A SURVEY OF RELATIONSHIP BETWEEN CORPORATE GOVERNANCE AND PERFORMANCE IN MICROFINANCE INSTITUTIONS IN KENYA

BY

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DECLARATION

This research project is my original work and has not been presented for a degree in any other university.

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This research project has been submitted for examinations with my approval as University Supervisor

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DEDICATION

To my family members and friends

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The completion of this research work was made possible by a number of people, to whom I am profoundly grateful.

Special thanks go to my supervisor Mr. Maalu, for all his support, encouragement and patience and for being readily available whenever I needed him.

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ABBREVIATIONS

NGO ------------------ Non- governmental Organizations

MFI-------------------- Microfinance Institutions

AMFI------------------ Association of Microfinance Institutions

NGOC----------------- Non- governmental Organization Council

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ABSTRACT

The study was set to investigate the influence of corporate governance in the performance of micro-finance institutions in Kenya. The objectives of the study were to establish the relationship between corporate governance and financial performance of MFIs in Kenya and to determine the challenges facing MFIs in implementation of corporate governance principles. The study is significant because it can aid the policy makers in the formulation of policies, which can be effectively implemented for better and easier regulation of MFIs. The government can also use the study so as to come up with clear criteria of promoting MFIs in Kenya. The researchers and academic community use this study as a source of reference in future studies on MFIs. The management of the MFIs will gain from this study in making decisions regarding corporate governance.

The survey design was found appropriate, given the small number of respondents targeted, time and resource limitations. The population of interest consists of all 15 MFIs registered as actively involved in MFI business. Open-ended and closed questions have been used in the questionnaires that are intended to capture both quantitative and qualitative data; the data collected was analyzed through the use of descriptive statistics.

The study found out that there exist a relationship between different aspects of corporate governance and firm performance. Specifically, the study found out that the size of the board was positively correlated with turn-over or disbursements. This means that large boards translate to higher turn-over for MFIs.

CHAPTER ONE: INTRODUCTION

1.1 Background

1.1.1 Concept of Corporate Governance and organization performance

Corporate governance is the set of processes, customs, policies, Laws and institutions affecting the way a corporation is directed, administered or controlled (Knell 2006). Corporate governance also includes the relationships among the many players involved (the stakeholders) and the goals for which the corporation is governed. The principal players are the shareholders, management and the board of directors. Other stakeholders include employees, suppliers, customers, banks and other lenders, regulators, the environment and the community at large (Knell 2006).

Corporate governance is a multi-faceted subject. An important theme of corporate governance deals with issues of accountability and fiduciary duty, essentially advocating the implementation of guidelines and mechanisms to ensure good behaviour and protect shareholders (Otero 1998). Another key focus is the economic efficiency view, through which the corporate governance system should aim to optimize economic results, with a strong emphasis on shareholders welfare. There are yet other sides to the corporate governance subject, such as the stakeholder's view, which calls for more attention and accountability to players other than the shareholders (e.g.: the employees or the environment) (Singh 2005). Recently there has been considerable interest in the corporate governance practices of modern corporations, particularly since the high-profile collapses of large U.S. firms such as Enron Corporation and Worldcom (Knell 2006).

The argument has been advanced time and time again that the governance structure of any corporate entity affects the firm's ability to respond to external factors that have some bearing on its performance. In this regard, it has been noted that well governed firms largely perform better and that good corporate governance is of essence to firms. The subject matter of corporate governance has dominated the policy agenda in developed market economies for sometime especially among very large firms. Subsequently, the concept is gradually warming itself to the top of policy agenda in the Africa continent. Indeed, it is believed that the Asian crisis and the seemingly poor performance of the corporate sector in Africa have made the concept of corporate governance a catchphrase in the development debate (Berglof and von Thadden, 1999).

It is believed that good governance generates investor goodwill and confidence. Again, poorly governed firms are expected to be less profitable. Claessens et al. (2003) also posits that better corporate framework benefits firms through greater access to financing, lower cost of capital, better performance and more favourable treatment of all stakeholders. They argue that weak corporate governance does not only lead to poor firm performance and risky financing patterns, but are also conducive for macroeconomic crises like the 1997 East Asia crisis. Other researchers contend that good corporate governance is important for increasing investor confidence and market liquidity (Donaldson, 2003).

Becht et al. (2002) identifies a number of reasons for the growing relevance of corporate governance, which includes the world –wide wave of privatization of the past two decades, the pension fund reform and the growth of private savings, the takeover wave of the 1980s, the deregulation and integration of capital markets, the 1997 East Asia Crisis, and the series of recent corporate scandals involving firms such as Enron and WorldCom in the USA and elsewhere. Developing countries are now increasingly embracing the concept knowing it

leads to sustainable growth. Indeed, corporate governance in Kenya is now gaining some level of recognition with very little work in the area even in the well-regulated institutions and sectors. The MFI and specifically, has tremendous governance problems.

Several studies have been done to establish relationship between governance structure and firm's performance. One argument is that a strong corporate governance structure, could lead to a high performance (Sanda et al, 2005). It will help to promote a firm's performance and protect stake holder's interests. Nam et al (2002) found that corporate governance should lead to better performance since managers are better supervised and agency costs are decreased. Poor corporate governance on the other hand is a fertile ground for corruption and poor financial performance. Brown et al (2003) found that firms with weaker corporate governance perform poorly compared to those with stronger corporate governance in terms of stock returns, profitability, riskness and dividend payments.

1.1.2 Microfinance Institutions in Kenya

The World Bank defines Microfinance Institutions (MFIs) as institutions that engage in relatively small financial transactions using various methodologies to serve low income households, micro enterprises, small scale farmers, and others who lack access to traditional banking services.

It is the providing of loans and banking services to the low income; small and micro entrepreneurs to help them engage in productive activities, to better organize their financial lives as well as expand their businesses (Chu, Michael 1998). The key objective of MFIs is to provide micro credit and other financial services like savings to the otherwise poor people and help alleviate poverty.

Micro Finance has been recognized as one of the most important tools for poverty alleviation (KWFT PILLAR 2005).

The Kenya Microfinance sector consists of a large number of competing institutions which vary in formality, commercial orientation, professionalism, visibility, size and geographical coverage. These institutions range from informal organizations e.g. rotating savings and credit associations (ROSCAs), financial services associations (FSAs). Savings and credit co-operative societies (SACCOs), NGOs, to commercial banks that are down scaling (Dondo 2003)

The goal of MFI organizations in Kenya is to raise the levels of income and welfare of people. They support the poor and unemployed by giving them loans often without collateral to establish small businesses. Kenyans today are faced by increased poverty, unemployment and insecurity of the AIDS pandemic, scarcity of food and rural urban migration among others. MFIs address the above problems by accessing small loans at affordable repayment rates, and other financial services for Micro and Small Enterprises (MSE). These take the form of self-help projects and individual enterprises. Most MFIs lend up to a maximum of Shs. 500,000 and a minimum of Shs. 5,000 per applicant.

The 1999 MSE base line survey found that micro-financing, a core source of funding for micro and small enterprises contributes about 18% of the county's GDP and employs 2.3 million people (The Financial Standard, March 19, 2002).

Most MFIs started as NGOs whose funding is from foreign donors and agencies. According to Wainana (2002), NGO’s in Kenya have been accused of misappropriation of donor funds and questions have been raised as to whether the funds they receive are used for the designated purposes. The issue of ownership of NGOs has raised fundamental concerns for their governance. For

instance, if there are no owners or shareholders, then who hold and exercises the supreme authority of the institution to appoint Directors or change the composition of the Board, appoint auditors and satisfy themselves that an appropriate governance structure is in place? (Mwaura, and Gatamah 2000). Secondly if the Board and Management are part owners of the institution, and have to balance the interests of all stakeholders including their own, what would prevent them from maximizing their "joint" interests through empire building, perks, and special benefits at the expense of other stakeholders – given that they are responsible for determining and implementing organization purpose and implied accountable to themselves? (Mwaura, and Gatamah 2000).

According to Dominion Consultants (2000), the relationship between management and the Boards of NGOs have also raised concerns as to whether; NGOs are management driven [or whether boards over depend on management]; and the role of governance is recognized as independent and / or separate from management. Microfinance is now at the stage of transformation to self – sustaining businesses and must therefore; infuse institution values into the day to day operations (Mwaura and Gatamah 2000).

Contrary to general opinion, there have been cases of successful transformation of MFIs from donor based to commercially sustainable institutions despite the governance issues. This is as a result of strong character of their founders e.g. KWFT and KREP in Kenya (AMFI 2005).

Governance has assumed increasing importance for microfinance institutions (MFIs). As microfinance institutions grow in their outreach, increase their assets, and an increasing numbers become regulated entities that can capture savings deposits, they require clear articulation of how their boards will ensure effective governance (Rock, Otero, and Saltzman 1998).

Moreover, according to the Association of Microfinance Institutions (AMFI) 2004, a growing number of microfinance institutions, source of capital has shifted or is shifting from being donor-dependent to accessing financial markets in increasingly sophisticated ways. The recent entrance of investors who are providing capital for the most advanced microfinance institutions also raises important issues regarding the characteristics and quality of the governing bodies that lead these institutions (Otero 2004).

According to the Micro Enterprises Best Practices Publication on "Principles and Practices of Microfinance Governance" (1998), governance is the process by which board of directors, through management, guides an institution in fulfilling its corporate mission and protects the institution's assets over time. Boards are established to provide oversight and give direction to the managers of an institution. In the case of for- profit organizations, the board of directors carries out this function on behalf of a third party, referred to as shareholders. In non-profit organizations ownership is not easily identified. Herein lays the dilemma that MFIs are faced with as they transform from non-profit donor funded organizations to commercialized self-sustainable institutions (Wainaina 2002).

The growth of Kenya's MFI industry has witnessed at least 100 non governmental organizations (NGOs) offering services to clients. However, only 15 organizations can be classified as significant players. It has however been recognized widely in Kenya that promotion of the micro and small enterprise sector is a viable and dynamic strategy for achieving national goals, including employment creation, poverty alleviation and balanced development between sectors and sub sectors. All these together are essential for the achievement of the government vision of industrialization by the year 2020 (Mullei and Bokea, 1999).

The importance of having strong performing MFIs can therefore not be overemphasized.

There has been no specific legislation to govern the MFIs in Kenya until Parliament passed MFI Bill 2006. The MFI Bill 2006 seeks to regulate all deposit taking organizations. In order to promote investor confidence and to assist companies meet stakeholders expectations MFI Bill 2006 has developed a set of guidelines and principles of corporate governance as key to maintaining the trust of the investors (Central bank newsletter 2006).

1.2 Statement of the Problem

The subject of corporate governance is a relatively new discipline. This has attracted worldwide attention because of its apparent importance for strategic health of organizations and society in general. This is particularly since the 1990's, with the concept assuming great importance of late due to the totally unexpected collapse of a few giant corporations in the United States such as World Energy Leader Enron and other biggies like WorldCom, Aldephia, Tyco, and Global Crossing (Singh 2005).

In Kenya, corporate frauds have continued to feature as a result of inadequate system of corporate governance. They include the collapse of several financial institutions such as Euro Bank, Trust Bank, Trade Bank, Akiba Micro Finance and the current fraudulent activities by Pyramid organization masquerading as MFIs.

As microfinance increases in financial sophistication, reaches vast numbers of clients, manages very large sums of money, engages highly professional staff,

taps financial markets more aggressively, and in more and more cases earns a profit, corporate governance becomes far more complicated (Rock, Otero, and Saltzman 1998).

Transformation into self- sustaining organizations will mean the introduction of investors as major stakeholders in the industry which will increase the need for control and accountability (Wainaina 2002). To attract capital flows, there is need for all Microfinance Institutions, to address the mechanism and ways of promoting corporate governance practices. If a company does not have a reputation for strong corporate governance practices, capital will flow elsewhere, if investors are not confident with the level of disclosure, capital will flow elsewhere, and if a company opts for lax accounting and reporting standards capital will flow elsewhere (Knell 2006).

It is therefore, clear that markets exists by grace of investors. And it is today's more empowered investors who will determine which companies and which markets will stand the test of time and endure the weight of greater competition (LEVITTS 2001). The importance of corporate governance practices cannot therefore, be understated as they are strong determinants in the survival or collapse of corporate bodies (Manyuru 2005).

Various studies have been done on MFIs. Such studies include Mutua and Mirero (1985) who examined what MFIs could learn form the Grameen Bank's Credit Model; Kamau, (1992) who provided a credit training manual; Mullei and Bokea (1999) who examined how the MFIs policy environment could be improved. Another study was conducted by Wainaina (2003) who surveyed the corporate governance practices by MFIs in Kenya. There is no study done in the country relating corporate governance with performance.

Improvement in corporate governance as found out by researchers such as Nam et al (2002) and Sanda et al (2002) results in improved performance. The researcher proposes a study to examine whether adoption of Corporate Governance by MFIs operating in Kenya could result to improvement in their performance.

1.3 Objectives of the Study

The objectives of the study are:

(i) Establish the relationship between corporate governance and financial performance of MFIs in Kenya

(ii) Determine the challenges facing MFIs in implementation of corporate governance principles

1.4 Significance of the Study

This study will be important to the following parties:

The policy makers will find the study useful as a basis of formulating policies, which can be effectively implemented for better and easier regulation of MFIs.

The government could use the study so as to come up with clear criteria of promoting MFIs in Kenya

The researchers and academic community could use this study as a stepping stone for further studies on MFIs.

The management of the MFIs will find the study invaluable in making decisions regarding corporate governance

CHAPTER TWO: LITERATURE REVIEW

2.1 The Concept of Corporate Governance

The theory on corporate governance stems from the thesis "The Modern Corporation and Private Property" by Berle and Means 1932). The thesis highlights a fundamental agency problem in modern firms where there is a separation between management and ownership. It has long been recognized that modern firms are run by professional managers (agents), who are accountable to dispersed shareholders (principals). The scenario fits into the well-discussed principal-agent paradigm. The question is how to ensure that managers follow the interests of shareholders in order to reduce cost associated with principal-agent theory. To do that, the principals have to deal with two problems. First, they face an adverse selection problem: that is, they must select the most capable managers. Second, they are also confronted with a moral hazard problem: that is how to adequately motivate the managers to put forth the appropriate effort and make decisions aligned with shareholders interests.

Corporate governance has attracted various definitions. Metrick and Ishii (2002) define corporate governance from the perspective of the investor as "both the promise to repay a fair return on capital invested and the commitment to operate a firm efficiency given investment". Metrick and Ishii argue that firm level governance may be more important in developing markets with weaker institutions as it helps to distinguish among firms. Cadbury Committee (1992) defines corporate governance as "the system by which companies are directed and controlled". On the other hand, Rajan and Zingales (1998) define a governance system as "the complex set of constraints that shape the ex post bargaining over the quasi rent registered by the firm". In Mayer (1997), corporate governance is seen as concerned with ways of bringing the interests of (investors

and managers) into line and ensuring that firms are run for the benefit of investors. Again, corporate governance is concerned with the relationship between the internal governance mechanisms of corporations and society's conception of the scope of corporate accountability (Deakin and Hughes, 1997). It has also been defined by Keasy et al. (1997) to include "the structure, processes, cultures and systems that engender the successful operation of organizations".

From these definitions, it may be stated more generally that different systems of corporate governance will embody what are considered to be legitimate lines of accountability by defining the nature of the relationship between the company and key corporate stakeholders. Thus, corporate governance describes how companies ought to be run, directed and controlled (Cadbury Committee, 1992). It is about supervising and holding to account those who direct and control management. Shleifer and Vishny (1997), describe corporate governance as "the way in which suppliers of finance to corporations assure themselves of getting a return to their investment".

Separation between ownership and control of corporations characterizes the existence of a firm. The design of mechanisms for effective corporate control to make managers act in the best interest of shareholders has been a major concern in the area of corporate governance and finance (Allen and Gale, 2001) and continuing research in agency theory attempts to design an appropriate framework for such control. In a corporation, the shareholders are the principals and the managers are the agents working on behalf of, and for the interests of, the principals. In agency theory, a well-developed market for corporate controls is assumed to be non-existent, thus leading to market failures, non-existence of markets, moral hazards, asymmetric information, incomplete contracts and adverse selection among others. Various governance mechanisms have been advocated which include monitoring by financial institutions, prudent market

competition, executive compensation, debt, developing an effective board of directors, markets for corporate control, and concentrated holdings. Developing an effective board of directors remains an important and feasible option for an optimal corporate governance mechanism.

Agents or managers may not always act in the best interest of shareholders when the control of a company is separate from its ownership. In June 1959, Simon Herbert (Baysinger and Hoskisson, 1990) proclaimed that managers might be “satisfiers” rather than “maximisers,” that is, they tend to play it safe and seek an acceptable level of growth because they are more concerned with perpetuating their own existence than with maximizing the value of the firm to its shareholders. But shareholders delegate decision-making authority to the agent (CEO) with the expectation that the agent will act in their best interest.

In contrast, Demesetz (1983) and Fama and Jensen (1983) suggest that the primary monitoring of managers comes not from the owners but from the managerial labour market. It is argued that management control of a large corporation is completely separate from its security ownership. Efficient capital markets provide signals about the value of a company's securities and thus about the performance of its managers. If the managerial labour market is competitive both within and outside the firm, it will tend to discipline the manager. Therefore, the signals given by changes in the total market value of the firm's securities become very important. Kaplan and Reishus (1990), find evidence consistent with this argument: directors of poorly performing firms, who therefore may be perceived to have done a poor job overseeing management, are less likely to become directors at other firms. On the other hand, reputation concerns do not correct all agency problems and can, in fact, create new ones.

A comprehensive theory of the firm under agency arrangements was developed by Jensen and Meckling (1976), who show that the principals (the shareholders) can assure themselves that the agent will make the optimal decisions only if appropriate incentives are given and only if the agent is monitored. Incentives include such things as stock options, bonuses and prerequisites which are directly related to how well the results of management's decisions serve the interests of shareholders. Monitoring consists of bonding the agent, systematic reviews of management prerequisites, financial audits, and placing specific limits on management decisions. These involve costs, which are an inevitable result of the separation of corporate ownership and control. Such costs are not necessarily bad for shareholders, but the monitoring activity they cover needs to be efficient.

Jensen and Meckling (1976) further define agency relationship and identify agency costs. Agency relationship, according to them, is a contract under which "one or more persons (principal) engage other person (agent) to perform some service on their behalf, which involves delegating some decision-making authority to the agent". The scenario normally generates a conflict of interests. This conflict of interest between managers or controlling shareholder, and outside or minority shareholders refers to the tendency that the former may extract perks out of a firm's resources and be less interested to pursue new profitable ventures. Agency costs in this case include monitoring expenditures by the principal such as auditing, budgeting, control and compensation systems, bonding expenditures by the agent and residual loss due to divergence of interests between the principal and the agent. Usually, the share price paid by shareholders (principal) reflects such agency costs. This is one way to view the linkage between corporate governance and corporate performance. Fama (1980) aptly comments that separation of ownership and control can be explained as a result of "efficient form of economic organization"

Previous empirical studies have provided the nexus between corporate governance and firm performance (Yermack (1996); Claessens et al. Klapper and Love, 2002; Gompers et al. 2003; Black et al. 2003 and Sanda et al. (2003) with inconclusive results). Others, Bebchuk and Cohen (2004), Bebchuk et al. (2004) have shown that well-governed firms have higher firm performance. The main characteristic of corporate governance identified in these studies include board size, board composition, and whether the CEO is also the board chairman.

There is a view that larger boards are better for corporate performance because they have a range of expertise to help make better decisions, and are harder for a powerful CEO to dominate. In recent times on the contrary, emphasis has geared toward smaller boards. Jensen (1993) and Lipton and Lorsch (1992) contend that large boards are less effective and are easier for a CEO to control. The reason is that when a board get too big, it becomes difficult to co-ordinate and process problems. Klapper and Love (2002) examine corporate governance and performance in a sample of firms in 14 countries, most of which are developing economies. They find that better corporate governance is associated with better performance in the form of Tobin's q and ROA.

John and Senbet (1998) provide a comprehensive review of the Stakeholder theory of corporate governance. The main issue raised in the theory is the presence of many parties with competing interests in the operations of a firm. They also emphasized the role of non-market mechanisms such as the size of the board, committee structure as important to firm performance; Jensen (2001) critiques the Stakeholder theory for assuming a single –valued objective. They thus, propose an extension of the theory called an enlightened stakeholder theory. However, problems relating to empirical testing of the extension have limited its relevance and applicability in a modern day corporate entity (Sanda et al., 2003).

In Kenya, corporate governance is still at its infancy stage and therefore an examination of its relationship with the performance of a vital sector such as the MFIs sector is not only desirable but long overdue.

2.2 Corporate Governance Practices

The elements of corporate governance vary from one country to the other and from company to company. Klappar and Love (2002) found that corporate governance provisions at the firm level matter more in countries with strong legal environment.

The emphasis placed on various aspects of corporate governance depends on how corporate governance is defined to bring out the key salient features. According to Hendrikse et al (2004) corporate governance is the system that maintains the balance of rights, relationships, roles and responsibilities of shareholders, directors and management in the direction, conduct, performance and control of sustainable performance of the company's business with honesty and integrity in the best long-term interests of the company, shareholders and business community stakeholders. The Capital Market Authority (CMA) provides a comprehensive list of recommended governance practices (CMA 1998). The recommended governance practices have three objectives which include; economical and financial well being of shareholders, directors and management, and employees; social well being of employees, community and society and environmental well being for every one (Manyuru 2005).The four board attributes namely; composition, characteristics, structure, and process , form the basis for categorizing the corporate governance practices in this study.

2.2.1 Board Attributes

The corporate governance literature identifies four sets of board attributes; namely, composition, characteristics, structure and process (Zahra and Pearce, 1989; Maassen, 1999). Board composition refers to the size of the board and the mix of different director's demographics (insiders/outsiders, male/female, foreign/local) and the degree of affiliation directors have with the corporations (Zahra and Pearce, 1989; Maassen, 1999). Board characteristics encompass director's background, such as director's experience; tenure; functional background; independence; stock ownership and other variables that influence director's interest and their performance (Hambrick, 1987; Zahra and Pearce, 1989). Board structure covers board organization; the role of subsidiary boards in holding companies; board committees; the formal independence of one-tier and two-tier boards; the leadership of boards and the flow of information between board structures (Maassen, 1999). Board process refers to decision-making activities; styles of board; the frequency and the length of board meetings; the formality of board process and board culture on evaluation of director's performance (Vence, 1983; Pettigrew, 1992).

Growing literature focused on some aspects of the four sets of board attributes from a variety of theoretical perspectives have produced a plethora of varying results regarding boards' attributes and corporate performance (Zahra and Pearce, 1989; Dalton et al., 1998; Maassen, 1999). A summary of the four sets of board attributes most commonly studied is provided in Table I

Table 2.1: Board attributes that may influence corporate performance

Attributes/dimensions	Composition	Characteristics	Structure	Process
Dimensions	Board size Outsider' representation Minority representations	-Director's background, beliefs and attributes. -Director's orientation (internal/external) In sidedness External expertise Interest groups Asset impact	- Board leadership - Efficiency of board structure (board leadership, activities amongst committees, flow of information among directors)	-Intensity and quality of director's interaction - Interface between the CEO/chairperson and the board Level of director consensus Comprehensiveness and explicitness and action - Internal proceedings
Sources: Adapted from Zahra and Pearce (1989); Maassen (1999); Kakabadse and Kakabadse (2001)				

The concern of corporate governance has been with both the accountability of the directors and with the board effectiveness Cadbury, (1997). To ensure the board effectiveness the Cardbury Committee (1992) recommends the inclusion of sufficient number of non-executive directors who would bring independence in the board's judgment. These non-executive directors should be, in the majority.

Mace (1986) and Herman (1981) argue that outside directors were valued for their ability to advise, to solidify business and personal relationships, and to send a signal that the company is doing well rather than for their ability to monitor. Mace (1986) further argues that in selecting outside directors, the title and the prestige of the candidates are the primary consideration.

The agency theory, at the other end of the spectrum, argues that the presence of boards of directors is to monitor the management and to protect the interest of the shareholders (Mallette and Fowler, 1992; Fama and Jensen, 1983). It is further argued outside directors are stricter in discharging their responsibilities, as they

are not directly affiliated with the management (Weisbach, 1988). Having outside directors, who are argued to be impartial, is vital as they can act as "… providers of relevant complementary knowledge" to the management (Fama and Jensen, 1983, p. 315). Hence, outside directors could bring into the board the wealth of expertise that is useful to the management in deciding the direction of the firm or to clarify its strategies. This could further enhance the boards' roles as being the ratification and the monitoring of management decisions, as argued by Fama and Jensen (1983). As a result, the performance of the management is expected to improve, and more importantly, increase the wealth of the shareholders. Evidence of board independence effectiveness was also offered by O'Sullivan (2000) who found that audit fees (a proxy for extensiveness of the audit works) were negatively associated with board independence. The author argued that board independence should lead to a better quality of financial reporting and, thus, the scope of the audit and, therefore, the audit fees would be reduced. The evidence found by Peasnell et al. (2000) on the effects of outside directors on the financial reporting aspects further confirms the high monitoring tendency of outside directors.

In addition, evidence has also showed that outside directors are more likely to join, and inside directors leave, the boards of poorly performing firms (Hermalin and Weisbach, 1988). Thus, it may be argued that poorly performing firms are expected to benefit from the entry of more outside directors. In a study on the extent of fraudulent reporting, Beasley (1996) further documented evidence supporting the significant roles of outside directors. Evidence of outside directors' effectiveness was also documented in New Zealand by Bradbury and Mak (2000).

The concern has been on the issue of non-executive directors, who may not be truly independent (Bhagat and Black, 1997; Vicknair et al., 1993). Perry (1995)

argues that the inclusion of independent non-executive directors may negatively influence the board cohesiveness since they are involved in the decision-making process of the firm and, at the same time, act as monitors of management. This, Perry (1995) argues, could lead to a conflict of interest. This argument could perhaps lead to the performance of the firm not being improved even though the board is dominated by outside directors. The lack of non-executive directors' incentives to remove members of the top management following the firm's poor performance as a result of their insignificant shares in the firm, and their compensation and the views of the CEOs could determine their re-appointment as non-executive directors (Conyon and Peck, 1998). Further, it was earlier found that the performance review by the board in most companies was minimal, and it was purported to satisfy the minimal requirement of law (Boulton, 1978) and, except during the period of crisis, most boards were content with a superficial review of the performance (Clendenin, 1972). In an empirical study, Fosberg (1989) found that there was no significant difference in various financial ratios (indicative of the firm's performance) between firms whose boards were dominated by outside directors and firms whose boards were not dominated by inside directors.

The argument, that having outside directors on the board could adversely affect the board performance, could largely be due to the fact that outside directors do not have access and adequate knowledge about the firm. This is due to the nature of non-executive directors' appointments who are not full-time employees in the company, and the limited time commitment that could result in boards that are composed, in the majority, of weak outside directors (Koontz, 1967). Moreover, these directors either hold no shares or hold insignificant shares in the firm, as argued by Conyon and Peck (1998). Thus, their incentives to monitor management, and thus contribute significantly in the pursuit of the shareholders' interests, may be low. In fact, Baysinger and Hoskisson (1990) argue that non-

executive directors have negative influences on corporate entrepreneurship. Research evidence showing a negative association between the proportion of independent non-executive directors and firm performance was documented (Klein, 1998; Agrawal and Knoeber, 1996; Yermack, 1996).

In a survey done in Singapore, Goodwin and Seow (2000) found that the majority of company directors felt that independent directors should make up between 25 and 50 percent of the board. The study also found that none of the directors in the survey felt that independent directors should be less than 25 percent of the board. These findings, therefore, are not different from the recommendation contained in the Report on Corporate Governance (1999) and the Malaysian Code on Corporate Governance (2001), which recommends that at least one-third of the board members be independent directors. Similar recommendation was also found in the Hampel Report (1998). However, according to Goodwin and Seow (2000), the respondents in their survey, which include directors, auditors and institutional investors, felt that there was a need for a clear definition of "independent directors." An absence of this definition would make it difficult to determine compliance with the recommendation. On the importance of non-executive directors' representation on the board, Goodwin and Seow (2000) found that non-executive directors were more convinced that strong corporate governance enhances the board effectiveness more than executive directors were. Though the findings are mixed, evidence generally supports the effects of outside directors on the firm's performance. This is because outside directors are expected to be independent of management and were generally "… appointed for their business acumen, wide commercial experience or contacts in the government or industry" (Reay, 1994, p. 74).

2.2.2 CEO Duality

The board of directors, argues Jensen (1993, p. 862), is "… at the apex of internal control system, has the final responsibility for the functioning of the firm." However, when the board chairman is also the CEO, the board intensity to monitor and oversee management is reduced as a result of lack of independence and a conflict of interest (Lorsch and MacIver, 1989; Fizel and Louie, 1990; Dobryzynski, 1991; Millstein, 1992, Daynton, 1984). The issue that arises when companies practice CEO duality is "Who monitors management?" This is best expressed as, "custodias ipso custodiet" or "who will watch the watchers." Unlike in a two-tier system, the unitary system has the board at the highest internal control system, as argued by Jensen (1993). It has been argued that the firm's managers' influence in setting board agenda and controlling information flows could impede the board's ability to perform its duties effectively (Solomon, 1993; Aram and Cowan, 1983). The firm's managers' ability to determine the board agenda and the flow of information is predicted to be much stronger when the board chairman is also CEO than when the firm adopts a non-dual structure. Daynton (1984) asserts that the board is the primary force pushing the company towards realizing the opportunities and meeting the obligations to the shareholders and other stakeholders. He argues that it is the CEO who enables the board to play the primary force.

In a similar vein, dual leadership structure "signals the absence of separation of the decision management and the decision controls" (Fama and Jensen, 1983, p. 314). Rechner (1989) argued that the ideal corporate governance structure is one in which the board is composed of a majority of outside directors and a chairman who is an outside director. She stated that the weakest corporate governance is one where the board is dominated by insider directors and the CEO holds the chairmanship of the board. When one person dominates a firm, the role of independent outside directors becomes "hypothetical" (Rechner, 1989; Daynton,

1984). Rechner (1989, p. 14) claimed, "… this structure is likely to function as a rubber stamp board given the total control of the CEO. A structure of this type is likely to lead to the board being incapable of protecting the interest of the shareholders. The board, with the high influence of the management, will not be able to discipline the management appropriately as the management who controls the board will over-rule such initiatives. Miller (1997) also argues that a non-executive chairman promotes a higher level of corporate openness.

The issue of separation of the top two posts has been addressed in the Cadbury Committee (1992), which recommended that the roles of the board chairman and the CEO be separated. The Malaysian Code on Corporate Governance (2001) also recommends a similar board structure. The reason for the need for separation is that when both the monitoring roles (i.e. the board chairman) and implementation roles (i.e. the CEO) are vested in a single person, the monitoring roles of the board will be severely impaired. The impairment in the board independence could affect the board incentives to ensure that management pursues value-increasing activities. The Hampel Report (1998) points out that, in some circumstances, the top two roles can be combined, but it recommends that the reasons for combining the roles be publicly disclosed.

Though the literature seems to consistently argue that separate individuals for the post of CEO and chairman leads to a better corporate governance system, the real issue is whether this leads the board to be a better monitor and, thus, is capable of increasing the value of the firm. Proponents of the CEO duality structure argue that combining these two roles provide a clear focus for objectives and operations (e.g. Andersen and Anthony, 1986; Stoeberl and Sherony, 1985). Separation of CEO and chairman posts has both costs and benefits and it was shown that, for larger firms, the costs are greater than the benefits (Brickley et al., 1997). Evidence by Shamsul Nahar Abdullah (2002) in the Malaysian setting and Bradbury and Mak (2000) in the New Zealand setting

confirmed the cost and benefit contention. In their study, Berg and Smith (1978) found that there was no significant difference in various financial indicators between firms, which experienced CEO duality, and firms which did not. The substantial cost of the separation could come from "… the incomplete transfer of company information, and confusion over who is in charge of running the company" (Goodwin and Seow, 2000, p. 43). This could hamper the performance of the firm's financial indicators. It could also be argued that when one person is in charge of both tasks, the decisions are reached faster. Moreover, when the board chairman and the CEO is the same person, he or she is well aware of the decisions needed to improve the performance of the firm.

In another study, Chaganti et al. (1985) also documented evidence similar to that found by Berg and Smith (1978) involving firms that experienced bankruptcy (failure) and survival. Rechner and Dalton (1991) also showed that firms with CEO duality consistently outperformed firms with a CEO non-duality structure, which contradicts the expectation. In another study, Baliga et al. (1996) investigated the announcement effect of changes in the leadership structure. Using accounting measures of operating performance and long-term measures of performance, their findings, however, suggests that:

- The market was indifferent to changes in the leadership structure;
- There was no significant effects on the firm's operating performance; and
- There was no significant influence on the firm's long-term performance.

In a survey in Singapore by Goodwin and Seow (2000), the respondents' opinion regarding the need for a separation of the board chairman and the CEO was not very strong, where the mean score was only 4.85 out of 7.00. Of the three groups in their study, only auditors had a mean score of 5.08, while the directors' mean score was only 4.52 and the mean scores were not found to be statistically different. This evidence could be interpreted that the issue of separating the

board chairman and CEO was not viewed as critical in the corporate governance structure.

As argued, the board independence is important in determining its effectiveness to discipline the management. It may also be further argued that a board is more independent if the board is dominated by outside directors and the chairman is not the CEO of the firm. As argued by Daynton (1984, p. 35), if one person is wearing two hats, "it is always the governance hat that is doffed." In fact, the Malaysian Code on Corporate Governance argues that when the roles of CEO and chairman are combined, the risk of a board being ineffective in discharging its leadership and control duties is high and thus, there needs to be a sufficient number of independent directors on the board. Hence, it appears that the performance of the firm is improved if the board is independent and the CEO is not the chairman of the board.

2.3 Corporate Performance

Performance refers to the extent to which organization's goals and objectives are achieved efficiently and effectively. Performance can take many forms depending on who and what the measurement is intended for. Different stakeholders require different performance indicators to enable them make informed decisions. Environmental and social groups are keen in following actions that the company undertakes with regards to corporate social responsibility; shareholders will be interested in viability, growth in profitability market share and turnover (Brown et al.). Governments and multilateral agencies are interested by expected social and economic benefits to micro entrepreneurs, such as increases in employment and income levels.

There are various measures of performance including financial and non financial measures. Most of these measures make use of the financial statements. Financial statement analysis seeks to evaluate management performance in several areas including profitability, efficiency and risk (Reily and Brown, 1997). Microfinance performance can take many forms depending on what the stakeholders are interested in. Different stakeholders require different performance indicators to enable them make informed decisions.

The content, format and frequency of reports depend on who needs the information and for what purpose. For example shareholders will be more interested in profitability, growth, return on investment and continued financial stability of the institution (Manyuru 2005). Governments and multilateral agencies are interested by expected social and economic benefits to micro entrepreneurs, such as increases in employment and income levels. Recent years have seen growing push for transparency in microfinance; this has seen an increasing use of financial and institution indicators to measure risk and performance of MFIs. For the purpose of this research project four indicators namely market share, turnover or disbursement, portfolio quality, and profitability are proposed as measures of microfinance performance. These are considered to be the most important indicators as they provide reasonable overview of the business volume, performance, risk and the financial condition of microfinance institution.

2.3.1 Market Share

Market share can be expressed as a company's sales revenue (from that market) divided by the total sales revenue available in the market. It can also be expressed as a company's unit sales volume (in a market) divided by the total volume of units sold in that market. Increasing market share is one of the most

objectives used in business; the main advantage of using market share is that it abstracts from industry-wide macro environmental variables such as the state of the economy, or changes in tax policy.

2.3.2 Turnover or Total Annual Disbursement

Disbursement is the total amount of loans given to the institution clients during the financial period under review. A high or increasing disbursement implies increased clientele base, improved average loan size and or high client retention. High disbursement will result from increased loan demand and hence reflecting expansion of the organization. Reduction in disbursement will on the other hand suggest declining demand and hence poor performance. The size and performance of an institution can therefore be assessed from growth or decline of the turnover or disbursement.

The data on disbursement has been used by many microfinance institutions in assessing corporate performance in terms of growth or decline (AMFI 2003). However, disbursement alone cannot on its own reveal the level of efficiency and related fundamental performance indicators. For this reason it is important to combine data on disbursement with other performance parameters.

2.3.3 Portfolio Quality

The most widely used measure of portfolio quality in microfinance industry is Portfolio at Risk Ratio (PaR), which measures the portion of the portfolio that is "contaminated" by arrears as a percentage of the total portfolio and therefore at risk of not being repaid. The older the delinquency, the less likely that the loan will be repaid. Although various other measures are regularly used, PaR has emerged as the indicator of choice. It is understandable, does not understate risk, and is comparable across institutions. The portfolio at risk is free from much of

the subjective interpretations that plague other portfolio quality indicators, such as repayment rate. Furthermore, portfolio at risk is a more conservative measure of the institutional risk than repayment rate or arrears because both the numerator and the denominator include the outstanding balance – it measures the complete risk and not only the immediate risk.

Portfolio quality is a crucial area of analysis, since the largest source of risk for any financial institution resides in its loan portfolio. The loan portfolio is by far an MFI's largest asset and, in addition, the quality of that asset and therefore, the risk it poses for the institution can be quite difficult to measure. For microfinance institutions, whose loans are typically not backed by bankable collateral, the quality of the portfolio is absolutely crucial.

Portfolio at risk is a useful measure, but it does not tell the whole story. Like all other performance measures, portfolio at risk can be manipulated. The most common form of doing this is to write off delinquent loans. Portfolio at risk must therefore always be analyzed together with other performance indicators.

2.3.4 Profitability – Net Surplus

This is the realizable income net of all costs, taxation, financial expenses and financial exchange loss if any. It is a measure that summarizes performance in all areas of the company. If a company portfolio quality is poor or efficiency is low, this will be reflected in profitability. Generally higher net surplus indicate better corporate performance while reduced profits point to poor performance unless there exists specific reasons such as natural calamities, changes in political or economic systems (Manyuru 2005).

The profitability analysis is complicated by the fact that a significant number of microfinance institutions still receive grants and subsidized loans. "Comparing apples with apples" is always a problem in microfinance, because subsidies are still widespread and accounting practices vary widely. When accompanied by full disclosure of these very important facts as is a requirement in corporate governance practices, net surplus is still a reliable measure of microfinance overall performance.

2.4 Corporate Governance and Organizational Performance

Although there is a growing focus on governance issues, such as specific board composition configuration or board leadership structure, the results are unclear with respect to firm performance (Dalton et al., 1998). Many studies that demonstrate positive relationships between variables of interest from the four sets of board attributes and firm's performance, when meta-analytically reviewed, show negative relationships and no statistically significant relationship at all (Dalton et al., 1998). For example, Hunter and Schmidth (1990, p. 29) have suggested that "conflicting rustles in the literature may be entirely artificial". There is no actual population of relationships at all. For example, a meta-analysis of 54 empirical studies of board composition and 31 empirical studies of board leadership structure and their relationship to financial performance, by Dalton et al. (1998, p. 269), concluded that these and other analyses "relying on firm size, the nature of financial preference indicators and various operationalizations of board composition, provide little evidence of a systemic governance structure and financial performance relationships".

Similarly, the analysis of 40 years of data from 159 studies, carried out by Dalton and Daily (1999), concluded that there is no clear evidence of a substantive relationship between board composition and financial performance, irrespective

of the type of performance indictors, the size of the firm or the manner in which board composition is measured. For example, a board could be completely independent and, at the same time, fail in its expertise, counsel and resource-dependency roles (Dalton and Daily; 1999). On the other hand, a board dominated by inside and affiliated directors could fall short in its ability to monitor and control (Daily and Dalton, 1994; 1999). Hence, reliance on the independence of board members or any one dimension of board roles and attributes will not ensure high levels of corporate financial performance, especially if it is at the expense of other director roles (Johnson et al., 1993; Dalton and Daily, 1999).

However, the key thing to note is that corporate governance compliance shows real confidence in the future and in the high growth prospects of your business. Corporate governance compliance makes organization more attractive because it is visibly managed and directed (ALEX KNELL 2006). The recent developments provide ample evidence that inadequate corporate governance standards in certain organizations could contribute to their failure. The inadequate governance standards in the corporate sector, raises the risk profile of companies and exposes the organization and especially lending institutions to greater potential default. The adherence to formal (or mandated) corporate governance practices are particularly crucial for banks and financial institutions as weak or inadequate corporate governance standards invariably result in ineffective risk management and ultimately to financial instability (Singh 2005). In the case of banks and financial institutions, the developments in one of them may trigger systematic consequences. The essence of formal corporate governance in financial institutions, are therefore, the responsibilities of the board and its independent committees for providing adequate checks and balances, transparency and disclosures, robust risk management systems, risk containment

procedures, early warning systems and prompt corrective actions to avoid default (Singh 2005).

According to agency theory, good corporate governance should lead to higher stock prices or better long-term performance, because managers are better supervised and agency costs are decreased. Poor corporate governance on the other hand is fertile soil for corruption and corruptive symbiosis between business and political circles (MANYURU 2005).

A comprehensive and integrative review of the corporate governance contribution to company performance research suggests a tendency, amongst scholars, to search for universal associations between board attributes, board roles and company performance (Zahra and Pearce, 1989; Maassen, 1999). Zahra and Pearce (1989), reviewing 22 empirical studies in their construction of an integrative model of a literature review identifying variables of board attributes and board roles in relation to firm's performance, identify a number of shortcomings in previous research and urge cautious interpretation of results on board roles and attributes. Using the same constructs of board roles and attributes for measuring impact on firm's performance, Maassen's (1999) empirical study of the USA, UK and the Netherlands listed companies came to similar conclusions. Moreover, both studies concluded that there is an over-focus on the financial dimensions of company performance, with some attention being given to systemic performance and very little attention being paid to social dimensions of company performance (Zahra and Pearce, 1989; Maassen 1999).

Most common measures of financial performance were: ROE; ROA; EPS; stock price; return on investment; profit margins; net income and profit margins on sales, income/sales and income/equity. A summary of a framework that incorporates five theoretical perspectives' treatment of board attributes, board

role and contextual variables for analyzing research results in relation to the corporate governance contribution to firm's performance is provided in table below

Table 1.2: Framework for analyzing governance contribution to company performance

Perspectives/characteristics	Legalistic	Resource dependency	Class hegemony	Agency theory/financial model	Stakeholders/political model
Board attributes	Composition Characteristics Structure Process	Composition Characteristics	Composition Characteristics Process	Composition Characteristics Process Structure	Composition Characteristics Process Structure
Board role	Ownership Concentration Company size	External environment Company life cycle Type of busines	Ownership Concentration CEO style Ruling capitalist values	Concentration of ownership External environment	External environment Distribution of ownership CEO style Operating Values
Strategic outcome	Approval	Review Approval Initiatives	Approval	Control Approval	Consensus Review Initiatives
Performance criteria	Financial(profitability) Systemic (survival, growth) Social (responsiveness to society)	Financial (profitability) Systemic (survival, growth in resources, goal achievement, relative market position) Social (responsiveness to society)	Financial (profitability) Systemic (oligopolistic market power)	Financial (low operating cost, profitability) Systemic (survival growth)	Financial (profitability) Systemic (survival,growth,goal achievement, market position) Social (responsiveness to society and ethical behaviour)
Sources: Adapted from Zahra and Pearce (1989); Maassen (1999); Kakabadse and Kakabadse (2001)					

The five perspectives are only representative of corporate governance models and it is recognized that there other models of corporate governance that provide insights and add to the complexity of results that attempt to link board role, attributes and contextual factors with corporate performance; as exemplified by the stewardship perspective. Although agency theory and the financial model, combined together, and the stakeholder perspective and political model have their differences, they also share considerable similarities – hence they are addressed as a group.

Models of good governance may differ as the internal and external features that come together reflect specific market structures, legal systems, traditions, and regulations, cultural and societal values (Wainaina 2002). MFIs in Kenya are in different stages of development. For this reason and for the purpose of this research the 15 MFIs under investigation have been categorized in three levels based on the relative importance of the four sets of Board attributes namely; Composition, Characteristics, Structure, and Process.

Table 2.3: Theoretical framework for analyzing corporate governance in MFIs

MFIs STATUS	Composition	Characteristic	Structure	Process
Level 1 Very strong CG	**Size** -Equal or more than 10 directors -board membership criteria well documented **Source** - Vast majority of directors are outsiders **Affiliation** -directors degree of affiliation with organization low. -Majority are professionals	**Background** - Highly multi-experienced directors. **Tenure** - Specific and limited tenure of service. **Independence** - highly independent	**Board leadership** - chairman outsider **Board committees** - strong audit committee - only outside directors serve on key committees e.g. audit and board governance **one tier/two tier** -No CEO duality	**Board meetings** -useful exchange of ideas in board meetings - meetings are long enough for substantive work **Board Meetings Frequency** very frequent and routine meetings **Accountability** Board is accountable to shareholders **Briefing** Sufficient briefing to the Board by top management.
Level 2 Strong CG	**Size** - size of the board is between 5 and 10 **Source** - outside directors is equal to inside directors **Affiliation** -few directors affiliated with the organization.	**Background** -experienced directors **Tenure** - sometimes tenure of service not uniform **Independence** - some directors have conflicting interests	**Board leadership** - board chairman sometimes insider **Board committees** - No very strong audit committee and other key ones. **One- tier/two tier** CEO duality sometime encouraged	**Board meeting** - Sometime useful exchange in board **meeting**. - Not very frequent **Briefing** - Not obvious/ not a must.
Level 3 Weak CG	**Size** Less than 5 directors -Vast majority of directors are insiders **Affiliation** -Vast majority of directors affiliated to the organization	**Background** - doubtful/weak education and technical background **Tenure** - no specific time limit **Independence** - stock ownership percentage is too high compromising independence	**Board leadership** - board chairman always insider **Board committees** Inside directors serve in key committees like audit -or key committees non-existent **one tier/two tier** - CEO-Duality always the case	**Board meeting** - agenda setting of meeting by CEO - no useful discussion **meeting frequency** - rarely **Briefing** - By top management does not exist.

SOURCES: Adapted from Zahra and Pearce (1989) – Board Attributes and Felton.

Alec. Witt (1995) – Building a stronger Board

Four indicators namely market share, turnover or disbursement, portfolio quality, and profitability are proposed as measures of microfinance performance. These are considered to be the most important indicators and they will be used for analyzing research results in relation to the level of corporate governance in the Institutions under study as provided below in Table IV

2.4.3 Framework for Analyzing Financial Performance in MFIs

A theoretical framework for analyzing research results in relation to the corporate governance contribution to firm's performance is provided below .

Table 2.2: Framework for analyzing financial performance in MFIs

PERFORMANCE MEASURE	YEAR 2006	YEAR 2005	YEAR 2004	YEAR 2003	YEAR 2002
TURNOVER OR DISBURSEMENT					
SURPLUS OR NET PROFIT					
MARKET SHARE PRICE					
PORTFOLIO AT RISK RATIO					

2.5 Summary of Literature Review

The essential implication of the study for establishing a desirable board climate is the necessity of having a keen focus on information. Boards should foster a climate receptive to information. Sticking to fiduciary responsibility and application of performance evaluations are also indispensable attributes of high performance companies. These attitudes all combined seem to culminate in effective board process to company performance (Zahra and Pearce 1989).

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 The Research Design

The survey design was found appropriate, given the small number of respondents targeted, time and resource limitations. MFIs in Kenya are in different stages of development and exhibit high level of diversity in aspects such as ownership and leadership. To address these differences and obtain a relevant result which is representative, it was found appropriate to carry out a census survey.

3.2 Population

According to the Kenya National Council of NGOs (2004), there are about 100 MFIs currently registered in the country. Of these organizations, 15 are considered as actively involved in Micro-Finance business (AMFI 2005). The population of interest consists of all 15 MFIs registered as actively involved in MFI business

3.3 Data Collection

This was a survey study and primary data was collected through the use of a structured questionnaire. Open-ended and closed questions were used in the questionnaires that are intended to capture both quantitative and qualitative data. The questionnaire was self administered.

The questionnaire is divided into 5 sections that cover the following arrears:-

Section A: Institutional information
Section B: Board composition
Section C: Board structure
Section E: Board Process
Section F: Financial performance data

The study was carried out between the month of July and October 2007.

The target respondents are the CEOs of the selected organizations or senior Managers with thorough understanding of the organization.

The "drop and pick" method was used to collect data for all MFIs in Nairobi. For MFIs outside Nairobi, a letter of introduction explaining the survey objectives was sent together with the questionnaire. This was followed up with telephone calls to ensure that the questionnaire had been received. The questionnaires were then picked up during which time completeness was verified and personal interviews undertaken to clarify answers where necessary.

3.4 Data Analysis

The data collected was analyzed through the use of descriptive statistics. Data editing was done to ensure completeness and consistency. The responses were tabulated and classified through coding. This was to help facilitate basic statistical and descriptive analysis. Frequency distribution and percentages were used to determine the extent of corporate governance practices in the MFIs.

Five year average score for turnover/disbursement, Net Surplus, Market Share, portfolio at risk ratio, are to be used to establish the performance of the companies under review. Excel computer package was used to analyze data and present if in form of tables and graphs, Product Moment correlation coefficient was used to help investigate the correlation between organization performance and corporate governance.

CHAPTER FOUR: DATA ANALYSIS AND FINDINGS

4.1 Introduction

This chapter presents the analysis and findings of the study from the data collected using the research questionnaire in appendix 3. The questionnaire was divided into sections from A to F. The questionnaires were sent out to a target population of 15 respondents. Ten questionnaires were received and found relevant for purposes of analysis. This shows a response rate of 66.7 per cent.

4.2 Analysis and Findings

4.2.1 Profile of Respondents and Firms

Table 4.1 Years served in the Firm

Period	frequency	Percentage
Below 10 years	6	60%
11-20 years	4	40%
20-30 years	0	0%

The analyses from the responses received from the 10 MFIs as shown above (Table 4.1) indicated that 60% of the respondents had served in the organizations for a period below 10 years while 40% had served up to 20 years. No respondent had served for more than 20 years in all the organizations.

Table 4.2: Position in the organization

Position	frequency	Percentage
CEO	0	%
Middle level Managers	8	80%
Supervisors	2	20%

The analyses from the responses received as per Table 4.2 above, indicates that 80% of the respondents were middle level managers while 20% were supervisors.

Though the investigator target respondents were the CEOs, it is clear from the analysis that they were not available to fill up the questionnaire. This could be attributed to their nature of work and tight schedules.

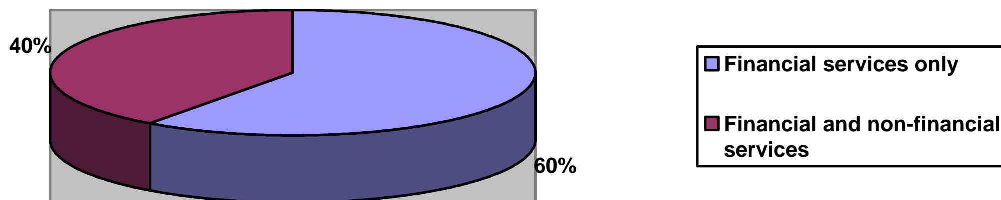
Table 4.3: Length of Firm's existence

Length	frequency	Percentage
3-5 years	2	20%
5-7 years	0	0%
Above 7 years	8	80%

The study also found out that 20% of the firms had been in existence for a period of 3-5 years while the rest had been in existence for over seven years (Table 4.3 above).

The nature of business of MFIs, determine the overall direction of the organization. The responses to this section helps establish the overall organization mission and outreach.

Figure 1: Nature of business of MFIs in Kenya



On the nature of the business, the study found out that 60% dealt in providing purely financial services. 40% of the firms provide both financial and non-financial services. The analysis of nature of business is presented in the chart above.

Table 4.4: Organization Outreach

Outreach	Frequency	Percentage
All Regions	3	30%
Major towns	6	60%
Single town	1	10%

The study also found out that only 30% of MFIs operate in all regions in Kenya. Most of the MFIs (60%) are located in the major towns while 10% are located in a single town as shown by Table 4.4 above.

4.3: Governance and Performance

4.3.1 Governance practices of MFIs

Good institutional governance seeks to ensure that there are transparent and efficient mechanisms for monitoring and disclosing the efficiency and effectiveness with which those entrusted to govern use entrusted resources; and that they account for stewardship (Gatamah 2000).

4.3.1.1 Board Composition

Board composition refers to the size of the board and the mix of different director's demographics (insiders/outsiders, male/female, foreign/local) and the degree of affiliation directors have with the corporations (Zahra and Pearce, 1989; Maassen, 1999).

In determining the "right" size of the board, a number of factors should be considered. Ideally, the board should be large enough to complete work effectively, help secure funding as needed, advance the reputation of the MFI, provide continuity, and ensure that quorums are easily met for meetings-yet will be small enough to allow for substantive decisions.

Table 4.5 Size of the Board

Size	Frequency	Percentage
Less than 5 members	0	0%
5-10 members	7	70%
More than 10 members	3	30%

The analysis from the responses shows that the board members in 70% of the MFIs are between 5 and 10. 30% of the MFIs have more than 10 board members.

The results are consistent with Ledgerwood (2006) recommendation that transforming MFIs should have between 5 and 25 members.

Composition of the board in terms of skill set of directors is an essential component of effective governance (Cadbury 1997). The skills should be diverse and comprehensive enough (Wainaina 2002).

Table 4.6 Board Member Skills and Residence

Skills and residence	Frequency	Percentage
Entrepreneurship	3	30%
Financial Management	4	40%
Legal	1	10%
Human Resources	2	20%
Micro-Finance experts	0	0%
Residence- Local	10	100%
Residence- Overseas	0	0%

The study revealed that in terms of academic qualification and experience, 30% of the board members in MFIs were inclined towards entrepreneurship, 40% were experts in financial management, 10% were had legal orientation while the remaining 20% were inclined towards human resources management discipline. From the analysis, it was also found that none of the board members were Micro- Finance expertise and none lived abroad.

The lack of Micro- Finance experts/skills in these MFIs is worrying and may warrant further research as it is highly doubtful.

Donors and public in general continue to be weary of lack of accountability of MFIs especially in developing countries. Only 40% of MFIs i.e 4 respondents in this study

indicated that they had financial skills represented in the board. The remaining 60% did not have them at all.
This is consistent with the expectations of the government, donors and the public at large that, lack of transparency may be deeply entrenched in MFIs.

To ensure the board effectiveness the Cardbury Committee (1992) recommends the inclusion of sufficient number of non-executive directors who would bring independence in the board's judgment. These non-executive directors should be, in the majority.

Table 4.7 Proportion of Executive to Non- Executive Directors and gender

Proportion and gender	Frequency	Percentage
0-25%	10	100%
26-50%	4	40%
51-75%	1.5	15%
76-100%	1	10%
Women	3.1	31%

From the table above, the board of directors in all the MFIs studied had the proportion of executive directors to non-executive director of up to 25 per cent. In terms of gender, women make up less than a third of the positions in the board of directors (both executive and non-executive directors). The study also revealed that all the MFIs have clear and documented rules for the appointment and removal of the board members.
From the table above, the board of directors in all the MFIs studied had the proportion of executive directors to non-executive director of up to 25 per cent. This is consistent with a survey done in Singapore, Goodwin and Seow (2000) who found that the majority of company directors felt that independent directors should make up between 25 and 50 percent of the board. And inconsistent with an empirical study, by Fosberg (1989) who found out that there was no significant difference in various financial ratios (indicative of the firm's performance) between firms whose boards were dominated by outside directors and firms whose boards were not dominated by inside directors.

Having sufficient number of board members and truly independent process of appointing them, are essential components of effective governance (Cadbury 1997).

Table 4.8: Criteria for nominating and selecting board members

Who nominates/selects board members	frequency	Percentage
By Managing Director	2	20%
By Members of Organization	8	80%
Total	10	100%

On nomination and selection of board members, the study revealed that managing directors nominated the board members in 20% of the MFIs. 80 per cent of the firms selected their board members using members of the organization (shareholders). This analysis is presented in Table 4.8 above. The study further revealed that the various boards in MFIs had developed procedures for removing members of the board who fail to meet high standards of ethical conduct and personal accountability in their work for the board.

From the findings it is clear that the value of good governance is not being recognized in 20% of the MFIs studied which could lead to dominant CEO and management driven governance.

4.3.1.2 Board Characteristics

For effective governance the board is required to renew its membership with infusion of new directors, evaluate its own decision making process and to declare any conflict of interests (Knell 2006). It also has responsibility of assessing its own performance on regular basis and to provide proper guidance to management regarding the strategic direction.

Quality of the chairperson leads to improvement of governance effectiveness and efficiency in MFIs (Gatamah 2005). It is therefore prudent to have well documented rules for their appointment.

Table 4.9 Documented rules for appointment and removal of chairperson

	Frequency	Percentage
Yes	10	100%
No	0	0%

The researcher also sought to investigate whether the micro finance organizations had clear and documented rules for the appointment and removal of the chairperson. The study revealed that this was present in all the MFIs investigated (Table 4.9 above).

The board chair is responsible for ensuring that the board carries out its mandate and ensure that top management action are in line with the MFI's organizational priorities and governance concerns (Ledgerwood et al 2006).

Table 4.10 Criteria for identifying Chair of the Board

	FREQUENCY	Percentage
By CEO	0	0%
Election by the board members	10	100%
Total	10	100%

The study has also shown that the chair of the board in all the organization was determined by election by the board. This analysis is presented in Table 4.10 above.

From all MFIs studied the criteria for selecting the board chair is very transparent and if well implemented could lead to good governance practices. This is because an independent chair will provide leadership in policy setting and management oversight.

Corporate failures world over are attributed to abuse of power (Wainaina 2002). This can be drastically reduced by limiting the length of the term of the chairperson.

Table 4.11 Length of Term for Board members

	Frequency	Percentage
Defined	10	100%
Indefinite terms	0	0%
Total	10	100%

On the length of term for board of the governors, all the respondents said that it was defined (table 4.11 above) and that these terms were renewable for the renewable terms only.

The board has a responsibility of assessing its own performance on regular basis and to provide proper guidance to management regarding the strategic direction (Singh 2005).

Table 4.12 Review of Board own Capacity and Performance

	Frequency	Percentage
Yes	3	30%
No	7	70%
Total	10	100%

The study also sought to investigate whether the board undertakes a regular review of its own capacity and performance. The findings as presented in table 4.12 above revealed that in the majority of micro finance (70%), the board does not undertake a regular review of its own capacity and performance, while 30% of the respondents said that in their organization, the board undertakes a regular review of its own capacity and performance.

From the study only 30% of MFIs undertake regular review this could be attributed to CEOs and top management fear of interfering with board members which Gatamah (2000) suggests as being a key hindrance to good corporate governance.

Many MFIs develop a conflict of interest policy to protect the MFI and its reputation from actual or even the appearance of conflicts of interest (Ledgerwood, 2006).

Table 4.13 Policies and procedures for declaring conflict of interest

	Frequency	Percentage
Yes	10	100%
No	0	0%
Total	10	100%

The study also investigated whether the board in MFIs had agreed and implemented policies and procedures for declaration of conflict of interest by board members. The findings as revealed in table 4.13 above shows that all the organizations had agreed and implemented the policies and procedures.

The study results are consistent with Ledgerwood 2006 who indicated that conflict of interest policy in transforming MFIs, must be in writing and will outline board procedures for determining whether a conflict exists.

According to Manyuru (2005) the term of board of directors should be well defined to avoid a situation of some becoming “permanent staff members”. This will go a long way in improving governance effectiveness.

Table 4.14 Employment tenure of board of directors

	Frequency	Percentage
Performance based	0	0%
Permanent	0	0%
Fixed contracts	10	100%
Total	10	100%

On the employment tenure of the board of directors in MFIs, the study found out that the tenure was a fixed term contract for all the organizations (table 4.14 above).

For effective governance the responsibilities of the board members should be clearly articulated (Gatamah 2000).

Table 4.15 Functions of the board of directors

Main functions of the board	Frequency	Percentage
Policy decisions	10	100%
Strategic Planning	7	70%
Monitor Organization activities	2	20%
Emergencies	1	10%

The functions of the board of directors were also sought from the study. The results in table 4.15 show, that the board of directors' main role is to give direction in terms of policy enactment in the organizations, strategic planning and ratification of all the decisions affecting the firms. They are also convened to discuss issues of importance that come up in the course of doing business but which may have come at a time when the board was not supposed to be convened (emergencies).

4.3.1.3 Board Structure

The board of directors argues Jensen (1993), is "…at the apex of internal control system, has the final responsibility for the functioning of the firm." However, when the board chairman is also the CEO, the board intensity to monitor and oversee management is reduced as a result of lack of independence and conflict of interest (Dayton 1994)

Table 4.16 Separation of powers between CEO and Chairperson

	Frequency	Percentage
Clear separation exists	7	70%
No separation exists	3	30%
Total	10	100%

The study sought to establish whether there was separation of powers between the board chairperson and the CEO. The researcher as table 4.17 shows, found out that in the majority of organizations (70%), there was separation of powers, while 30% of the respondents suggested that there was no separation of powers in their organizations between the board chairperson and the CEO.

From the study results 30% of MFIs studied have not separated the powers between CEO and Chairperson. This evidence could be interpreted that the issue of separating the board chairman and CEO was not viewed as critical in their corporate governance structure.

This is consistent with proponents of CEO duality Berg and Smith. In their study, Berg and Smith (1978) found that there was no significant difference in various financial indicators between firms, which experienced CEO duality, and firms which did not. However, literature seems to consistently argue that separate individuals for the post of CEO and chairman leads to a better corporate governance system.

4.17 Clear documentation of the duties of the Chairperson, and the CEO

	Frequency	Percentage
Yes	10	100%
No	0	0%
Total	10	100%

The researcher also requested the respondents to state whether in their MFIs there was clear documentation of the duties of the chairperson, and the CEO. The findings as presented by table 4.18 above revealed that there was clear documentation of the duties of the chairperson, and the CEO in all the organizations

The study results is consistent with the Cadbury Committee (1992), which recommended that the roles of the board chairman and the CEO be separated

Table 4.18 Disclosure of corporate governance policies, guidelines, and objectives.

Are specific guidelines and objectives disclosed?	Frequency	Percentage
Yes	10	100%
No	0	0%
Total	10	100%

The study found out that the specific corporate governance policies and guideline are disclosed in the MFIs under study. This scored 100% affirmative response meaning that specific practices are disclosed. The study further revealed that corporate objectives are also disclosed. This analysis is presented in Table 4.16 above.

Duties and responsibilities of each board member must be defined to organize the efficient conduct of their board's work (Mwaura 2000).

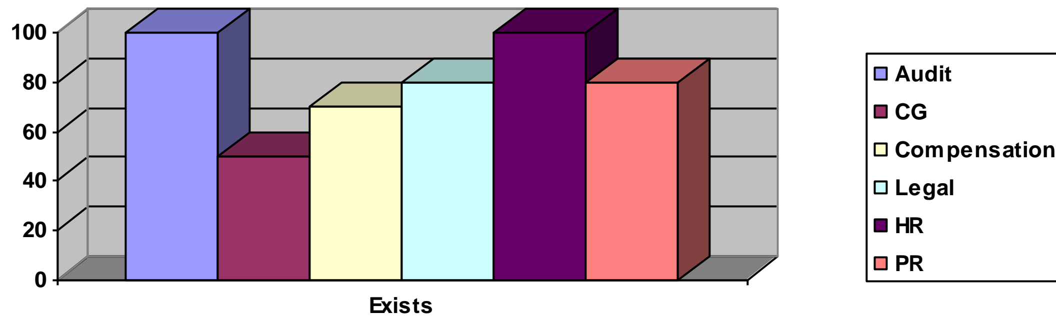
Table 4.19 Written statements of duties of other "officers" of the board

Exists	Frequency	Percentage
Yes	10	100%
No	0	0%
Total	10	100%

The findings also revealed that in all the micro finance institutions, the board of directors had agreed and prepared a written statement of the responsibilities of other officers of the board such as the vice chairperson, secretary, and the treasurer. This analysis is presented in Table 4.19 above.

According to Ledgerwood (2006), board's responsibilities are diverse and labor intensive requiring significant time both in and out of board meetings. Accordingly transforming MFIs rely heavily on its board committees. These committees guide the board in making informed decisions.

Figure 2: Existence of committees other than the board of directors in MFIs



The analysis presented in Figure 2 above shows the findings on whether the supervisory committees exists other than the main board. From the findings, it was clear that in all the organizations, audit and human resource board committee had been established, in 80% of the organizations legal and public relation board committee had been established, in 70% of the organizations compensation board committee had been established, while 50% of the respondents said that corporate governance board committee had been established in their organizations.

The researcher in addition found out that the purpose and powers of these committees are clearly documented in all the organizations.

From the study results it is clear that the MFIs under study are having sufficient number of board committees and thus the study concurs with Cadbury (1997) recommendations that board committees are essential components of effective governance.

4.3.1.4 Board Process

Board process refers to decision-making activities; styles of board; the frequency and the length of board meetings; the formality of board process and board culture on evaluation of director's performance (Vence, 1983; Pettigrew, 1992).

Table 4.20 Evaluation of board performance

Mechanism exists	Frequency	Percentage
Exists	3	30%
Does not exist	7	70%
Total	10	100%

The researcher sought to investigate on whether the organizations had a mechanism for performance evaluation of the board. From the findings presented in table 4.20 above, it was clear that in majority of the organization (70%), they did not have mechanisms for performance evaluation of the board. Only 30% said that they had.

Park (1995) suggests that the board has responsibility of using formal procedures to evaluate its own performance on regular basis. This is in contrast with the findings of this study which found out that most MFIs do not have an existing mechanism of evaluation of board performance and due to it's complexity the issue needs further study.

According to Wainaina (2002) the traditional cycle of monthly meetings gives managers little time to prepare carefully considered strategy papers, while structured agendas leave little room to consider medium or long-term issues.

Table 4.21 Schedule of board meetings

Clear schedule exists	Frequency	%
Yes	10	100%
No	0	0%
Total	10	100%

On issues to do with meetings, the study as presented in table 4.21 above, found out that in all the MFIs investigated the board of directors had agreed on a schedule of meetings.

Table 4.22 Specification on frequency of board meetings

Exists	Frequency	Percentage
Yes	8	80%
No	2	20%
Total	10	100%

From table 4.22 above, 80% of the MFIs have specification on the frequency of board meetings while in the rest the meetings are not frequent. In 70% of the firms, there existed useful exchange of ideas and the boards meet regularly in all the MFIs surveyed.

Table 4.23 Suitability of the frequency of board meetings to the organization needs

Is the frequency suitable to organization needs	Frequency	Percentage
Yes	7	70%
No	3	30%
Total	10	100%

From table 4.23 above, 70% of the respondents said that the frequency of board meetings was suited to the needs of the organization but sometimes goes against schedule while 30% of the MFIs board meetings must follow the schedule.

According to White (2006), the board chair sets the agenda for board meetings with the CEO and chairs the meetings. The effectiveness of those meetings is highly dependent on board chair's ability to manage the agenda.

Table 4.24 Board Agenda

Who creates the Agenda?	Frequency	Percentage
Chairperson	7	70%
CEO	0	0%
CEO and Board Members	3	30%
Total	10	100%

The study as presented in table 4.24 above revealed that in 70% of the firms, the chairperson created the agenda while in the rest of the firms, the CEO and the board members created the agenda.

Having outside directors, who are argued to be impartial, is vital as they can act as "… providers of relevant complementary knowledge" to the management (Fama and Jensen, 1983, p. 315).

Table 4.25 Views of outside Members

Views have significant weight	Frequency	Percentage
Yes (sometimes)	8	80%
No (never)	2	20%
Total	10	100%

From table 4.25 above the findings on whether the views of outside members have significant weight in board meetings, the researcher found out that in the majority of the organizations as shown by 80%, the views of outside members had significant weight in board meetings sometimes, while 20% of the respondents said that the views of the outside members never had a significant weight in the board meetings.
The study results, therefore, agrees with the findings of Fama and Jensen, 1983 who consider outside directors as providers of complementary knowledge.

The board and especially the chair, in addition to their individual responsibilities as board members will often serve as a partner to the top management to ensure the MFIs achieves their mission and purpose (Ledgerwood 2006). Therefore, they require consistent update from the top management.

Table 4.26 Briefing of the Board by top Management

Is there sufficient briefing	Frequency	Percentage
Yes (always)	5	50%
Yes (sometimes)	5	50%
No (never)	0	0%
Total	10	100%

From the findings in table 4.26 above, 50% of the respondents indicated that there was always sufficient briefing by top management, while 50% said that there was sometimes sufficient briefing by top management.

The effectiveness of board meetings is often highly dependent on the board chair's ability to build an agenda that is structured by priorities and by time (Klapper, 2002).

Table 4.27 Length of board meetings

Is length adequate to enable useful exchange of ideas	Frequency	Percentage
Yes (always)	7	70%
Yes (sometimes)	3	30%
No (never)	0	0%
Total	10	100%

The researcher also sought to investigate on whether the length of the board meetings was adequate to enable useful exchange of ideas. The majority of respondents as presented in table 4.27 above, comprising of 70% suggested that the length of the board meetings was always adequate, while 30% said that sometimes it was adequate to enable useful exchange of ideas.

The study findings agree, with many literatures that, the meetings should be long enough to enable useful exchange of ideas at board meetings (Vafeas 1999).

When the board determines to act, the board chair's responsibility is to make sure that the board reaches unanimous decision in line with MFIs organizational priorities (Cutting and Kouzmin 2000).

Table 4.28 Board Decisions

Does the board reach unanimous decision	Frequency	Percentage
Yes (always)	2	20%
Yes (sometimes)	8	80%
Total	10	100%

The findings as presented in table 4.28 above showed that sometimes but not always the boards reach unanimous decisions (80%), while 20% said that they always agree on all decisions. The findings also revealed that there was a well-kept clear written record of the meetings of the board, including decisions and actions to be taken, kept and agreed as a true record by the board in all the organizations.

Board members should understand the legal regulatory framework, which will specify the standard of care that is expected of directors, including rules related to conflicts of interests that are to be avoided by insiders such as board members (Ledgerwood, 2006).

Table 4.29 Understanding of Regulatory Framework by Board Members in MFIs

Response	**Frequency**	**Percentage**
YES(Only chairperson)	3	30
YES(All members)	7	70
Total	10	100

The researcher also found out that in 70% of the organizations the board had a clear understanding of its legal regulatory framework and conditions of compliance while 30% said it is only the chairperson. This is indicated in Table 4.29 above.

Table 4.30 Legal Registration Document

Available to board members	Frequency	Percentage
All members	6	60%
Chairperson only	4	40%
Total	10	100%

The findings on whether a copy of the legal registration document had been made available to each member of the board. From table 4.31 above majority of the respondents as shown by 60% said that it was made available to all the members of the board, while 40% of the respondents said that in their organizations, it was made to the chairperson only.

Appointment of a legal/ company secretary to ensure that all legal compliance are met is key to governance effectiveness (Gatamah and Mwaura 2000)

Table 4.31 Appointment of Board Secretary

Board has appointed one of the members as a Secretary	Frequency	Percentage
Yes	10	100%
No	0	0%
Total	10	100%

The results of the analysis also revealed that all the boards of MFIs investigated (100%) had appointed one of the members to act as a secretary having responsibility to ensure that legal compliance is met. This analysis is presented in Table 4.32 above.

4.3.2 Financial performance

For the purpose of this research project four indicators namely market share, turnover or disbursement, portfolio quality, and profitability were used as measures of microfinance performance. These were considered to be the most important indicators as they provide reasonable overview of the business volume, performance, risk and the financial condition of microfinance institution.

4.4 Relationship Tools

The Pearson correlation matrix illustrates the correlation coefficients (degree of association) of corporate governance mechanism and performance measures. The size of the board (BRDSIZE) is significantly positively associated with turn over or disbursement at confidence levels of 0.01 , while board structure is significantly

negatively associated with turn-over or disbursements at a significance level of 0.01 Other corporate governance mechanism are not significantly associated with turn over or disbursement.

The correlation analysis statistics portrays the degree of association between corporate governance mechanisms and performance variables. In addition to this, cross section multiple regression analysis is carried out to predict the relationship between corporate governance mechanism and firm performance and also to indicate the contribution of each independent variable (corporate governance mechanism) to the response variable (performance measures). The table below shows a summary of regression coefficients and other statistics of performance measures regressed on corporate governance mechanisms and performance variables. Summary of beta coefficients (β) (denoting the relationship of performance measures and corporate governance mechanisms), the intercept and the coefficient of multiple determinations (R-) is as below.

Table 4.33 Relationship between performance and corporate governance

Variables	Turnover/ Disbursements	Surplus/ Net profit
Intercept	-2.308	-79.271
BRDSIZE	0.136	0.396
BRDSTR	-0194	-0.230*
R^2	0.366	0.370

4.4.1 Corporate Governance Mechanisms and Disbursements/turn over

The estimated relationship between corporate governance mechanism and disbursements or turn over as the performance measure is as follows:

$$DSBSNTS/TURN\ OVER = 2.308 + 0.136BRDSIZE - 0.096BRDSTR$$

From the extracts in the table above, the coefficient on multiple determination (R^2) for disbursements on corporate governance mechanisms is 36.6%, this means that the proportion of the variation in net disbursements that is explained by the set corporate governance characteristic is 36.6%, 63.6% of the variation in ROA is explained by other factors.

4.4.2 Corporate Governance Mechanisms and Net profit/Surplus (NET)

The estimated relationship between corporate governance mechanism and net profit/surplus as the performance measure is as follows:

$$\text{Net profit/surplus} = -79.271 + 0.396\text{BRDSIZE} - 0.23\text{BRDSTR}$$

The coefficient of determination (R^2) for net profit or surplus on corporate governance mechanisms is 37%. This means that the proportion of the variation in surplus and net profit that is explained by the set of explanatory variables (corporate governance characteristics) is 37%. 63% of the variation in net profit or surplus is explained by other factors.

The coefficient for board structure is significantly negative while that of board size is significantly positive. The findings on board structure are in line with the strong sentiment among board reform advocates, most notably public pension funds and shareholder activists groups that the C.E.O. should not serve simultaneously as chairperson of the board (Dalton et al 1998). The preference for the separate board leadership structure is largely grounded in agency theory, concerns regarding the potential for management domination of the board.

4.5 Challenges facing MFIs in implementation of Corporate Governance

As Ledgerwood and White (2006) pointed out governance is broadly defined as the system of checks and balances whereby stakeholders of the MFIs (its owners, senior managers, donors, regulators, customers) ensure that the MFI fulfills its institutional mission and is managed effectively. Corporate governance is the regulating influence applied to the affairs of a company to maintain good order and apply predetermined standards (Knell 2006).

The challenges that confront many transforming MFIs is how to develop effective boards that can respond to a growing number of internal and external stakeholders, many of whom may be new to the MFI – such as shareholders, regulators and new customers (Ledgerwood et al. 2006). Another challenge is to how to develop a governance structure

that sets clear boundaries between management and governance, while also establishing policies for holding management accountable for its performance (Ledgerwood et al. 2006).

CHAPTER FIVE: CONCLUSIONS

5.1 Summary and conclusions

This study was concerned with the determination of the relationship between corporate governance and financial performance of MFIs in Kenya. The study was also designed to determine the challenges facing MFIs in implementation of corporate governance principles.

5.1.1 Performance and corporate governance

The study found out that 70 per cent of MFIs have boards consisting of up to 10 members while 30 per cent of the MFIs have over 10 members in their board of directors.

When the relationship between corporate governance and performance was explored using financial aspects of the MFIs, the study found out that there exist a relationship between different aspects of corporate governance and firm performance. Specifically, the study found out that the size of the board was positively correlated with turn-over or disbursements. This means that large boards translate to higher turn-over for MFIs.

With respect to board size the findings are in contrast with those of Goodstein et al (1994) who found evidence that large and diverse board may have limitations in their strategic functions. They also contrast those of Yermack (1996) who suggested that small boards of directors are more effective and exhibited better values for financial ratios. The findings on the board size of the firm are in line with those of De Jong et al (2002) who found a positive significant coefficient with disbursements.

On the other hand, the study also revealed that there is a negative relationship between board structure and turnover or disbursements. The findings on board structure are in line with the strong sentiment among board reform advocates, most notably public pension funds and shareholder activists groups that the C.E.O. should not serve simultaneously as chairperson of the board (Dalton et al 1998). The preference for the separate board leadership structure is largely grounded in agency theory concerns

regarding the potential for management domination of the board. The results are in line with those of Rechner and Dalton (1991) and Pi and Timme (1993) but differ with those of De Jong et al (2002) and Brickley et al (1997) who do not find systematic effects on net profit or surplus in US, Belgium, Netherlands and UK.

5.1.2 Status of MFIs in Kenya

Using the theoretical framework for analyzing the status of MFIs provided in chapter two of this study in the Kenyan context give an outright picture of whether an MFI is very strong, strong or weak as far as incorporation of corporate governance principles are concerned. On average, considering all the variables involved in the classification of the status of MFIs, it can be concluded from the study that all the firms studied have very strong corporate governance policies in their organizations despite the issue of board size. All the MFIs studied thus fall in level 1 (very strong CG).

5.2 Limitations of the study

The study suffered from a couple of limitations. One of them is that getting the respondents to fill in the questionnaire was a hassle as it took the researcher several days to obtain data from the companies.

5.3 Suggestions for further research

One of the findings of this study was that 70 per cent of MFIs have up to 10 board members while only 30 per cent of them have over 10 board members. Then, the relationship that came out in as far as performance is concerned was that there is a positive relationship between board size and performance. More studies should be done to ascertain the relationship between other aspects of corporate governance other than board size and structure.

5.4 Recommendations for policy and practice

The study found out that all MFIs studied qualify as having very strong corporate governance principles. The study further revealed that there is a positive correlation between performance and corporate governance.

The study therefore recommends that policy makers for MFIs take serious notice of these findings to implement policies that sustain the already existing strong corporate governance structures.

The study also recommends to the government through the central bank of Kenya to use the level of corporate governance existing in MFIs as a basis of promotion.

The study also recommends to the management of MFIs to use the findings of this study to upgrade their corporate governance practices.

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APPENDICES

Appendix 1: List of selected/ sampled MFIs

	Organization	Type of organization	Outreach
1	**KWFT**	**MFI**	**Country Wide**
2	**KREP Dev.Agency**	**MFI**	**Country Wide**
3	**BIMAS**	**MFI**	**Eastern Side**
4	**KADET**	**MFI**	**Country Wide**
5	**Faulu Kenya**	**MFI**	**Country Wide**
6	**SMEP**	**MFI**	**Country Wide**
7	**ECLOF**	**MFI**	**Nairobi,Central,Eastern,Western,And Rift Valley**
8	**SISDO**	**MFI**	**Country Wide**
9	**Jitegemee (P.C.E.A)**	**MFI**	**Nairobi, Central And Rift Valey**
10	**Jamii Bora**	**MFI**	**Coutry Wide**
11	**Equity Bank**	**Commercial Bank**	**Country Wide**
12	**Family Bank**	**Commercial Bank**	**Country Wide**
13	**KCB**	**Commercial Bank**	**Coutry Wide**
14	**Cooperative Bank**	**Commercial Bank**	**Country Wide**
15	**Opportunity Africa**	**MFI**	**Nyanza, Western And Rift Valley**

Appendix 2: Letter of introduction

Dear Respondent,

Re: MBA RESEARCH PROJECT

I am a Post Graduate Student at the University of Nairobi, pursuing Masters of Business Administration (MBA) degree. In partial fulfillment of the requirements of the degree, I will be undertaking a research project on corporate governance and performance in the MFIs in Kenya.

I am kindly requesting you to participate in this study by filling the attached questionnaire to the best of your knowledge. The information provided will be used solely for academic purposes.

Your kind assistance will be highly appreciated

______________________	______________________
JACKSON WANJAU	***MR. J MAALU***
MBA STUDENT	PROJECT SUPERVISOR

Appendix 3: Survey Questionnaire

TITLE: A questionnaire on the relationship between corporate governance and Microfinance performance in Kenya.

The information provided here will be used only for academic purposes and thus it will be treated with maximum confidentiality.

Instructions

The questionnaire has Six sections A,B, C, D, E and F. Kindly answer all the questions in each section. If a question is not applicable, kindly mark "N/A". If you simply do not have the knowledge, kindly mark "NK"

(PLEASE WRITE AS LEGIBLY AS POSSIBLE. THANK YOU)

PART A: Institutional information.

1) Name of the organization (optional)…………………………………………..

2) Years you have served in the organization (Tick)

a) Below 10 years ______________
b) 11-20 ______________
c) 21-30 ______________
d) 31-40 ______________
e) Above 40years ______________

3) Your position in the organization (Tick)

a) CEO _____________
b) Middle level manager _____________
c) Supervisor _____________

d) Any other (Specify) ____

4) How long has the firm been in existence? (Tick as appropriate)

a) Below 2 years _____________
b) 3-5 years _____________
c) 5-7 years _____________
d) Above 7 years _____________

5) What is the nature of the firms business?

a) Provides Financial Services only ___________
b) Provides Financial and non financial Services ___________

Any other (Please specify)

………………………………………………………………………………………………
………………………………………………………………………………………………
………

6) Where does the organization operate _____________
a) All Regions _____________
b) Located only in Major cities _____________
c) Located only in a single town _____________

d) Any other location? Please specify……………………………………………..

SECTION B: BOARD COMPOSTION

1. **Size of the board**

a) Less than 5 members ___________
b) 5 to 10 members ___________
c) 11 to 15 members ____________

d) More than 15 members______________

Comment (s) (if any)

____

2. **academic qualification and experience of each board member (tick as appropriate)**

a) Entrepreneurship ____________
b) Financial management ____________
c) Legal ____________
d) Micro-finance experts ____________
e) Human resource management ____________
f) Others ____________

Comment (s) ____

3) **Foreign/local**

How many live overseas?

a) Non ________
b) All ________
c) Half ________
d) A third ________

3 What is the proportion of executive directors to non – executive directors?

a) 0% - 25% _________

b) 26%-50% __________

c) 51% - 75% __________

d) 76% - 100% _________

4 Gender

Of these, how many are women (Tick appropriately)

a) a third ______

b) Less than a third ______

c) More than a third ______

5 Board members appointment

Does the organization have clear and documented rules for the appointment and removal of the board members?

a) YES ________

b) NO _________

6 How are the board members nominated and selected?

a) by managing directors _______
b) by chairperson _______
c) by members of the organization _______
d) by other board members ________
e) by man power search firm _______

7 Has the board developed procedures for removing members of the board who fail to meet high standards of ethical conduct and personal accountability in their work or the board?

a) YES ____________
b) NO _____________

SECTION C: BOARD CHARACTERISTICS

1. Term

What is the length of terms for board members? (Mark appropriately)

a) Defined _______
b) Indefinite terms _______

2. Are the terms renewable?

a) YES, for renewable terms only ________

b) NO _________

c) YES, indefinitely __________

3. Does the organization have clear and documented rules for the appointment and removal of the chairperson?

a) YES _________

b) NO __________

4) How is the chair of the board identified?

a) Selection by CEO ___________

b) Election by the board ____________

c) Others specify ____________

4. Does the board undertake a regular review of its own capacity and performance?

a) YES ____________

b) NO _____________

5. **Has the board agreed and implemented policies and procedures for declaration of conflict of interest by Board Members?**

a) YES ______________

b) NO _______________

6. **What is the employment tenure of Board of Directors?**

a) Performance based _________________

b) Fixed term contracts _________________

c) Permanent and Pension able _________________

d) Any other? Please specify

____

7. **What are the roles/functions of the Board of Directors?**

a) ________________________________

b) ________________________________

c) ________________________________

d) ________________________________

SECTION D: BOARD STRUCTURE

1. Are specific corporate governance policies and guidelines disclosed? (mark appropriate)

a) YES (specific practices disclosed ____________
b) NO (only general statement made ____________

2. Is the declaration of corporate objectives disclosed?

a) YES __________
b) NO ___________

3. Is there separation of powers between the Board Chairperson and the CEO?

a) Clear separation exists __________
b) Slight separation exist ____________
c) No separation exist ____________

4. Is there clear documentation of the duties of the chairperson and CEO?

CHAIRPERSON

a) YES (Documented) ____________
b) NO (Not Documented) ____________

CEO

a) YES (Documented) ____________
b) NO (Not Documented) _____________

5. Has the board agreed and prepared a written statement of the responsibilities of other "officers" of the Board such as Vice chairperson, Secretary, Treasurer?

a) YES (written statement exist) ___________

b) NO (No written statement exist) ___________

6. Have the Board established supervisory committees other than the main Board? (Please complete the table below that outlines the Board Committees. (Listed in order of importance to the efficient functioning of the organization)

	Name of the committee	**Exist**	**Score**
1	Audit		
2	Corporate Governance		
3	Compensation		
4	Legal		
5	Human resource		
6	Public Relation		

7. Are the purpose and powers of these committees clearly documented?

a) YES (clearly documented)_____________

b) NO (Not documented) _____________

SECTION E: BOARD PROCESS

1. Does the organization have mechanisms for performance evaluation of the Board?

a) YES (exist) ___________

b) NO (exist) ____________

2. Has the Board agreed on a schedule of meetings?

a) YES (clear schedule exist) ____________
b) NO (does not exist) _____________

3. Is there specification on frequency of Board Meetings?

a) YES(exist) ____________
b) NO (does not exist) ____________

4. Is there useful exchange of ideas at Board Meetings?

a) YES (always) _________
b) NO (not always) _________

5. Does the Board meet regularly?

a) YES ____________
b) NO ____________

6. Is the frequency of the Board Meetings suited to the needs of the organization?

a) YES (sometime goes against schedule) ______________
b) NO (must follow the schedule) (1) ______________

7. Who creates Agenda for the Board Meeting?

a) Chairperson ___________
b) CEO ____________
c) CEO and Board Members ____________

8. Do the views of outside members have significant weight in Board Meetings?

a) YES (always) ____________
b) YES (sometimes) ____________
c) NO (never) ____________

9. Is there sufficient briefing by top Management?

a) YES (always) ____________
b) YES (sometimes) ____________
c) NO (never) ____________

10. Is the length of the Board Meetings adequate to enable useful exchange of ideas?

a) YES (always) ____________
b) YES (sometimes) ____________
c) NO (always in hurry) ____________

11. Does the Board reach unanimous decision?

a) YES (always) ____________
b) YES (not always) ____________
c) NO (disagrees all the time) ____________

12. Is there clear written record of the meetings of the Board, including decisions and actions to be taken, kept and agreed as a true record by the Board?

a) YES (well kept) ______________
b) NO (not well kept) ______________

13. Does Board use formal Procedures to evaluate itself?

a) YES _______________
b) NO _______________

14. Does Board use formal procedures to evaluate Managers?

a) YES _______________
b) NO _______________

15. Does the Board have a clear understanding of its legal regulatory framework and conditions of compliance contained within these?

a) YES (only chairperson) ______________
b) YES (all members) ______________
c) NO (non has) ______________

16. Has a copy of the legal registration document been made available to each member of the Board?

a) YES (All members) ______________
b) YES (Chairperson only) ______________
c) NO (non has) _______________

17. Has the Board appointed one of the members to act as a Secretary and having responsibility to ensure that legal compliance is met?

a) YES ___________
b) NO _____________

PART C: FINANCIAL PERFOMANCE DATA

PERFORMANCE MEASURE	YEAR 2006	YEAR 2005	YEAR 2004	YEAR 2003	YEAR 2002
TURNOVER OR DISBURSEMENT					
SURPLUS OR NET PROFIT					
MARKET SHARE PRICE					
PORTFOLIO AT RISK RATIO					

Thank you, for your response

Appendix II Descriptive statistics Table

DESCRIPTIVE STATISTICS				
Mean	60	23.39	7.7955	0.1364
Standard Error	0.92	4.64	0.3388	0.0523
Median	6.91	18.03	8	0
Standard Deviation	6.13	30.79	2.2473	0.3471
Sample variance	37.55	948.01	5.0502	0.1205
Kurtosis	-0.34	0.17	0.8632	2.9492
Skewness	0.03	0.47	0.0228	2.1948
Range	26.34	127.99	8	1
Minimum	-6.78	-27.05	4	0
Sum	19.56	100.94	12	1
Count	290.3	1029.2	343	6
Confidence Level (95.0%)	44	44	44	44

Appendix III Table of Correlation co-efficient

				CORRELATION MATRIX	
		NET PROFIT/SURPLUS	DISB/TRN OVER	BRDSIZE	BRDSTR
BRDSIZE	Pearson Correlation	0.071	.446(*)	1	-440
	Sig. (2-tailed)	0.646	0.002		0.003
	N	44	44	44	44
BRDSTR	Pearson Correlation	-0.088	-377	-440	1
	Sig. (2-tailed)	0.571	0.012	0.003	
	N	44	44	44	44