

*** CORPORATE GOVERNANCE PRACTICE IN THE PUBLIC SECTOR; THE
CASE OF NATIONAL HOSPITAL INSURANCE FUND (NHIF)**

BY

**UNIVERSITY OF NAIROBI
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(MBA) DEGREE.**

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DECLARATION

This research project is my original work and has never been presented for a degree in any other University.

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DEDICATION

To my mum, Esther N. Mulinge, thanks for always being there for me. You are appreciated.

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Many thanks, to my committed and supportive supervisor, Mr. Luther Otieno, for his relentless support and knowledge that has enriched this paper.

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Above all, greatest thanks to God for his continued blessings

Abstract

In the past corporate governance has been emphasized in the private sector. However, corporate governance at all levels is increasingly being seen as the most important factor for the success of organizations in both the private and public sector. NHIF is one of the organizations in the public sector with the key responsibility of providing affordable and accessible healthcare to all Kenyans.

NHIF is faced by the challenge of good corporate governance practice. This was evident during a launch by KACC of the Anti-graft plan (Daily Nation, July 6, 2006). During this launch KACC released its first National Corruption Perception Survey in which NHIF was mentioned and rated No. 18. The purpose of the study was to determine what corporate governance structure NHIF has put in place.

The study applied a descriptive research design approach. The study targeted all the employees drawn from the entire branch network of NHIF. A sample size of 151 respondents was selected from the target population through stratified and simple random sampling techniques. The study used questionnaires to collect primary data. Descriptive statistics and factor analysis techniques were the principal data analysis techniques. The results are presented using tables and charts.

The study established that NHIF has the necessary corporate governance structures in place i.e Board of directors, Audit Committees, Code of Conduct and a Tendering Committee. However, it was also noted that NHIF does not have a Directors Nomination and compensation Committee not to mention there is political influence in the decision-making process.

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LIST OF ACRONYMS

CEO	:	Chief Executive Officer
CCG	:	Centre for Corporate Governance
CMA	:	Capital Markets Authority
IFA	:	International Federation of Accountants
NHIF	:	National Hospital Insurance Fund
NSE	:	Nairobi Stock Exchange
PSCG	:	Private Sector Corporate Governance Trust
SEC	:	Securities Exchange Commission
SOE	:	State Owned Enterprises
SPSS	:	Statistical Package for Social Sciences
UK	:	United Kingdom
USA	:	United States of America

CHAPTER ONE

INTRODUCTION

Background to the study

In the past, corporate governance reforms have mainly concentrated on companies listed on the Nairobi Stock Exchange (NSE). However, as Yener (2001) notes, corporate governance is an essential tool to combat corruption, which is one of the major vices in State Owned Enterprises (SOE's). The researcher finds it essential therefore; to identify the responses of state owned enterprises to recent corporate governance reforms undertaken worldwide and in Kenya specifically, to gauge the level of acceptance of the principles of good governance and make recommendations on what needs to be done.

State Owned Enterprises (SOEs) generally known as parastatals, are partially or fully government owned and controlled corporations. According to IEA (1999), there are approximately 200 state owned enterprises in Kenya and they employ approximately 200,000 people. The government, in an attempt to ensure and acquire control of all productive assets formed the corporations to take up business and in the process, promote socialism and guarantee that the public derived maximum benefits from the resources after independence. The government felt that the citizens would reap benefits from such businesses if they were state owned. The primary objectives of the parastatals, according to a study carried out by IEA (1999) were; a desire to take hold of the economy, to promote a Kenya entrepreneurial class and to earn a share of the profit otherwise received by the private sector.

Over the years, parastatals have had their share of problems; they have been characterized by corruption and excessive interference in the management of the institution by the government. Poor planning and budgeting has also been a common feature between most SOE's. Poor management of SOE's affect all players within and beyond boundaries which led to; withdrawal of donor funding which has led to local borrowing, dilapidated infrastructure, relocation of investors, and increase in poverty levels.

Generally, Corporate Governance can be described as a process and structure used to direct and manage businesses, enhance shareholder value and ensure financial viability. According to Cadbury report, 1998 "Corporate governance is the system by which companies are directed and controlled." The main purpose of corporate governance is to build and strengthen Accountability, Credibility, Transparency, Integrity and Trust. Good corporate governance protects the interests of shareholders, employees, customers and the general public.

After independence, one of the government's commitments was to provide good health care to her citizens. To compliment this, NHIF was created in 1966 through an Act of parliament CAP 255, Laws of Kenya, to provide for a health contributory scheme for the employed. Since then NHIF has undergone various changes the latest being enactment of NHIF Act No 9 of 1998, whereby it became an autonomous state corporation with a broadened mandate.

The period between 1992/3 and 1994/5 were glaringly of abuse of the NHIF scheme. Reimbursements almost ate into all receipts (premiums collected) because of increased number of accredited healthcare providers, increased rebates and, more importantly, fraudulent claims from hospitals, individual members, coupled with the NHIF weak controls (Arasa and Njeru, 2004). The mandate and expectations of the current NHIF include Providing health cover to all population categories in Kenya from the formal and informal sector, making the scheme accessible and affordable to all, and offering in-patient and out-patient benefits to the beneficiaries.

In order to achieve these goals, NHIF is faced by the challenge of good corporate governance practice. During the recent launch of the Anti-graft plan (Daily Nation, July 6, 2006), KACC released its first National Corruption Perception Survey in which NHIF was rated No. 18. Though NHIF has adopted corporate governance practices, this is an indicator that the level at which corporate governance is practiced is still wanting. Good corporate governance practices can ensure reduction of corruption and promote accountability, integrity, credibility, transparency and trust.

Over the years, the fund has witnessed growth in various areas: daily rebates, contributions, memberships, branch network, and technology, decentralization of services and workforce, and improved corporate governance practices. Good health is vital to socio-economic development, given that it enables people to participate in economic, social and political development. It is also an important indicator of quality of life and major contributor to human capital. Improved health leads to improvement in life

expectancy and reduces production time wasted, thus resulting in economic development. The linkages of the health to poverty reduction and to long-term economic growth are powerful, much stronger than is generally understood (WHO,2001) Kenyans need a functional quality healthcare system and consequently, good corporate governance practices in the health sector will play a major role to achieve this goal This study will seek to establish what corporate governance structures NHIF as put in place.

1.2 Statement of the Problem

Corporate governance is an essential tool to combat corruption, which is one of the major vices in the public sector. To effectively fight the vice, both in the public and private sector, the government, the business community and civil society must work together to promote transparency, accountability and integrity in public organizations and in transactions between and among public and private sector players. Given the importance of good governance as enumerated above, it is imperative to study the governance structures of parastatals in Kenya with a view to establishing whether they are taking on board generally accepted principles of good corporate governance.

According to a report by Price Waterhousecoopers on global economic crime survey released in January 2006, economic crime is on the rise with asset misappropriation as the top candidate. This, the survey found out is the result of ongoing race for luxury and opulence in the corporate world. The report pointed an accusing finger at senior managers and board of directors as the leading perpetrators of economic crime (The Accountant, April 2006).

A study by the CCG found out that governance remains the biggest challenge to the success of corporations in Kenya, blaming it for the near collapse of key sectors of the economy including tea, coffee and sugar sub sectors. Investors too shied away from investing in an economy that is under-pinned by corruption, and underhand dealings (The Accountant, April 2006).

Karugor Gatamah, the CEO of CCG attributes economic stagnation that was experienced in the country in the 1990s to gross mismanagement of key sectors. He said in an interview, "We've moved away from the concept of reward for hard work to reward for connectedness". Gatamah says drive for good corporate governance is underpinned by evidence that, a high standard of corporate governance increases the rate of economic growth and ultimately improves general welfare. "Corporate governance equals increased business growth, more taxes to the government and increased employment in the economy" he says. The proposed study therefore intends to determine how recent corporate governance reforms undertaken in Kenya have impacted on corporate governance practices in NHHF, by seeking responses to the following questions;

- i) What corporate governance structures has NHHF put in place?
- ii) Does NHHF adhere to generally accepted principles of good corporate governance?
- iii) What corporate governance structures are wanting and what is NHHF doing to improve on them?

1.3 Objectives of the Study

To determine how recent corporate governance reforms undertaken in Kenya have impacted on corporate governance practices in NHIF. The study will seek to achieve the following specific objective;

- i) To establish what corporate governance structures has NHIF put in place.

1.4 Importance of the study

As Yener (2001) puts it, sound corporate governance is an essential pillar of holistic anti-corruption strategy; one that promotes integrity in both the public and private sectors. Effective corporate governance extends beyond the critically important task of preventing and deterring bribery of public officials. To successfully combat public and private sector corruption, which he defines as the abuse of a position of trust by an agent for private gain at the expense of the principal – the government, the business community and civil society must work together in promoting principles of good governance in the public sector which are transparency, accountability and integrity. At one point, parastatals in Kenya accounted for nearly 30% (by value) of the GDP of the country. Had corporate governance in these enterprises has had dramatic effects on welfare and economic growth.

The challenge of good corporate governance is more pronounced in public enterprises than in the private sector, due to the practice in the state enterprises where government delegates authority to ministers. The existence of multiple chains of command including parliament, ministers, boards and Chief Executive officers imposes an elaborate set of

relationships in the governance of state owned enterprises. The respective powers, roles and responsibilities of these players may result in greater management complexity in terms of stewardship than is the norm in the private sector. With the right positioning and leadership, internal audit function can provide objective opinions to the board and management on the organization's operations. Audit committees and the internal audit function are yet to be made mandatory for state owned enterprises. But even where established it is debatable whether audit committees perform the roles envisaged in the CMA guidelines.

The study will help in the deduction of what NIIIF has done so far to eradicate corruption and whether good governance is being embraced with meaningful results as far as achievement of goals are concerned both in the performance of its core business and the way it perceives itself. The corporate governance gaps will be identified and suggestions made on how best they can be bridged. The findings of this study can be utilized by other SOE's in identifying aspects of corporate governance that need attention.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

The Private Sector Governance Trust (1999) defines corporate governance as the manner in which the power of a corporation is exercised in the stewardship of the corporation's portfolio of assets and resources with the objective of maintaining and increasing shareholder value and satisfaction of other stakeholders in the context of its corporate mission.

World Bank (1994) defines governance in relation to government as the “practical exercise of power and authority by governments in the management of their affairs in general and of economic development in particular”. Good governance is an important concept for African Development and is related, first of all, to the necessity to create the basic extra-economic conditions that are important for the Growth of African economies. as for example, an effective public administration, a functioning legal framework, efficient regulatory structures, and transparent systems for financial and legal accountability. In this context, it is the issue of the quality of the public goods supplied at country-level that makes good governance such an important concept ADB (1994).

At its broadest, corporate governance encompasses the framework of rules, relationships, systems and processes within and by which fiduciary authority is exercised and controlled in corporations. Relevant rules include applicable laws of the land as well as internal rules

of a corporation. Relationships include those between related parties, the most important of which are the owners, managers, directors of the board (when such exists), regulatory authorities and to a lesser extent employees and the community at large. Systems and processes deal with matters such as delegation of authority, performance measures, assurance mechanism, reporting requirements and accountabilities.

Given the need for quality public services, it is not feasible that the parastatals with their myriad problems can deliver unless there is proper governance in the public corporations and the country has well functioning institutions, which will facilitate corrective mechanism. Such corrective mechanisms include movement of capital from areas where it is poorly utilized to where it will be well utilized. In attempt to give the citizenry quality services, there areas that should be addressed by good governance structures. Top on the list is defective capital structure; most of the SOEs were undercapitalized from the onset and a number of them ended up being wound up not long after commencing business. These include, Kenya Furfural, Kenya Fibre corporation and Synthetic Fibres among others. Others whose financial viability is at stake include Nzoia Sugar, Sony Sugar, Muhoroni Sugar, Kenya Railways, Kenya posts and Telecommunication and Kenya Power & Lighting Company. *IEA (1994)* when there is undercapitalization, even the little capital employed goes to waste and it is better off not to have undertaken the project at all.

Excessive bureaucratic control and intervention has contributed to poor performance by the organizations. The organizations are run through patronage and have large numbers of employees, most of who are not technically qualified to do their jobs. In this case, an

organization ends up paying staff that do not add value to the management of the institution.

Transparency, accountability and integrity are important indicators of good corporate governance structures in the public sector. At a glance, it is clear that these important indicators are lacking and the result has been poor performance.

Institutional development would dictate a clear separation of powers between the judiciary, the executive and the legislature. Tsumba (2002) points out, there is need to create an environment where stakeholders, citizens or other interested parties are assured that the "going on" are not detrimental to their own political and financial interests.

Institutional development will equally benefit the private investor. Corporate governance structures, as has been revealed by research worldwide, is important in the proper functioning of privately run institution, be they fully privately owned or having distributed ownership, such as the companies quoted at the Nairobi Stock Exchange.

In a past-unpublished research-Jebet (2002), the findings were that in all companies listed at the Nairobi Stock Exchange, the positions of the chairman and that of CEO are held by different persons. This is a notable finding since most countries have been struggling with the issue and it has been one of the corporate governance requirements that the two roles be separated.

Of the companies sampled, only 28% had formed Audit committees and only two of those made use of other committees. One of the two companies had a remuneration committee.

Though the Capital Market Authority required disclosure, most of the companies sampled did not disclose information on corporate governance on the face of their accounts. It seems then that disclosure is not mandatory and the shareholders do not even understand the need for disclosure. What is of note however, is the fact that over 30% of the companies quoted at the Nairobi Stock Exchange are not locally controlled.

It was found that most companies did not disclose how many of their directors were executive and how many were non-executive. For those that did, the distribution ranged from 83% to 40% non-executive directors in the board. The size of the Audit Committees also ranged from 3 to 9 persons.

The analysis of financial performance was not conclusive since there were differences in performance despite similarities in governance structure. This means that the Kenyan investor is indifferent to corporate governance and the market may not reward good corporate governance practices.

2.2 Parties to Corporate Governance

According to Cadbury2006, parties to corporate governance include the governing or regulatory body, the Chief Executive Officer, the board of directors, management and shareholders. Other stakeholders who take part include suppliers, employees, creditors, customers, and the community at large.

In corporations, the principal (shareholder) delegates decision rights to the agent (Manager) to act in the principal's best interests. This separation of ownership from control implies a loss effective control by shareholders over managerial decisions. Partly as a result of this separation between the main two main parties, a system of corporate governance controls is implemented to assist in aligning the incentives of managers with those shareholders, in order to limit the self-satisfying opportunities for managers. With the significant increase in equity holdings of institutional investors, there has been an opportunity for a reversal of the separation of ownership and control problems because ownership is not so diffuse (Clarke, 2004).

A board of directors often plays a key role in corporate governance. It is their responsibility to endorse the organization's strategy, develop directional policy, appoint, supervise and remunerate senior executives and to ensure accountability of the organization to its owners and authorities. Individuals may be members of the board of directors of multiple corporations.

All parties to corporate governance have an interest, whether direct or indirect, in the effective performance of the organization. Directors, workers and management receive salaries, benefits and reputation; whilst shareholders receive capital returns. Customers receive goods and services; suppliers receive compensation for their goods or services. In return these individuals provide value in the form of natural, human, social and other forms of capital (Cadbury , 1992).

A key factor in an individual's decision to participate in an organization (e.g. through providing financial capital or expertise or labor) is trust that they will receive a fair share of the organizational returns. If some parties are receiving more than their fair return (e.g. exorbitant executive remuneration), then participants may choose to not continue participating, potentially leading to organizational collapse (e.g. shareholders withholding their capital). Corporate governance is the key mechanism through which this trust is maintained across all stakeholders (Bolton and Roell, 2002).

2.3. Elements of Corporate Governance in the Public Sector

Figure 2.1 shows the separation of executive and legislative functions of government, whereby the government (legislature) provides the authority for the acquisition and use of resources to fund the overall public sector plan while the elected government (executive) is responsible for specific resourcing, planning, directing and controlling of public sector operations. The legislature has the right and responsibility to hold the government accountable for its management of public sector activities. One of the many ways it discharges this responsibility is through auditing and reporting by the legislated auditor (Barret , 2001).

Figure 2.1. Public sector accountability process



Source: International Federation of Accountants, *Corporate Governance in the Public Sector: A Governing Body Perspective*, July 2000.

Thus one element of governance in the public sector involves 'public governance' and includes the systems of accountability to ministers and in turn, parliament. This will often dictate the high-management structures of a public sector entity. Core mission, vision and objectives for public agencies are also often set at this level. It is fair to say that most agencies have put in place many of the elements of good corporate governance. These include corporate plans setting out corporate objectives and strategies; public sector values; business planning; audit committees; control structures, including risk management; performance assessment; and performance monitoring (including evaluation and review) (Narroccott, 2001).

Figure 2.2 presents this perception of corporate governance diagrammatically. It illustrates the inter-relationship between all the elements of governance and thus the need to integrate them effectively in order to achieve good governance. It also indicates the difficulty of balancing all these elements at any point in time, and over time, to provide the appropriate mix of conformance and performance (Barrett, 2004)

Figure 2.2: Elements of governance of public sector



Source: International Federation of Accountants, *Corporate Governance in the Public Sector: A Governing Body Perspective*, July 2000.

2.4. Key Steps to Enable Effective Corporate Governance

Through the findings of audits undertaken by the CMA, and by examination of corporate governance literature six main principles were identified that public sector entities must adhere to in order to effectively apply the elements of corporate governance to achieve better practice governance (Figure 2.3). Three of these elements- Leadership, integrity and commitment- relate to personal qualities of those in the organization. The other three elements- accountability, integration and transparency- are mainly a product of strategies, systems, policies and processes in place (Gekas, 2002).

Figure 2.3: Principles of good governance in public sector



Source: International Federation of Accountants, *Corporate Governance in the Public Sector: A Governing Body Perspective*, July 2000.

2.4.1 Leadership

Barrett,(2003) points out that, effective public sector governance requires leadership from the governing Board and/ or executive management of organizations. An effective framework requires clear identification and articulation of responsibility and a real understanding and appreciation of the various relationships between the organization's stakeholders and those who are entrusted to manage resources and deliver required outcomes. In the public sector, this necessitates lucid and unambiguous communication with the Minister and clearly stated government priorities

The CEO's role in government is fundamental. An indication of an Agency's effectiveness is the way in which the organization as a whole works together under the CEO's leadership. Executive management must also have a collective ability to provide leadership; to communicate a coherent set of governance principles throughout the agency; and to ensure the operation of the checks and balances which effective public sector governance demands. Public sector executives leading by example is perhaps the most effective way to encourage accountability and improve performance (Wilkins, 2001).

2.4.2. Commitment

Concern has been expressed that there has been more emphasis on the form rather than the substance of good corporate governance in both public and private sectors. Effective corporate governance is more than just putting in place structures, such as committees and

reporting mechanisms, to achieve desired results. Such structures are only a means for developing more credible corporate governance framework and are not ends in themselves. That is, corporate governance is not just about process as many critics are now observing. Better practice public sector governance requires a strong commitment by all participants to effectively implement all elements of corporate governance. An effective framework is very much people oriented, involving better communication; a more systematic approach to corporate management; a greater emphasis on corporate values and ethical conduct; risk management; relationship with citizens and clients; and quality service delivery (Clennel, 2000).

2.4.3. Integrity

Integrity is based on honesty and objectivity, as well as on high standards of propriety and probity in the stewardship of public funds and the management of an agency's affairs. It is dependent on the effectiveness of the control framework and on the personal standards and professionalism of the individuals within the agency. Integrity is reflected in the agency's decision-making practices and procedures and in the quality and credibility of its performance reporting (Barrett, 2003).

2.4.4 Accountability

The principles of corporate governance require those involved to identify and articulate their responsibilities and their relationships; consider who is responsible for what, to whom, and by when; acknowledge the relationship that exist between stakeholders and those that are entrusted to manage resources; and deliver required outcomes. It provides a

way forward to those, whether in the public or private sectors, who find themselves in somewhat different relationships than perhaps they've previously experienced. Hence, a clear understanding and appreciation of the roles and responsibilities of the relevant participants in the governance framework, importantly, those of responsible Minister(s), Board and CEO, are key components of sound accountability. The flip side is that the absence of these features weakens accountability and threatens the achievement of organizational objectives (Barrett, 2003).

2.4.5 Transparency

Openness, or equivalent transparency, is about providing stakeholders with complete confidence regarding the decision-making processes and actions of public sector agencies in managing their activities. Being open, through meaningful consultation with stakeholders and communication of complete, accurate and transparent information, leads to effective and timely action, thus enhancing the process of scrutiny. Such transparency is also essential to help ensure that public bodies are fully accountable and is therefore central to good governance overall (Gekas, 2002).

According to the International Federation of Accountants (2000):

Openness is more than structures and processes. It is also an attitude and belief amongst key players, politicians, public servants and other stakeholders that information is to be shared and is not owned by any particular entity – it is a public resource, just like public money or assets.

2.4.6 Integration

The real challenge is not simply to define the various elements of effective corporate governance but to ensure that they are holistically integrated into a coherent corporate approach by individual organizations and well understood and applied throughout those organizations. If implemented effectively, corporate governance should provide the integrated strategic management framework necessary to achieve the output and outcome performance standards required to fulfill organizational goals and objective (Clennel,2003).

2.5 Effectively Implementing Some Important Elements of Corporate Governance

2.5.1 Boards

CMA Act confers legislative responsibility only on a CEO for the efficient, effective and ethical use of resources. Therefore, in the absence of legislation to the contrary, boards established by Agency CEOs are only advisory, with the CEO retaining legislative responsibility for the administration of the agency. Many Budget-funded agencies have such Executive Boards, which nevertheless provide a cornerstone for building, or renewing, corporate governance of the agency. Further, some public sector entities do have a governing board to which the CEO is accountable. Despite legislative differences to the private sector, if public sector boards are to effectively support the CEO they must exhibit many of the attributes of effective private sector boards (CMA Act, 2002).

According to the corporate governance literature, there are four main sets of board attributes: composition, characteristics, structure and process. Board composition refers to the size of the board and the mix of director demographics. It includes the concept of board independence. Board characteristics encompass the directors' background, skills, training and experience. Board structure covers board organization, board committees and the role of subsidiary boards. Board process refers to the arrangement for boards' operations, including for example, the frequency and duration of meetings, succession planning and the evaluation of directors' performance (Moodie, 2001).

2.5.2 Composition of Boards

The literature on board performance places great weight on selecting appropriate directors and particularly in the private sector, the CEO. It also advocates choosing board members that are multi-skilled, experienced in a variety of business areas, prepared to update their knowledge, flexible, analytical and prepared to monitor and assess their individual or collective capabilities. In the private sector, it is common to have a mix of internal and external directors to complement the skills and perspectives of company executive members, and to provide greater independence from management (Moodie, 2001).

2.5.3 Performance of Boards

Directors need to assess, and contribute to, the effectiveness of the board. One effective mechanism is the implementation of a 'corporate governance health check', that is, formal annual boards review with the introduction of formal performance measures. There are advantages in using an independent facilitator to assist with this process. According to

Korn/Ferry international (2001), the five important criteria which board regard as essential for evaluating board performance, are:

- i) An understanding of the company's mission and strategic plan;
- ii) A comprehension of the organizations business;
- iii) A willingness to challenge management when required;
- iv) A willingness to appraise the chief executive; and
- v) The special expertise that board members have to add value to the company

2.5.4 Independence of Boards

Dunlop I, (2000) explains that an executive Board should ensure that the agency is conforming to legislation and government policies and achieving agreed outcomes. A major issue in carrying out the Executive Board's conformance function is independence- whether board members who are likely to be also managers can sensibly be expected to report openly on what is effectively their own management performance- and be seen to be doing so by those to whom they are accountable. The following four conditions that can materially assist boards in developing a culture that provides opportunity for both directors and management to feel comfortable when management positions are challenged:

- i) Strong board members who are independent of management, provided with appropriately diverse set of experiences, competencies, skills and judgment to the board;
- ii) Strong leadership within the board from an outside director;

- iii) A CEO who understands the role of the board and is openly supportive of building a health governance culture; and
- iv) Regular meetings of the outside directors without management to build relationships of confidence, and cohesion among themselves.

These characteristics are as important for public sector board as they are for those in private sector. Where there are deficiencies in the four conditions noted above, or in any other conditions that compromise the independence of the board, then appropriate actions should be taken to remedy them. It is important to be pro-active rather than re-active in such situations (Moodie, 2001).

2.5.5 Succession planning and other board issues

According to Barret.(2003), succession planning for the board is required just as it is for the chief executive and senior management. The trend towards shorter fixed terms has given structure to succession planning. If a board does actively plan for its own succession, there several benefits, as follows

- i) Matching the future configuration of the board with the strategic direction of the organization;
- ii) Regularly refreshing the board's membership;
- iii) Enhancing the depth of intellectual knowledge; and
- iv) Ensuring opportunities to target the new members will be better organized.

It is now being advocated that, to improve board performance, it is important that new board members should attend an induction program, while all board members undertake ongoing professional development. Continuing education and lifelong learning are as critical for directors as they are for anyone else in the organization.

An executive board should be concerned about both performance and conformance issues. If boards are to add value, they must involve themselves actively and regularly in the functions of strategic planning and risk management. Thus the board should be primarily responsible for strategic formulations, strategic analysis, developing agency strategies and internal policy-making. While the board should not be involved in operational management, it should initiate links across program, functional or business units and actively seek out opportunities for adding corporate value to the agency. As well, it should set the tone for the corporate culture (Johnson and Scholes, 2002).

In summary, the board's relationship to management is critical to health governance. It is a relationship that must continue to be maintained in a positive, complementary and supportive manner. What is required is a common (shared) appreciation by management and the board of their respective roles, a mutual respect for each party in carrying them out, continuing open dialogue and communication, and strong leadership within the board (Moodie, 2001).

2.6 Public sector challenges and issues that need to be resolved

2.6.1 Recent issues arising from audits of corporate governance

Audit reports over recent years have highlighted the value of corporate governance as a stimulus to performance and a constructive vehicle for self-assessment and review. In addition, there are some noteworthy areas and common themes where weaknesses may arise in public administration which agencies should take account of in their governance arrangements. All relate to core business of the public service, including:

- i) Mission and operational alignment;
- ii) Contract management;
- iii) Management (including performance) reporting;
- iv) Costing of services; and
- v) Internal control and good house keeping.

Audits confirm that it is not only the vision or plan that is critical to success but also their implementation. This requires senior management involvement and/or oversight to deliver the required results. Severe reputation damage can be sustained by poor administration in the public sector. It is, therefore, incumbent on all agencies to have in place appropriate mechanisms to continually assess operational performance and conformance with statutes and agency procedures (Barrett P, 2003).

2.6.2 Joined up or connected government

The UK Comptroller and Auditor General describes 'joined-up government' as the bringing together of a number of public, private and voluntary sector bodies to work across organizational boundaries towards a common goal. Joined-up government has lead

to an increasing complexity of relationships to deliver services traditionally provided by the public sector. The realization of Joined-up government services will require considerable cooperation across levels of government in order to deliver transparent, customer-focused solutions.

Delivering services under the joined-up arrangements raises the corporate governance 'bar' considerably, particularly in terms of 'joint' performance and results to be achieved. In any such arrangements, a clear governance framework and accountability and reporting arrangements, which clearly define roles and responsibilities of the various participants are essential (Barrett,2003).

2.6.3 Broader responsibility- Triple Bottom Line reporting

Dawson,(2002) explains that a broad view of responsibility of business and government organizations is that it is accountable to a large body of stakeholders, rather than just shareholders (for corporate) or the parliament (for government entities). This broad view of organizational responsibility and accountability forms the basis for the concept of triple bottom line reporting, that incorporates economic, social and environmental performance considerations. The definition of 'triple bottom line' has recently been expanded to include governance issues.

More specifically, a corporate sense of social responsibility dictates that business and government organizations are responsible to all stakeholders, employees, local community, customers, suppliers, business partners, government and the environment.

2.6.4 Electronic government: records management and other e-systems

What is e-government? Most definitions associate e-government with the use of Internet as a vehicle to deliver government services to citizens and to interact with the business community. Australia's Government Online Program, administered by the National Office for the Information Economy, recognizes that: Getting Government Online is a natural and important step in the development of government and community interaction. The government must develop more and better services online- integrated services that break down the barriers of government structure and jurisdiction, and services that meet the real needs of individuals and business (The Economist, 2000).

The move towards e-systems has had its impact on changing governance frameworks. The delivery of services via the Internet introduces new risks and exposures that can also result in a legal liability for government. Transacting business in the electronic environment, whether acting as an individual agency or in partnership with the private sector or other government agencies, also raises the issue of record keeping, and particularly the provision and maintenance of electronic records (Barrett, 2003).

2.6.5 Audit committees and audit independence

Many recent corporate collapses (Especially Enron and locally Uchumi) have stimulated debate about the role of audit committees and the independence of auditors.

2.6.5.1 Audit committees

According to Hunt and Carey (2001), an effective audit, as a crucial component of corporate governance, provides a complementary vehicle for implementing relevant control systems incorporating sound risk management plans. The internal auditing function of an organization plays an important role in this respect by examining and reporting on control structures and risk exposures and on the agency's risk management efforts to the agency governance team. An effective audit committee can also improve communication and coordination between management and internal as well external audit, and strengthen internal control frameworks and structures to assist CEOs and boards meet their statutory and fiduciary duties.

An audit committee's strength is its demonstrated independence and power to seek explanations and information, as well as its understanding of the various accountability relationships and their impact, particularly on financial performance. In particular, it can ensure that accepted audit recommendations are followed up and properly actioned, which greatly improves both internal and external audit effectiveness (Barrett P, 2003).

The CEO or the board of an organization, as well as senior management, is responsible for devising and maintaining the control structure. In carrying out this responsibility, management should review the adequacy of internal controls on a regular basis to ensure that all key controls are operating effectively and are appropriate for achieving corporate goals and objectives. This is an obviously an area of significant interest to audit and one

where it can work positively with the audit committee to achieve greater organization effectiveness.

Questions about possible conflicts of interest, audit rotation and selection of auditors are central to the roles and responsibilities of audit committees as part of the corporate governance framework. One challenge is therefore how to strengthen those roles to enhance their effectiveness and credibility in the eyes of both internal and external stakeholders. As with board of management, it is important that audit committees select appropriately qualified members and rotate them on a regular, on-going basis. According to Hunt & Carey (2001), essentials of an audit committee member include common sense, wide experience, good judgment, a general understanding of the role of an audit committee, healthy skepticism, an ability and willingness to ask difficult questions that challenge management's actions and not to put up with unintelligible "techno speak".

There is a growing level of opinion that audit committee directors, chairs and the auditors themselves should only be allowed to serve for a specified period of time. While this may require extensive learning for new appointees, it would allay concerns about these audit representatives getting too close to management over a period of years and threatening their objectivity. Recent discussions involving Ernst & Young (2002) provided a view that:

Rotation of audit partners every seven years was seen as more appropriate than legislated rotation of audit firms

2.6.5.2 Audit independence

The major challenge for public sector audit committee is the appointment or termination of senior internal audit staff and ensuring that the function remains independent of the activities of the company. Many internal audit functions in state-owned enterprises report to the CEO and not to the audit committees in addition to being involved in the processing of transactions, actions which compromise their independence. It is recommended that government makes it policy for all state-owned enterprises to enterprises to establish audit committees and internal audit functions in accordance with the guideline stipulated by the CMA (CMA Act, 2002).

A critical component of the ethical conduct of auditors is that they remain sufficiently independent in fact and in perception, to provide an unbiased and hence credible audit opinion. In order for the audit report to carry any weight, the auditor must have the freedom to perform the audit, report findings and express an opinion free from external influence. It is important to note that external auditors are not accountable to management. Moreover, audit committees need to be fully supportive of audit independence and be prepared to work constructively and openly with them. This involves, inter alia, full, frank and timely discussion of all material issues and ensuring the full cooperation of management (Johnson and Scholes, 2002).

2.6.5.3 Factors affecting audit independence

The Securities Exchange Commission (SEC) in the USA has recognized the need to modernize the rules for determining whether an auditor is independent. Similarly, Blake Dawson Waldron (2002), in its Corporate Governance Update noted that:

Lack of independence is a slippery concept, and legal independence does not always equate with real independence

In February last year, the SEC released a final ruling on the requirements for auditor independence. Taking on board this guidance, Blake Dawson Waldron (2002) noted a number of relationships that mean an auditor is not independent, including: an organization employs a current auditor or employee of an auditor, an organization employs certain (immediate) relatives of the auditor, an organization employs a former auditor or employee of the auditor; a retired audit partner joins the board of the organization, Audit firm employs a former employee of the organization it audits, an employees of an organization received remuneration from its audit firm, Audit firm invests in an organization it audits, or where there are loans between an organization and the audit firm.

It is important to note that pricewaterhousecoopers has recently formed an independent board to oversee the firm's audit standards, quality and independence, in a major new development for the accounting profession (Ramsay, 2001)

2.7 Theories and Models of Corporate Governance

Letza(2002) explains that the current debate on corporate governance has been 'polarized' between, on one hand, the shareholding paradigm (distributed ownership) and, on the

other hand, the stakeholding paradigm (concentrated ownership). Letza(2002) has summarized the two by grouping the main theories and models of corporate governance into either the shareholding camp or the stockholding camp according to their mutually exclusive proposition and assertions.

2.7.1 Shareholding perspective

The shareholder model is common in the US and Britain and is characterized by distributed ownership, with majority of the shares held by individuals. The various theories under this perspective are:

2.7.1.1 Inherent Property Rights Theory

The Inherent property rights concept is based on the view that private ownership is fundamental to a desirable social order and to the development of an efficient economy. Thus, the assumption is that private ownership rights are inviolable in any way. The 'inherence' perspective was developed during the seventeenth and eighteenth centuries in corporate law theory. Letza(2002) points out that it was assumed that the right to incorporate is inherent in the right to own property and write contracts, and corporations should be regarded as legal extensions of their owners. This theory has further developed to a stage where the corporation is viewed as a separate legal entity, which can own property, have rights and obligations. The directors and managers are therefore viewed as agents of the shareholders and have fiduciary duty to the shareholders.

According to Letza (2002) corporate governance is maintained through enhanced accountability of the company to shareholders. This could be done either through effective internal monitoring such as shareholder voting rights, independent non-executive directors, and information disclosure to shareholders, or through the market for corporate control.

2.7.1.2 Agency theory

Agency theory can be traced back to Adam Smith. Letza (2002) explains the basis of the theory as the assumption that individuals have a desire to maximize their own utility. The agency theory asserts that managers as agents will not always act in the best interest of the shareholders and may pursue their own interest at the expense of the shareholders.

This theory is associated with the agency costs. It is assumed that if the agent is being watched, the agent will act better for the welfare of the principal. The shareholder therefore observes the behavior of the agent (through auditors) and the outcome of the behavior in the form of firm profitability.

2.7.1.3 Stewardship Theory

The stewardship theory is based on the assumption that managers are good stewards of the corporation. Letza (2002) explains that, according to the theory, managers have a wide range of motives beyond a simple self-interest, this includes achievement, recognition and responsibility needs, the intrinsic satisfaction and pleasure of successful performance.

respect for authority, social status and work ethics. Thus the separation of ownership from control does not inherently lead to goal and interest conflict between shareholders and managers. The separation actually promotes the development of managerial profession, which is certainly beneficial for corporate performance and shareholder wealth. In this regard, empowering managers to exercise an encumbered authority and responsibility is necessary for the maximization of corporate profits and shareholders' value.

2.7.1.4 The finance Model

Letza (2002) notes that a financial economic theorem assumes that the share price today fully reflects the market value of all future profits and growth that will accrue to the company. Believing in this assumption, the advocates of the finance model hold that the shareholders' interests are best served by maximizing share price in the short run. The share price is an indicator of corporate performance and the stock market is the only objective evaluation of management performance. If a firm under-performs, its share price will be lower, which provides a chance for outsiders to buy the firm's stock and run the firm more efficiently in order to earn a larger reward. The threat of a takeover provides management with an incentive to make efforts to perform better and maximize shareholders' return in order to make their firm bid-proof.

Supporters of the finance model argue that corporate governance failures are best addressed by removing restrictions on factor markets and the market for corporate control (Lama, 1998)

2.7.1.5 The Myopic Market Model

Letza (2002) points out that the Myopic market model share a common view with the agency theory, the view is that the corporation should serve shareholders' interests only. However, the model criticizes the Anglo-American model of corporate governance as being fundamentally flawed by been overly concerned with short-term interest, short-term return on investment, short term corporate profits, short-term management performance, short-term stock market prices and short-term expenditures, due to huge market pressures. This model argues that the current corporate governance systems encourage managers to focus on short term performance by sacrificing long-term value and competitive capacity of the corporation (c.g. Sykes, 1994; Moreland,1995).

The Myopic market model contends that corporate governance reforms should encourage shareholders and managers to share long-term performance horizons.

2.7.2 Stake holding Perspective

The stakeholder model is common in the Japan and the other eastern countries. It is characterized by concentrated ownership, with majority of the shares held by families, other companies and government.

2.7.2.1 Social Entity Theory

The Social entity concept of the corporation is directly at odds with inherent property rights, but as a public association constituted through political and legal process and as a social entity for pursuing collective goals with public obligations (Gamble and Kelly,2001). This perspective is primarily associated with communism theories that view

the corporation as a political tool for social purposes (Dine,2000) and the communitarian view of property conditionality which argues that individual property rights are conditioned and restrained in a social context and in community(Warren, 2000).

Corporations are granted by the state to the individual not only as an economic entity for a commercial purpose, but more importantly, as a social entity for general community needs. The corporation has a collective, rather than individual entity and executives are representatives and guardians of all corporate stakeholders' interests (Hall, 1989). This theory prefers to resolve disputes, conflicts of interests, overcome market failures and reduce transaction costs by nationalizing corporations or by using legal intervention within a public law frame work and improving the system of checks and balances (Millon, 1990).

2.7.2.2 The Pluralistic Model

The pluralistic model supports the idea of multiple interests of stakeholders, rather than shareholder interest alone. It argues that the corporation should serve and accommodate wider stakeholder interests in order to make the corporation more efficient and more legitimate.

2.7.2.3 The Trusteeship Model

The trusteeship Model differs from the agency model in two ways. First, the fiduciary duty of the trustees is to sustain the corporation's assets, including not only the shareholders' wealth, but also broader stakeholders' value such as the skills of employees,

the expectations of customers and suppliers, and the company's reputation in the community (Vinten 2001).

Managers as trustees are to promote the broader interest of the corporation as a whole, not solely the financial interest of its shareholders. Secondly, managers have to balance the conflicting interests of current stakeholders and future stakeholders and to develop the company's capacities in a long-term perspective rather than focus on short-term shareholder gains. To establish trusteeship model, they ask for statutory changes in corporate governance, such as changing the current statutory duties of the directors, ensuring the power of independent directors to nominate directors and select senior managers and appoint CEOs for fixed four-year term, etc.

None of the models listed above fits the public sector governance structures. Identifying the most suitable model or alternatively crafting a suitable model from available theories by picking the best practice in each classification could help in designing the corporate governance structures that will encourage best practice in SOE's management

2.8 Capital Markets Authority Rules in Kenya

The Capital Markets Authority Act, cap 485A (2002) has developed guidelines for good corporate governance practices by publicly listed companies in Kenya in response to the growing importance of governance issues both in emerging and developing economies and for promoting growth in domestic and regional capital markets. It is also in

recognition of the role of good governance in corporate performance, capital formation and maximization of shareholders value as well as protection of investors' rights.

The Act defines corporate governance, as the process and structures used to direct and manage business affairs of the company towards enhancing propensity and corporate accounting with the ultimate objective of realizing shareholders long-term value while taking into account the interest of other stakeholders (CCG Report 2003).

The Authority, in developing these guidelines has adopted both a prescriptive and non-prescriptive approach in order to provide for flexibility and innovative dynamism to corporate governance practices by public listed companies.

The Act covers the roles and obligation of the various players in a corporate entity, which includes Directors, Chairman of the Board, The Chief Executive and shareholders.

It prescribes best practices by public listed companies and expects directors of every public listed company to undertake or commit themselves to adopt good corporate governance practices as part of their continuing listing obligations.

It is notable that the guidelines only cover listed companies, which are a total of 49 companies in the various sectors. This is a very small proportion of total companies operating in Kenya and only equal to approximately 25% of the parastatals operating in

Kenya Given the above scenario, it means that the guidelines issued by CMA should be extended to cover other organizations (CMA Guidelines, 2002).

2.9 Principles for Corporate Governance In Kenya

According to CCG, the key elements of good corporate governance principles include honesty, trust and integrity, openness, performance orientation, responsibility and accountability, mutual respect and commitment to the organization.

Of importance is how directors and management develop a model of governance that aligns the values of the corporate participants and then evaluate this model periodically for its effectiveness. In particular, senior executives should conduct themselves honestly and ethically, especially concerning actual or apparent conflicts of interests, and disclosure in financial reports.

In Kenya, these principles have been compiled in a document authored by the Private Sector Corporate Governance Trust, which is currently known as Center for Corporate Governance. This was a good start, but the initiative has not been very well supported. The center for corporate governance is a non-governmental organization without a wide mandate. It has done exemplary work given the constraints. The organization has recommended the principles of best practice but cannot ensure compliance.

The principles, though modeled around those of the combined code, need updating to keep in touch with changes taking place elsewhere. We need to re-evaluate the recommended practice and see if it has stood the test of time and if it is applicable to the Kenyan

situation. Kenya needs to, identify a benchmark against which to model the best practice and identify the best method, to ensure compliance to best practice. In this case, the decision should either be for legislating or developing other means of enforcement like creating watchdog bodies.

2.10 Corporate Governance Practices in the Private Sector Vis A Vis The Public Sector

The above literature deals mainly with the private sector, whereby the emphasis is on the role, structure and rules relating to boards of directors, especially in their accountability relationships, with shareholders in ensuring the organization's financial performance. However, Pat Barret (2003) notes that the public sector governance is a broader concept, driven by the breadth and complexity of the powers and responsibilities of public institutions and multiple levels of accountability. In emphasizing the diversity that the public sector is faced with, a proposed study by IFAC.(2000) notes that its not possible to develop one framework and one set of recommendations of corporate governance that would be applicable to all public sector entities, but similar principles nevertheless apply whether the controlling body is elected or appointed. In particular, public sector entities have to satisfy a complex range of political, economic and social objectives, which subject them to a different set of external constraints. They are also subject to forms of accountability to various stakeholders, which are different to those that a company in the private sector has to its shareholders, customer's e.t.c. The stakeholders in the public sector may include the ministers, other government officials, electorate (parliament),

customers and clients and the general public, each with legitimate interest in public sector entities, but not necessarily with any "ownership rights".

Barret,(2003) gives four key attributes of good governance, which he believes are more important in the public sector, than the financial performance and shareholder value. These attributes are; Transparency, Integrity, Accountability and stewardship.

Transparency means been open through meaningful consultation with stakeholders and communication of full accurate and clear information. Integrity is based on honesty, objectivity, high standards of propriety, probity in the stewardship of public resources and management of the entity's affairs. Accountability as defined by Barret,(2003) is the process through which, the public sector entities and the individuals within them are responsible for their own decisions and actions and submit themselves to appropriate external scrutiny. Stewardship is the knowledge that the resources under the management of individuals in the public sector belong to the public and the role of the managers is mainly that of being stewards and hence, exercises their powers on behalf of a wider stakeholder, the Nation.

In trying to determine factors affecting good corporate governance practices in the public sector, one parastatal will be chosen, NIIIF. Her systems operations, activities, policies and organizational behavior compared vis a vis her general performance. The findings will be studied, summarized and analyzed and inferences drawn.

CHAPTER THREE

RESEARCH METHODOLOGY

3.0 Introduction

This chapter details the approach used in this project. This includes the population, the sample, type of data collected, method of data collection, and also the data analysis procedures employed. Data editing and validation procedures are mentioned.

3.1 Research design

The study was a descriptive study that aimed at establishing what corporate governance structures that NHIF has put in place. Descriptive research determines and reports the way things are (Gay, 1981). This approach is appropriate to this study since the study will involve fact-finding and enquiries of different kind to describe the state of affairs, as they exist at present. To effectively achieve this objective, the study will use both quantitative and qualitative approaches. The use of the two approaches combined reinforces each other (Kiggundu et al., 1993).

3.2 Target respondents.

Mugenda et al. (2003) has defined target population as the set of individuals, cases or objects with some common observable characteristics, which a researcher wants to generalize the results of the study. The researcher targets NHIF board members, managers and employees of NHIF in head office and all her branches countrywide. This population was chosen because they are involved directly in the operations of NHIF.

Table 3.1: Distribution of the Target Population

LEVEL OF MANAGEMENT	POTENTIAL NO. OF RESPONDENTS
BOD	15
MANAGERS	70
OTHER STAFF	1408
TOTAL	1493

Source: NHIF Human Resource Department (2006)

3.3 Sample Design

A sample size of 151 respondents was selected from the target population through Stratified random and simple random sampling techniques. The levels of management were treated as strata from which random samples of 10% of the stratum total was drawn through simple random sampling technique. Table 3.2 is a tabulation showing how the sample will be derived.

Table 3.2: The sampling matrix

LEVEL OF MANAGEMENT	Sample Size (10%)
BOD	2
MANAGERS	8
OTHER STAFF	141
TOTAL	151

3.4. Data collection

Relevant data was collected through the use of questionnaires. The questionnaires consisted of both open-ended and closed questions covering mainly the corporate governance structures put in place by NHIF. Sections 1 & 2, aimed at gathering background information on NHIF's operations and organizational behavior. Section 3, 4 & 5 covered board issues, audit committees and corporate governance challenges respectively. Open-ended questions permitted free responses from the respondents without providing or suggesting any structure for the replies. The closed questions enabled responses of the respondents to be limited to stated alternatives. The questionnaire was administered using the drop and pick method, follow-up were made through phone calls to ensure that the questionnaire were filled out.

3.5 Data analysis

After the fieldwork, before analysis, all the questionnaires were adequately checked for completeness. This was done through scrutiny so to minimize the variations due to missing responses, multiple entries and blank questionnaires. The data was coded and entered into a spread sheet and analyzed using both qualitative and quantitative techniques. Using qualitative technique, information gathered was studied and patterns, trends and relationships were established. Factor analysis was used to identify the most prominent factors that explain corporate structures and practices. Frequencies and percentages have also been used to analyze data. The findings have been presented using Tables and Charts.

CHAPTER FOUR

DATA ANALYSIS AND PRESENTATION

4.1 Introduction

This chapter presents data analysis on corporate governance structures in NHIF, interpretation and discussion of the research findings.

4.2 Demographic characteristics of the sample

The total response was 140 respondents. This represented a response rate of 92.7%. Table 4.1 shows the split responses regarding the experience of the respondents at NHIF. The findings indicate that majority of the respondents interviewed (54.3%) had worked for NHIF for a period of 1 to 5 years. This is a good indicator that majority of the respondents are conversant with the operations of NHIF and can comment authoritatively on issues regarding corporate governance in the organization.

Table 4.1 Duration of working at NHIF (in years)

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Less than 1 year	17	12.1	12.1	12.1
	1 - 5 Years	76	54.3	54.3	66.4
	6 - 9 Years	41	29.3	29.3	95.7
	Over 10 Years	6	4.3	4.3	100.0
	Total	140	100.0	100.0	

SOURCE: Researcher (2007)

4.3 Operations and Organizational Behavior

Principles of corporate governance require those involved to identify and articulate their responsibilities. Hence, a clear understanding of the roles and responsibilities of the relevant participants in the governance framework, importantly, those of the responsible

Minister, Board and CEO, are key components of sound accountability. The flipside is that the absence of these features weakens accountability and threatens the achievement of organizational objectives. Table 4.2 shows the split respondents regarding whether there are clear lines of responsibility and accountability in NIIIF. The findings indicate that, majority of the staff 87.1% agree that there are clear lines of responsibility and accountability. This is a strong indicator of good corporate governance practice.

Table 4.2: Clear lines of Responsibility and Accountability

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Yes	122	87.1	87.1	87.1
	No	18	12.9	12.9	100.0
	Total	140	100.0	100.0	

SOURCE: Researcher (2007)

4.4 The Board

4.4.1 Size and Term of board

According to the Basel Guidelines on corporate governance, the number of board members should be significant, independent and Directors should not serve for a protracted time period. The findings indicate that there are 15 board members and 91.4% of respondents, as presented on Table 4.3, concurring that the board has a fixed term of 3 years. The findings also indicate 91.4% of respondents believe that the board of Directors is diversified. This compares favorably with a study by Ann-Maree Moodie (2000) which makes the point that Board diversity enriches a board with alternative perspectives. She also established that on average organizations have 13 board members with a term of 3 years.

Table 4.3: Board term and Diversification

Term		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Yes	128	91.4	91.4	91.4
	No	12	8.6	8.6	100.0
	Total	140	100.0	100.0	
Diversification		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Yes	128	91.4	91.4	91.4
	No	12	8.6	8.6	100.0
	Total	140	100.0	100.0	

SOURCE: Researcher (2007)

4.4.2 Board Members Educational Qualification

Board should recognize the need for members to be able to strengthen their governance skills in light of technological developments, changing corporate environment and other variables. This calls for minimum educational qualification with a clear understanding of principles of good corporate governance. A question was posed to find out whether board members educational qualification influenced board performance. The findings on Table 4.4 show that a big number of respondents indicated that level of education is most significant. This is in agreement with recommendations by the Centre for Corporate Governance and in tandem with other requirements; understanding the financial structure of the organization, the relevant sector and communication with fellow Board members, CFO and Shareholders.

Table 4.4: Board Member's Educational qualification

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Not Significant	5	3.6	3.7	3.7
	fairly Significant	40	28.6	29.9	33.6
	Significant	30	21.4	22.4	56.0
	Most Significant	59	42.1	44.0	100.0
	Total	134	95.7	100.0	
Missing	System	6	4.3		
Total		140	100.0		

SOURCE: Researcher (2007)

4.4.3 Board Members Professional Qualifications

According to private Sector Corporate Governance Trust, the board should recognize and encourage professional development and, and both collectively and individually, have the right to consult the corporation's professional advisers and, where necessary, seek independent professional advice at the corporation's expense in the furtherance of their duties as directors. According to findings in Table 4.5, majority of the respondents are for the view that Board members professional qualifications are significant. The successful dynamics of a board depends on a combination of professional skills. This helps them make informed, independent and astute decisions on issues relevant to the corporation.

Table 4.5: Board Members Professional qualification

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Not Significant at all	6	4.3	4.5	4.5
	Not Significant	5	3.6	3.7	8.2
	Fairly Significant	35	25.0	26.1	34.3
	Significant	53	37.9	39.6	73.9
	Most Significant	35	25.0	26.1	100.0
	Total	134	95.7	100.0	
Missing	System	6	4.3		
Total		140	100.0		

SOURCE: Researcher (2007)

4.4.4 Board Members Experience at Board level

Experienced board members are more conversant with duties and responsibilities of Directors and in general corporate governance practices. Induction, development and strengthening of skills of experienced board members take less time. The findings on Table 4.6 show that 35.1%, which was the highest percentage, the Board Members experience at board level was most significant. This implies that appointing experienced board member in NIIF board would remarkably improve good corporate governance practice.

Table 4.6: Board member's Experience at Board level

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Not Significant at all	11	7.9	8.2	8.2
	Not Significant	23	16.4	17.2	25.4
	Fairly Significant	35	25.0	26.1	51.5
	Significant	18	12.9	13.4	64.9
	Most Significant	47	33.8	35.1	100.0
	Total	134	95.7	100.0	
Missing	System	6	4.3		
Total		140	100.0		

SOURCE: Researcher (2007)

4.4.5 Independence of the Board

According to the CCG, the independence of the board is fundamental to its stewardship role and to its effectiveness. The role of the board is to act in the best interests of an organization and stakeholders as it supervises all aspects of the management of the organization. Table 4.7 findings on the independence of the Board Members. The findings indicate that an overwhelming 78% of respondents agree that the Boards independence is most Significant. This is backed by a study by the Canadian Joint Committee on Corporate Governance whose findings support a strong independent board. Independence of the board is a strong pillar of corporate governance. However, a study by Bagahat and Black (2002) found that companies with more independent board do not perform better than other companies.

Table 4.7: Independence of the Board Members

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Not Significant at all	6	4.3	4.5	4.5
	Not Significant	17	12.1	12.7	17.2
	Fairly Significant	17	12.1	12.7	29.9
	Significant	16	11.4	11.9	41.8
	Most Significant	78	55.7	58.2	100.0
	Total	134	95.7	100.0	
Missing	System	6	4.3		
Total		140	100.0		

SOURCE: Researcher (2007)

4.4.6 Significance of the Board Size

The board shall include a balance of executive and non-executive directors such that no individual or group of individuals or interests can dominate its decision making.

Table 4.8 shows the significance of the size of the Board on its performance. 40% of the respondents indicated the size of the board members as most significant. This is

an indication that the respondents did not place a lot of weight on the board size contrary to principles of good corporate governance practice.

Table 4.8: Size of the Board

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Not Significant at all	23	16.4	18.9	18.9
	Not Significant	24	17.1	19.7	38.5
	Fairly Significant	12	8.6	9.8	48.4
	Significant	23	16.4	18.9	67.2
	Most Significant	40	28.8	32.8	100.0
	Total	122	87.1	100.0	
Missing	System	18	12.9		
Total		140	100.0		

SOURCE: Researcher (2007)

4.4.7 Appointments

PSCG requires that appointments to the board of directors should, through a managed and effective process, ensure that a balanced mix of proficient individuals is made and that each of those appointed is able to add value and bring independent judgment to bear on the decision making process. Table 4.9 shows responses regarding how the Board members, Chairman and the CEO are appointed. The findings show that they are appointed directly by the president or the minister. In addition, the findings indicate that a small number of the respondents are of the view that the Board members, Chairman and CEO are appointed through recruitment. Presidential or ministerial appointments may not be objective and decision making may be affected and this compromises good corporate governance practice.

Table 4.9: Appointment of Board members, Chairman and CEO

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Direct	117	83.6	87.3	87.3
	Presidential Recruitment	6	4.3	4.5	91.8
	None of the Above	11	7.9	8.2	100.0
	Total	134	95.7	100.0	
Missing	System	6	4.3		
Total		140	100.0		

SOURCE: Researcher (2007)

4.4.8 Influence of Boards decision making process

The board should ensure that the agency is conforming to governance practices, accounting and auditing standards, legislation and government policies and achieve agreed outcomes. Notwithstanding, this should not interfere with the board independence. Table 4.10 shows responses regarding the influence of Management, CEO and The Minister on decision making of the Board. The findings indicate that the Management, the CEO and The Minister respectively influence the Boards decision making. The Centre of Corporate Governance recommends that the board be free from any influence in its decision making. The board of directors should function in partnership with, but importantly, independent of executive management.

Table 4.10: Influence on the decision making of the Board

	Frequency		Percent
Management	Yes	110	82.1
	No	24	17.9
CEO	Yes	128	95.5
	No	6	4.5
Minister	Yes	126	91.4
	No	12	8.6

SOURCE: Researcher (2007)

4.4.9 Board Succession Plan

It is recommended by the CCG that a succession plan is in place for the chairperson, Chief Executive Officer Board members and senior management and is reviewed regularly. If a board does actively plan for its own succession, one of the key benefits is healthy governance. Table 4.11 shows findings on whether there is a succession plan for the board. The findings established that there is no succession planning for the NHHF board. This is a contravention of the principles of good corporate governance practice.

Table 4.11: Succession planning for the Board

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Yes	18	12.9	14.8	14.8
	No	104	74.3	85.2	100.0
	Total	122	87.1	100.0	
Missing	System	18	12.9		
Total		140	100.0		

SOURCE: Researcher (2007)

4.5 Elements of Good Corporate Governance

Through the findings of audits undertaken by the CMA, and by examination of corporate governance literature, five main principles were identified that public sector entities must adhere to effectively apply the elements of corporate governance to achieve better practice. A question was posed to find out which of the various elements of good corporate governance were of concern in NHIF. Mean scores was used to measure the relative importance of each of the performance factors. Standard deviation was also used to a measure how spread out the distribution was, thus the variability. It is calculated as the square root of the variance, where variance is the average squared of each number of the mean. Table 4.12 shows the respondents mean and standard on various elements of good corporate governance. All the elements had a coefficient of variation less than less than one (CV<1) which means a less spread variance. Transparency had the least CV of 0.2688 which means the operations of the organization are seen to be most transparent.

Table 4.12 Elements of good corporate governance

	N	Minimum	Maximum	Mean	Std. Deviation
Transparency	128	1	2	1.09	.293
Accountability	128	1	2	1.32	.468
Leadership	122	1	2	1.32	.468
Integrity	122	1	2	1.34	.474
Commitment	122	1	2	1.33	.471
Valid N (listwise)	122				

SOURCE: Researcher (2007)

4.6 Audit Committees

According to Hunt and Carey (2001), an effective audit, as a crucial component of corporate governance, provides a complimentary vehicle for implementing relevant control systems incorporating sound risk management plans. Further, the board shall establish an Audit Committee to keep under review the scope and results of audit, its effectiveness and the independence and objectivity of the auditors. Table 4.13 shows responds on whether there are Audit committees in NIIIF. The findings show that there are audit committees in NIIIF. Effective audit committees enhance communication and coordination between management and internal as well as external audit, and strengthen internal frameworks and structures and ultimately good governance.

Table 4.13: Audit Committees

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Yes	128	91.4	95.5	95.5
	No	8	4.3	4.5	100.0
	Total	134	95.7	100.0	
Missing	System	8	4.3		
Total		140	100.0		

SOURCE: Researcher (2007)

Findings in Table 4.14 show that 62.7% of respondents said that the Audit committees are both external and internal and 66.3% indicated the committees are independent. These results are in tandem with CCG requirements that an audit committee's strength is its demonstrated independence. Establishment of both internal and external audit committees enables board directors to contribute an independent judgment and play a positive role in the organization.

Table 4.14: Internal or External Committee

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Internal	34	24.3	27.9	27.9
	External	6	4.3	4.9	32.8
	Both	82	58.6	67.2	100.0
	Total	122	87.1	100.0	
Missing	System	18	12.9		
Total		140	100.0		

SOURCE: Researcher (2007)

4.7 Knowledge of Corporate Governance

Senior management is responsible for setting up corporate governance structures and enforcing good governance structures. The findings in Table 15 indicate that the CEO and Senior Management are most knowledgeable about corporate governance. This is in order with recommendation by the Centre for Corporate Governance but in addition, this should trickle down to other levels of management.

Table 4.15: Level of Management knowledgeable about Corporate Governance

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	CEO and Senior Mgt	87	62.1	64.9	64.9
	Middle Level Managers	41	29.3	30.6	95.5
	Other Staff	6	4.3	4.5	100.0
	Total	134	95.7	100.0	
Missing	System	6	4.3		
Total		140	100.0		

SOURCE: Researcher (2007)

4.8 Directors Nomination Committee

According to the PSCG, appointments to the Board of Directors should, through a managed and effective process, ensure that a balanced mix of proficient individuals is made and that a nomination committee shall be established for this purpose. Table 4.16 presents responses on whether there is a Directors Nomination Committee in

NHIF. The findings indicate that NHIF does not have in place a Directors nomination committee. This is against the principles of good corporate governance principles.

Table 4.16: Directors Nomination Committee

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Yes	30	21.4	25.9	25.9
	No	80	57.1	69.0	94.8
	3	8	4.3	6.2	100.0
	Total	118	82.9	100.0	
Missing	System	24	17.1		
Total		140	100.0		

SOURCE: Researcher (2007)

4.9 Directors Compensation Committee

CCG recommends that in order to avoid conflict of interest, the Board of directors shall set up an independent remuneration committee to determine the remuneration of respective individual executive directors. The committee shall make a report to shareholders every year. Findings in Table 4.17 present data on the presence of Directors compensation committee. The findings established that there is no Directors compensation committee in NHIF. This jeopardizes the principles of good corporate governance.

Table 4.17: Directors Compensation Committee

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Yes	24	17.1	20.7	20.7
	No	92	65.7	79.3	100.0
	Total	118	82.9	100.0	
Missing	System	24	17.1		
Total		140	100.0		

SOURCE: Researcher (2007)

4.10 Code of Conduct

According to the principles of good corporate governance, the Board of directors shall develop and put in place a code of ethics outlining the values, ethics and beliefs that guide the policy and behavior of the company and define the ethical standards applicable to it and to all who deal with it. Table 4.18 presents data on whether there is a code of conduct. The findings indicate that there is a code of conduct. This is in agreement with the Public Sector Initiative for Corporate Governance recommendations on good governance practice.

Table 4.18: Availability of Code of Conduct

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Yes	118	82.9	90.6	90.6
	No	8	4.3	4.7	95.3
	5	8	4.3	4.7	100.0
	Total	128	91.4	100.0	
Missing	System	12	8.6		
Total		140	100.0		

SOURCE: Researcher (2007)

4.11 Tendering Committee

In order to have an effective and transparent tendering process, an organization should have a tendering committee. This is a strong weapon to fight any elements of corruption in the tendering process. Table 4.19 shows 95.3% of respondents reported that there is a tendering committee. This is a strong indication that there is a tendering committee in NIIF.

Table 4.19: Tendering Committee

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Yes	122	87.1	95.3	95.3
	No	6	4.3	4.7	100.0
	Total	128	91.4	100.0	
Missing	System	12	8.6		
Total		140	100.0		

SOURCE: Researcher (2007)

4.12 Importance of Audit Committee

An effective audit committee is a crucial component of corporate governance in an organization. It ensures that accepted audit recommendations are followed up and properly actioned, which greatly improves both internal and external audit effectiveness. Table 4.20 shows findings on the importance of Audit committees in influencing corporate governance practices in NHIF. Among the respondents interviewed, 71.5% indicated Audit Committees are most important. This compares favorably with a research conducted by KPMG (2000) which observed audit committees should be a part of an effective audit system.

Table 4.20: Importance of Audit Committee

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Not Important	6	4.3	4.9	4.9
	Fairly Important	11	7.9	8.9	13.8
	Important	18	12.9	14.6	28.5
	Most Important	88	62.9	71.6	100.0
	Total	123	87.9	100.0	
Missing	System	17	12.1		
Total		140	100.0		

SOURCE: Researcher (2007)

4.13 Directors Performance Vs Pay Increase

It is important to establish whether directors' performance is in any way related to their remuneration. Previous studies have shown that there is no direct relationship between directors pay and their performance. Table 4.21 shows the effect of Directors pay on increment on their performance. 73.9% of respondents indicated that an increase in Directors pay would not improve their performance. The findings support a study conducted by Centre for corporate governance in 2004 which showed that a higher pay does not mean better performance.

Table 4.21: Effect of Directors Pay Increment

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Yes	30	21.4	22.4	22.4
	No	99	70.7	73.9	96.3
	5	5	3.8	3.7	100.0
	Total	134	95.7	100.0	
Missing	System	6	4.3		
Total		140	100.0		

SOURCE: Researcher (2007)

CHAPTER FIVE

CONCLUSIONS AND RECOMMENDATION

5.1. Introduction

This chapter presents the summary and description of findings derived from the study. The chapter also provides findings, conclusions and recommendations as well as recommendations for further research.

5.2. Discussion of Findings

The broad objective of the study was to establish what corporate governance structures National Hospital Insurance Fund (NHIF) has put in place. The findings established that NHIF has various corporate governance structures in place. These structures include Board of Directors, Audit committees, a Lending Committee and a Code of Conduct. The study also established that there are clear lines of responsibility and accountability.

According to the Private Sector Initiative for Corporate Governance (PSCG, 2007), the board shall include a balance of executive and non-executive directors such that no individual or group of individuals or interests can dominate its decision making. The findings established that there are 15 diversified board members who are independent with a 3 years fixed term. However, investigations also revealed that there is no succession planning for the board. Further, it was established that the board members experience at board level is most significant.

According to Centre of Corporate Governance, there will be formal and transparent procedures for nomination and appointment of new directors to the Board. In this regard; there shall be set up a search and nomination committee of the Board. Findings indicate that NHIF does not have a Board Nominations and Directors Compensation Committees. The findings also show that the Board members and the CEO are appointed through ministerial and presidential appointments. Majority of the respondents, 68.8% indicated that the process is not appropriate. The findings also established that the Minister influences the Boards decision making.

An Audit committee's strength is its demonstrated independence and power to seek explanations and information, as well as its understanding of the various accountability relationships and their impact, particularly on financial performance (Harret, 2004). The findings established that NHIF has both internal and external Audit Committees. It was also indicated that the committees are independent. The study also shows that Audit Committees are most important in influencing good corporate governance practices in NHIF.

The study established that The CEO and the senior Management are most knowledgeable about corporate governance. According Moodie, 2001, Board members should be multi-skilled, experienced in a variety of business areas, prepared to update their knowledge, flexible, analytical and prepared to monitor and asses their individual or collective capabilities.

The study also established that if Directors remuneration was increased, this would not affect their performance. 73.9% of the respondents indicated that if the Directors pay was increased their performance would decline and they will have less time for their duties and responsibilities.

5.3 Conclusion

The study established that NHIF has the fundamental corporate governance structures in place. The Fund has a diversified Board of Directors comprising of 15 members drawn from the various sectors of the economy. There is also in place a Lending Committee and independent Audit committees' i.e both external and internal. The Fund has also in place a code of ethics outlining the values, ethics and beliefs that guide the policy and behavior of the company and define the ethical standards applicable to it and to all who deal with it. However it was also established that NHIF does not have Directors Nomination and compensation committees.

5.4 Recommendations

5.4.1 To the management of NHIF

The organization has a vital role to play in promoting economic development and social progress. It is the engine of growth nationally, and increasingly responsible for providing affordable and accessible healthcare. The efficiency and accountability of the organization is now a matter of both private and public interest, and governance has, thereby, come to the head of the national agenda. Consequently, the following recommendations will go a long way to ensure the organization thrives.

Appointments to the Board of Directors should, through a managed and effective process, ensure a balanced mix of proficient individuals is made and that each of those appointed is able to add value and bring independent judgment to bear on the decision-making process. The Board should regularly assess its performance and effectiveness as a whole and that of individual members, including the Chief Executive Officer. A summary of the major findings together with a statement confirming that the Board has carried out a self-assessment exercise should be made to the annual general meeting.

The board should recognize the need for new member to be inducted into their roles and for all Board members to develop and strengthen their governance skills in light of technological developments, changing corporate environment and other variables. The Board should accordingly organize for the systematic succession, induction and continuous development of its members. The Board should also ensure there is in place an independent Directors Nomination and Compensation Committee, evolve procedures for the selection and removal of individual directors (including the chairman and chief executive) to facilitate regular alteration of the mix and composition of the board ensuring relevant rejuvenation.

The Board of Directors should ensure that the Code of ethics is well defined and understood. The Code of ethics should apply to: Directors and managers, all employees, the Government (shareholder), suppliers and lenders and other relevant stakeholders. There should also be in-house trainings for all the various levels of management on corporate governance. Good corporate governance is a prerequisite for organizational growth and

thus, Transparency, Accountability, Leadership, Integrity and Commitment should be emphasized.

3.4.2 Limitations of the Study

The sample covered mainly employees in head office whilst NHIF has twenty seven branches country wide. It was not easy to reach out to employees in remote area offices. Some respondents were not well versed with corporate governance and others were not willing to divulge information.

5.4.3. Recommendation for Further Research

A similar study should be undertaken focusing on all Health Management Organization (HMO's) in Kenya. The study should focus on whether these organizations adhere to generally accepted principles of good corporate governance. The scope should also be widened to cover other organizations in the health sector like Hospitals.

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Appendix 1: Questionnaire cover Letter

Daniel W. Mulinge
P.O Box 14202 -
00100
Nairobi

Dear Respondent,

I am a student at the University of Nairobi undertaking an MBA course. In partial fulfillment of the course requirements, I am conducting a survey on corporate governance in NHIF. I would be glad if you could spare a few minutes of your time and answer the attached questions to the best of your knowledge. The information in this questionnaire will be strictly confidential. The information will not be used for any other purpose other than for this research. Your assistance in facilitating the same will be highly appreciated.

I thank you in advance.

Daniel w. Mulinge

Appendix 2: Questionnaire

The questionnaire is meant to collect information on the challenges faced in the application of corporate governance principles and organizational performance in NHIF. Kindly answer the questions by writing a brief statement or ticking in the boxes provided as will be applicable.

Section 1: Background information

1. Job Title of respondent

- a) BOD b) Manager c) Staff

2. How long have you been working for or dealt with NHIF?

- a) Less than 1 year
b) 1-5 years
c) 6-9 years
d) Over 10 years

Section 2: Operations and organizational behavior

3. What is the core business of your organization?

.....

4. Are there clear lines of responsibility and accountability in NHIF?

Yes No

If no, Explain.....

.....

5. Would your organization to be effectively carrying out its core business?

Yes No

6. If no to 5, above, what would you consider are the constraints?

a).....

b).....

Section 3: The Board

7. How many board members does your organization have?

8. Does the board have a fixed term? Yes No

If Yes, how many years?.....

9. Do you think the membership of NIIIF board is diversified (Represents all stakeholders)? Yes No

10. Which of the following do you think is lacking in NIIIF board?

- a. An understanding of the organization's mission and strategic plan
- b. A comprehension of the organizations business
- c. A willingness to challenge management when required
- d. A willingness to appraise the Chief Executive
- e. The special expertise that board needs to add value to the organization

11. On a scale of 5-1 (Ranging from most significant) specify the significance of each of the factors listed below in influencing board performance.

a) Board member's educational qualification

b) Board member's professional qualification

c) Board member's experience at board level

d) Proportion of outside directors

e) Independence of the board members

f) Size of the board

12. How are the board members, chairman of the board and the CEO of your organization appointed?

- a. Direct presidential appointment
- b. Through recruitment process
- c. None of the above

13. Would it make a difference if the process 12 above were different? Explain...

.....

.....

.....

14 Do the following influence the performance/ decision making of the board (tick)?

- a. Management
- b. CEO
- c. The Minister
- d. None
- e. Others.....Explain.....

.....

15. Is there succession planning for the board? Yes No

If yes, please explain.....

.....

16. How are tenders awarded in your organization?

- a. Secretly
- b. Through a well understood evaluation criteria published in the press
- c. None of the above. Explain

.....

17. Which of the following element(s) of good corporate governance do you think needs improvement? (Tick)

- i) Transparency
- ii) Accountability
- iii) Leadership
- iv) Integrity
- v) Commitment

Section 4: Audit committees

18. Does NHIF have an Audit Committee? Yes No

19. Is the committee(s) (i) Internal (ii) External (iii) Both?

20. If Yes above (19), is the committee independent? Yes No

Section 5: Corporate Governance Challenges, Reforms and Improvement

21. Which level of management in NHIF would you consider most knowledgeable about corporate governance?

- i) Board Members
- ii) CEO and senior managers
- iii) Middle level Managers
- iv) Other staff

22. Who are responsible for the accuracy and content of the financial statements and other reports?

- i) Board Members
- ii) CFO and senior managers
- iii) Certified accountants employed by the organization to oversee The financial management and reporting
- iv) External auditors

23 Does NHIF have the following elements in place?

- i) Audit committee Yes No
- ii) Directors Nomination Committee Yes No
- iii) Directors Compensation Committee Yes No
- iv) Code of Conduct Yes No
- v) Tendering Committee Yes No

24. On scale of 5-1 (Range is from most important to least important), indicate the importance of each of the factors listed below in influencing good corporate governance practices in your organization.

- i. Audit Committee
- ii. Directors Nomination committee
- iii. Directors compensation committee
- iv. Availability of code of conduct

25. Do you think the directors in your organization would perform better if their
Pay was to be increased? Yes No

If Yes/ No Explain.....

.....

26. Which of the following elements of conformance and compliance do you think are lacking in your organization?

- i) Upholding NHIF values and ethics
- ii) Guidance on policies, procedures, processes, principles and tasks
- iii) Ensuring and maintaining confidentiality
- iv) Enforcing security and fraud controls
- v) Ensuring legislative compliance as required
- vi) Quality Assurance

27 Please suggest ways of improving corporate governance in NHIF

- i)
- ii)
- iii)

THANK YOU FOR RESPONSES