with variances of 55.37% and 11% respectively. ROA was used as the indicator for financial performance. These findings support the stakeholder theory that there exist a positive relationship between corporate governance practice and performance of a business entity. From the study findings, the regression analysis confirmed this positive relationship using the ROA as the financial performance indicator. In consideration of the study variables which included board independence, board size, board composition and ownership structure, the regression analysis results for all the variables showed positive relationship with financial performance which was

measured by ROA. The study found that though board size has positive relationship and can influence performance, the extent of the board size influence on financial performance is small. This resonates with findings by Haniffa and Hudaib (2006), who argued that big sized boars are not effective and at some point may hinder performance and thus a moderate board size is recommended.

Correlation analyses performed on the study variables found that all the study variables had positive relationship with financial performance. This finding resonated with the findings by Mashayekhi and Bazaz (2008), Ehikioya (2009), Uadiale (2010) and Heenetigala and Armstrong (2011) that corporate governance attributes influence financial performance of companies. This Lorsch(1995) linked it to the role played by boards in resolving internal conflicts which in return creates a smooth running of an organization thus leading to better financial performance.

The findings of the study further indicated that SOEs in Kenya had a relatively larger board sizes. The large board sizes affected their effectiveness due to: lack of meaningful dialogue among directors and the ability of the CEO to control and manipulate large boards. The findings from this study were in line with the relevant literature with all the variables showing positive relationship with financial performance.

## 5.3 Conclusion

The findings of the study really achieved the main objective which was to determine whether the practice of corporate governance had an effect on the financial performance of the SOEs. The study in this regard has answered all the research questions and the specific objectives of the study have been determined. The corporate governance attributes of ownership structure, board independence, board size and board composition are hereby well explained in regard to their influence on financial performance of SOEs in Kenya. This influence of corporate governance attributes can be linked to the contribution of corporate governance practices into enhancing tranquility in a company by sorting out conflicts among stakeholders. The corporate governance practice also leads to improved corporate image and better working relationship among stakeholders leading to sustainable growth of the firm.

The empirical study findings outlined some issues of concern among the SOEs in relation to corporate governance. The study concludes that board size does not significantly affect financial performance of the SOEs but an optimal board size should be maintained relative to the organization size. The study also concludes that RAO is a proper measure for financial

performance as has been indicated from the study findings. These findings are in line with shareholders wealth maximization objective of the firm and the definition of corporate governance by Shleifer wand Vishny, (1997) that it is ways in which suppliers of finance to corporations assure themselves of getting a fair return on their investment.

Just as was conceptualized in the study empirical review and the theoretical framework, the study findings show that there is a significant influence of corporate governance on financial performance of SOEs just as was theorized in the agency and stakeholder theories. It is thus concluded in this study that improved corporate governance would lead to improved financial performance.

The study concludes that there is a positive and significant relationship between, board independence, ownership structure, board size and board composition with financial performance in terms of ROA. Therefore if SOEs in Kenya are to improve their performance they should direct their efforts towards these variables. At the same time, SOEs in Kenya should explore ways in which they should improve on boards' effectiveness.

## 5.4 Recommendations

The study findings are relevant in outlining the strong points for the practice of corporate governance especially for SOEs that will enhance better financial performance. Initiatives that seek to improve corporate governance in the public sector need to be supported by the government. Some of the initiatives that can be enhanced are the corporate governance institutes like the Centre for corporate governance (CCG). The enhancement of such institutes should be in the form of training, raising awareness for SOEs CEOs and directors as well as training of experts in the field of accounting and finance. The programs could shape their integrity, create effective management and offer advice on how to enhance corporate governance quality in their own listed companies.

The study recommends further for a review of the accounting and auditing certifications in order to inculcate integrity and professionalism among the professionals. The government needs to identify gaps and loopholes in the existing corporate governance regulations and standards being applied in Kenya and enhance proper implementation within the public sector. In addition, the Kenya government should develop the accounting and auditing profession in Kenya through the

adoption of international accounting and auditing standards. These standards must be enforced by law and must be controlled by the Kenya government.

## 5.5 Limitation of the study

Since the study used “drop and pick” questionnaire method rather than an in-depth interview method, a lot of information which could have been given by the would-be respondents was not captured and this could have given a much more detailed analysis of the relationship between corporate governance and financial performance of SOEs’ parameters. One-to-one interaction between the interviewer and the interviewee and facial expressions/body language could enhance the quality and authenticity of the information. Cost of questionnaire method is also more expensive compared to face- to- face interview.Also, the study did not use a whole population of parastatals but just a sample of them and this limited the scope of the study and limited fuller and deeper analysis of the factors involved in the study.

## 5.6 Suggestions for further research

The study focused only on how certain sets of board characteristics impact on SOEs financial performance in Kenya. While the characteristics covered were important, there are other diverse variables such as managerial ownership, audit committee; board meeting, capital structure and disclosure that could not be included hence should be considered in future studies.

From the foregoing analysis, it is evident that corporate governance has an influence on a firm’s performance. Indeed, while some of the study’s findings are revealing, clear policy implications should not be lost. For enhanced performance of corporate entities, it is important to separate positions of CEO and board chair and also SOEs should be encouraged to maintain relatively independent audit committees. It should be emphasized, however, that in trying to examine the link between corporate governance and performance of SOEs, it would have been appropriate to use a broader spectrum of variables. The data which dates back to 2005 also constitute another limitation of the study. These limitations, however, do not compromise on the validity of conclusion drawn based on the results.

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**Appendix I: Questionnaire**

Dear Respondent: My name is Kibe Hilton Maina, a Master of Business Administration Student at the the University of Nairobi. In partial fulfilment of the requirements for the award of MBA Degree; I am conducting a study entitled: **the effect of corporate governance on the financial performance of state owned enterprises (SOEs) in Kenya**. Kindly complete the following questionnaire by ticking the appropriate boxes and filling the spaces provided. Any information provided will be treated with utmost confidentiality. Please tick (√) as appropriate.

**1.0 General information about the organization** The following questions are facts about your organization that you are required to clarify to the respondents in the survey on the relationship between corporate governance and performance of commercial SOEs in Kenya. The information you will provide will be held in confidence, will specifically be used for academic purposes and will not be disclosed to another party without your prior permission. Please respond to the statement by a tick (√) where appropriate except where instructions are given to the contrary. 1-Strongly Agree 2-Agree 3-Neither agree nor disagree 4-Disagree 5-Strongly disagree

1.1 Name of your organization (optional)…………………………………………………..…

**2.0 Information on Respondent**

Respond to the statement by a tick (√) on appropriate; 1 strongly agree, 2 agree, 3 neutral, 4 disagree and 5 strongly disagree.

| **Statement** | **1** | **2** | **3** | **4** | **5** |
|---|---|---|---|---|---|
| 2.1 What is your view of corporate governance in your organization compared with other SOEs? | | | | | |
| 2.2 How do you compare your Organization's current corporate governance practices with those of five years ago? | | | | | |
| **Ownership Structure** | | | | | |
| 3.1 How do you describe the ownership and control structure of the organization based on the following statements? | 1 strongly agree, 2 agree, 3 neutral, 4 disagree and 5 strongly disagree. | | | | |
| | **1** | **2** | **3** | **4** | **5** |
| 3.1.1 The largest shareholder has a substantial voting right and effectively controls the organization | | | | | |

| | | | | | |
|---|---|---|---|---|---|
| 3.1.2 Two or more large shareholders collectively control the organization | | | | | |
| 3.2 What is the ownership/control structure of the biggest shareholders of your organization? | | | | | |
| | **1** | **2** | **3** | **4** | **5** |
| 3.2.2Organization is mainly owned by Government | | | | | |
| 3.2.3 Organization mainly owned by investors/financial institutions | | | | | |
| **Institutional Ownership** | | | | | |
| 4.0 Is your organization wholly or partially owned and controlled by the government? 1 strongly agree, 2 agree, 3 neutral, 4 disagree and 5 strongly disagree | | | | | |
| | **1** | **2** | **3** | **4** | **5** |
| The organization is substantially owned and controlled by the government | | | | | |
| 4.1. Is your organization partially or wholly controlled by foreign financial institutions? | | | | | |
| | **1** | **2** | **3** | **4** | **5** |
| The Organization is owned and substantially controlled by foreign financial institutions | | | | | |
| 4.2 To what extend do you agree with the following statement about institutional investors in your organization? | | | | | |
| | **1** | **2** | **3** | **4** | **5** |
| 4.2.1 They are required to disclose their voting policies with respect to their investment in the organization | | | | | |
| 4.2.2 They are required to disclose their governance policies with respect to their investment in the organization | | | | | |
| 4.2.3 They rarely use their vote. | | | | | |
| 4.2.4 They are required to disclose how they manage material conflict of interest that may affect the key ownership and performance rights. | | | | | |
| 4.2.5 They are allowed to consult each other on issues concerning their basic rights on share ownership | | | | | |
| 4.2.6 Their engagement in the organization is beyond just voting. | | | | | |
| **5.0 Board independence**<br>5.1 Do you believe "independent directors" of your organization are truly independent from the CEO or controlling shareholders?<br>Yes (1) No (2) | | | | | |

| 5.2 What do you think about the following reasons for "independent directors not being fully independent from the CEO or controlling shareholders?<br>1 strongly agree, 2 agree, 3 neutral, 4 disagree and 5 strongly disagree | | | | | |
|---|---|---|---|---|---|
| | **1** | **2** | **3** | **4** | **5** |
| 5.2.1 The CEO has effectively selected the board members. | | | | | |
| 5.2.2 Concern over personal relationships with other directors. | | | | | |
| 5.2.3 Openly objecting to the management agenda is viewed as a defiance that is contrary to the norm. | | | | | |
| 5.2.4 Concern of possible blame or responsibility when their views turn out to be wrong in future | | | | | |
| 5.2.5 CEO and management team are supposed to be informed better on most issues and have better judgment | | | | | |
| Do you agree that your organization's board is active and makes much contribution to the following tasks?<br>1 strongly agree, 2 agree, 3 neutral, 4 disagree and 5 strongly disagree | | | | | |
| | **1** | **2** | **3** | **4** | **5** |
| 5.5.1 Plays an important role in selecting, monitoring and replacing the CEO | | | | | |
| 5.5.2 Revises key executive and director remuneration | | | | | |
| 5.5.3 Reviewing potential conflicts of interest including related party transactions | | | | | |
| 5.5.4 Ensures integrity of the organization's financial reporting | | | | | |
| 5.5.4 Ensures proper disclosure and actively communicates with shareholders and stakeholders | | | | | |
| **6.0 Board size**<br><br>6.1 What was the board size of your organization during the following periods? Please tick where appropriate 1-More than 10 members, 2-between 1-10,3-between 1-8,4-between 1-8, 5, between1-6. | | | | | |
| Year | | | | | |
| 2011 | | | | | |
| 2015 | | | | | |
| 2017 | | | | | |
| 6.2 How can you justify the board size you have mentioned 7.1 above | | | | | |

| | | | | | |
|---|---|---|---|---|---|
| 6.2.1 Need for professional diversification in decision making | | | | | |
| 6.2.2 To check the excesses of the CEO | | | | | |
| **7.0 SOE performance**<br>What is your take on the following performance measures in your organization?<br>1 strongly agree, 2 agree, 3 neutral, 4 disagree and 5 strongly disagree | | | | | |
| | **1** | **2** | **3** | **4** | **5** |
| 7.1 Your organization has good improvement of ROA in the last five years | | | | | |
| 7.2 Your organization has better ROA than industry average | | | | | |
| 7.3 Your organization has a good improvement of ROE in the last five years | | | | | |
| 7.4 Your organization has better ROE than industry average | | | | | |
| 7.5 Your organization has a good improvement in Tobin's q in the last three years | | | | | |
| 7.6 Your organization has a better Tobin's q than industry average | | | | | |

Thank you for your response.

## APPENDIX IV: LIST OF SOEs PARTICIPATING IN THE STUDY

| | |
|---|---|
| Agricultural Development Corporation | Kenya Post Office Savings Bank |
| Agricultural Finance Corporation | Kenya Railways Corporation |
| Kenya Re-insurance Corporation | Kenya Re-insurance Corporation |
| Athi Water Services Board | Kenya Safari Lodges & Hotels |
| Bomas of Kenya Ltd | Kenya Seed Company Ltd |
| Central Water Services Board | Kenya Safari Lodges & Hotels |
| Chemilil Sugar Company Limited | Kenya Seed Company Ltd |
| Coffee Board Of Kenya | Kenya Sisal Board |
| Consolidated Bank of Kenya | Kenya Sugar Board |
| Cooperative College of Kenya | Kenya Sugar Research Foundation |
| East African Portland Cement Co. | Kenya Tourist Board |
| Kenyatta International Conference Centre | Kenya Tourist Development Corporation |
| Export Processing Zone Authority | Kenya Utalii College |
| Kenya College of Communications Technology | Kenya Wildlife Service |
| Kenya Electricity Generating Company | Kenya Wine Agencies Limited |
| National Bank of Kenya | Kenyatta International Conference Centre |
| National Hospital Insurance Fund | National Oil Corporation of Kenya |

## APPENDIX V: NET INCOME/PROFIT

| Net Income /Profit (Ksh) | | | | |
|---|---|---|---|---|
| **2012** | **2013** | **2014** | **2015** | **2016** |
| 12,982,833,441.00 | 14,710,274,812.00 | 1,004,643,000.00 | 1,120,529,000.00 | 1,772,577,000.00 |
| 3,768,933,000.00 | 2,445,666,000.00 | 5,896,679,000.00 | 1,943,807,000.00 | 3,320,812,000.00 |
| 1,664,231,000.00 | 1,718,477,000.00 | 1,764,870,000.00 | 3,225,094,000.00 | 16,738,306,000.00 |
| 411,793,000.00 | 764,164,000.00 | 536,652,000.00 | 1,834,054,000.00 | -292,402,000.00 |
| 1,756,000.00 | 2,319,525,000.00 | 2,737,936,000.00 | 2,967,962,000.00 | 4,863,067,000.00 |
| 879,063,000.00 | 1,506,151,000.00 | 1,829,322,000.00 | 2,502,355,000.00 | 2,439,718,000.00 |
| 1,240,610,000.00 | 1,119,396,000.00 | 1,240,600,000.00 | 1,699,847,000.00 | 2,021,919,000.00 |
| 1,016,101,000.00 | 1,252,663,000.00 | 992,483,000.00 | 1,425,687,000.00 | 2,743,000,000.00 |
| 8,375,049,000.00 | 9,563,202,000.00 | 9,011,320,000.00 | -7,412,772,000.00 | 17,360,118,000.00 |
| 99,000,100.00 | 101,000,000.00 | 109,000,000.00 | 123,000,000.00 | 127,000,000.00 |
| 87,780,120.00 | 97,000,000.00 | 118,000,000.00 | 126,000,000.00 | 134,000,000.00 |
| 1,010,644,010.00 | 1,393,611,000.00 | 1,213,837,000.00 | 1,609,972,000.00 | 829,095,000.00 |
| 66,006,700.00 | 73,662,000.00 | -782,872,000.00 | -517,598,000.00 | -324,898,000.00 |
| 57,011,800.00 | 60,345,000.00 | 72,634,000.00 | 89,592,000.00 | 36,381,000.00 |
| 711,800,909.00 | 716,274,606.00 | 793,813,107.00 | 804,813,118.00 | 848,632,199.00 |
| 2,009,876.00 | 2,143,122.00 | 2,220,000.00 | 2,700,000.00 | 2,817,000.00 |
| 2,476,900,010.00 | 2,720,993,000.00 | 3,295,000,000.00 | 3,765,529,000.00 | 4,538,208,000.00 |
| 754,700,180.00 | 742,466,811.00 | 777,531,812.00 | 797,561,912.00 | 812,641,100.00 |
| 118,138,000.00 | 122,000,000.00 | 132,000,000.00 | 146,000,000.00 | 154,000,000.00 |
| 212,000,090.00 | 213,143,952.00 | 217,412,833.00 | 222,567,622.00 | 221,997,999.00 |
| 1,350,900.00 | 1,642,677.00 | 1,867,843.00 | 1,977,614.00 | 1,991,967.00 |
| 1,667,700,000.00 | 1,866,947,000.00 | 1,917,812,000.00 | 2,101,211,000.00 | 2,112,812,000.00 |
| 198,100,650.00 | 201,124,340.00 | 214,124,312.00 | 225,217,814.00 | 288,494,854.00 |
| 1,990,123,000.00 | 2,400,221,000.00 | 2,731,812,000.00 | 300,201,000.00 | 3,142,101,000.00 |
| 7,700,670.00 | 9,521,470.00 | 9,464,810.00 | 9,828,800.00 | 10,210,014.00 |
| 22,580,000.00 | 25,821,000.00 | 96,223,000.00 | 80,938,000.00 | 172,478,000.00 |
| 3,070,000.00 | 3,121,000.00 | 3,141,000.00 | 4,220,000.00 | 4,223,000.00 |
| 2,700,000.00 | 2,997,000.00 | 3,000,000.00 | 3,012,000.00 | 3,116,000.00 |
| 1,980,000,000.00 | 2,008,000,000.00 | 21,124,120.00 | 3,002,000.00 | 3,212,000.00 |
| 1,768,670.00 | 2,000,000.00 | 3,000,000.00 | 4,000,000.00 | 4,100,000.00 |

# APPENDIX VI: LETTER FOR DATA COLLECTION

UNIVERSITY OF NAIROBI
SCHOOL OF BUSINESS

Telephone: 020-2059162
Telegrams: "Varsity", Nairobi
Telex: 22095 Varsity

P.O. Box 30197
Nairobi, Kenya

DATE..16th/10/2017

**TO WHOM IT MAY CONCERN**

The bearer of this letter ...KIBE HILTON MAINA...

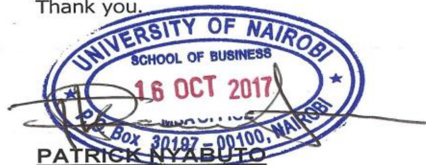
Registration No. D61/61203/2013...

is a bona fide continuing student in the Master of Business Administration (MBA) degree program in this University.

He/she is required to submit as part of his/her coursework assessment a research project report on a management problem. We would like the students to do their projects on real problems affecting firms in Kenya. We would, therefore, appreciate your assistance to enable him/her collect data in your organization.

The results of the report will be used solely for academic purposes and a copy of the same will be availed to the interviewed organizations on request.

Thank you.




PATRICK NYABUTO
SENIOR ADMINISTRATIVE ASSISTANT
SCHOOL OF BUSINESS