RELATIONSHIP BETWEEN CORPORATE GOVERNANCE PRACTICES AND FINANCIAL PERFORMANCE OF UNIT TRUSTS IN KENYA

BY

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DECLARATION

This research project is my own original work. I confirm that the contents of this project have never been presented in this or any other university for examination or any other purposes.

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

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DEDICATION

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ABBREVIATIONS AND ACRONYMS

AGM -	Annual General Meeting
ANOVA-	Analysis of Variance
BAAM -	British American Asset Managers
BODs -	Board of Directors
CEO -	Chief Executive Officer
CIS -	Collective Investment Schemes
CMA -	Capital Markets Authority
CSIA -	Corporate Secretaries International Association
E&Y -	Ernest and Young
GCGF -	Global Corporate Governance Forum
HHL -	Handelshochschule Leipzig
ICPSK -	Institute of Certified Public Secretaries of Kenya
IFC -	International Finance Corporation
IMAS -	Investment Management Association of Singapore
NSE -	Nairobi Securities Exchange
OECD -	Organization for Economic Co-operation and Development
ROA-	Return on Asset
SPSS -	Statistical Package for Social Science
UK -	United Kingdom
US -	United States
PR-	Public Relations

ABSTRACT

The study's main objective was to establish and identify relationship between corporate governance practices and the financial performance of unit trusts in Kenya. A total of 18 registered unit trusts were studied. A descriptive research design was adopted for this study to enable a deeper search for factual information. A Likert scale questionnaire with a set of structured questions was served to the PR managers and company secretaries together with senior managers. A total of 36 questionnaires designed to contain both closed and open ended questions were issued out. But first the questionnaire was subjected to a pilot test on three different unit trust companies for appropriateness.

The findings on testing the association between corporate governance practices and financial performance revealed a strong positive and significant association between the variables. The findings also revealed that of the corporate governance variables, the association between financial performance and shareholder right and responsibility had the strongest correlation. A positive linear relationship between the financial performance and corporate governance practices was also found to exist in the unit trusts in Kenya. It is recommended that the unit trust boards need to be efficient in all their responsibilities towards increased profitability of the company. The shareholders should exercise genuine and participative selection criteria in appointing the board members which determine the ability of the board to effectively manage the operations. Limitations and challenges encountered included time and financial constraints. The study was also limited to the unit trusts in Kenya only which limits the generalization of the findings to other sectors of the economy. It is recommended that further studies be carried out to determine on other sectors in Kenya considering the situation in the private sector organizations as well. A study should also be undertaken to evaluate the best practices in social responsibility played by the unit trusts and the significance of these practices to the society and economic development.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Separation of ownership and control in business concern has led to agency problem and indeed necessitated the emergence of corporate governance. In the advent of agency theory it means that the legal rights of shareholders/unit holders being diluted and waived as the executive management and the board take control (Reddy and Raju, 2000). For this reason professional standards are set to guide these agents of stewardship on what and how services are to be carried. The standards define and establish scope for activity, competence framework, care, knowledge and skills that ought to be employed to achieve the expected levels deemed to satisfy stakeholders interest (Kihumba, 2015). Corporate governance can be understood to mean the set of processes, customs, systems, policies, laws and institutions affecting the way in which a corporation is directed, administered or controlled and held accountable in order to ensure that the corporation owns up to the expectations of the fund providers, the general society and other stakeholders (OECD, 2004).

In the recent past corporate governance has been an area of emphasis for corporations in particular the publicly traded companies. Globally big corporations such as Adelphia Communications, WorldCom, Arthur Anderson and Enron Corporation are a good example of the adversity of poor corporate governance. In Kenya corporate failures include the Uchumi supermarket, Mumias Sugar Company, Nairobi-based Euro Bank and Lake Star insurance. The need for accountability, honesty, transparency and corporate ethics sets the agenda for corporate governance. One of the challenges that are facing

world economies is corporate governance; a topic that the Organisation for Economic Co-operation and Development (OECD) has developed internationally agreed Principles of Corporate Governance, which have served as a basis for regional policy dialogue programmes throughout the world (IFC, OECD and GCGF, 2009).

The capital markets provide investment vehicles ranging from bonds, shares and unit trusts. A 2002 NSE report highlighted that the Capital Markets Authority (CMA) had issued guidelines for the development of Collective Investment Schemes (CIS) in 2001 in an attempt to deepen the capital markets access to more investors.

CIS are linkages that pool the savings from individual investors to provide them with professional fund management, economies of scale, and to achieve wide diversification. They include Unit Trusts, Mutual Funds (open and closed), and Special Interest Collective Investment Schemes.

Unit trusts are becoming more popular in today's investment vehicles as the number of CMA-approved unit trust funds grew to 18 in 2014 from virtually none in 2001 (Kangethe, 2014). Since 2003, investors have invested over Shs 10 billion (US$ 145 million) in unit trusts in Kenya. CMA defines Unit Trust Fund as an investment scheme that pools money together from several investors with a shared financial objective to be managed by a group of professional managers who invest the pooled money in a portfolio of securities such as shares, bonds and money market instruments or other authorized securities to achieve the objectives of the fund. In exchange of the money received from the investors, the fund issues units to investors who are known as unit holders. The fund earns income from the investments in the form of dividends, interest income and capital gains (CMA).

1.1.1 Corporate Governance

The UK's "Cadbury Committee on Corporation Governance" definition of the topic (as cited by Lumumba, 2015) is that corporate governance as a field of economics is the system by which companies are directed and controlled. With the wave of corporate scandals, there has been a unanimous agreement on the importance of good corporate governance to firms and to an economy as a whole. Companies are under the spotlight than ever before to adopt governance best practices and to convince investors that they are responsible through governance.

Corporate governance has two faces: On one hand emphasize is on shareholder welfare and on the other hand is the stakeholder view which focus on accountability to market players for example suppliers (Awino, 2011).Adams and Mehran (2003) define corporate governance as a tool by which a company's stakeholders (creditors, shareholders, clients, the government and the society) monitor the management and insider in safeguarding their invested interested. A corporation that embraces good corporate governance practice provides crucial information to its equity holders and other stakeholders thus minimize information asymmetry (Luo, 2009).

In response to the collapsed corporations worldwide as linked to the structure and conduct of both the executive management and the Board of Directors (BODs), business scholars and professionals for example the Corporate Secretaries International Association (CSIA) and the Institute of Certified Public Secretaries of Kenya (ICPSK) have continued to champion the set-up of robust mechanisms that focus on ensuring good business and social practices, corporate values and protection of shareholders (Clarke, 2007).

At the centre of corporate governance discourse there are stakeholders, namely the board of directors, the executive management and the shareholders. Codes of corporate governance are a set of best practice recommendations that impact the structure and behaviour of the BODs of a company (Ruth et al, 2008). An independent audit committee too is a crucial stakeholder in corporate governance as it undertakes governance audits. The BODs, chief executive officer (CEO) and shareholders comprise of the internal governance mechanism whereas the external corporate governance mechanism include foreign, institutional, individual investors, government, customers and creditors and stakeholders in general.

1.1.2 Financial Performance

Financial Performance is a discriminative measure of how efficiently and effectively a firm uses the resources at its disposal in its primary business to generate revenues (Gitari, 2008). Financial variables found in the financial statements such as revenue from operations and cash flows can be used. Performance evaluation of unit trusts is an imperative aspect of determining whether fund managers do add value to the fund pooled together by unit holders. The analysis of accounting variables will explain the earning power of a company and which by large reflect the net outcome of an array of policies and decisions (Michael and Eugene, 2011).

For Unit Trusts, there are various determinants involved in the running of the business. Importantly it is the total expense ratio (Ombongi, 2014). IMAS in its publication of 'Making Sense of Unit Trusts' defines 'total expense ratio' as the operating expenses of the fund expressed as a percentage of the fund's assets. In this ratio the management fees

and trustee fees form a large component, is calculated to ensure that investors are properly informed of all relevant costs of having their funds managed (http://www.moneysense.gov.sg/). It also enables meaningful comparison among fund managers with different cost structures.

Secondly Indro et al (1999) argued that fund size of a unit trust has a significant role on its performance. They expounded their argument further that with a fund size that is growing this will provide cost advantages, since brokerage costs for bigger transactions are lower while research expenses increase less than proportionately with fund size (Ombongi, 2014). However when optimal fund size is attained, empirical argument is that extra-large funds could deviate from original investment objectives and start focusing on low quality assets and increased administrative costs (Ombongi, 2014).

1.1.3 Corporate Governance and Financial Performance

The unilaterally agreed value of corporate governance is: its creation of better corporations through improved access to and lower cost of capital as well as better risk management. Corporate governance makes a provision for self-regulation thereby meaning that corporations have a chance for self-initiative to reward from good governance practices. Earlier empirical evidence has argued that superior corporate governance mechanisms are highly regarded by the stock market (Center for Corporate Governance HHL, 2012). For example, prior findings argue that good corporate governance system is a superior determinant for firm valuation (Lang et al, 2003), market liquidity (Roulstone, 2003), cost of equity (Bowen et al, 2008) and firms credit ratings.

Bruno (1999) states that performance evaluation is a two folds affair: the determination of whether the fund manager added value by outperforming the set target and how the fund manager attained the calculated return. Investors will be interested in knowing whether the fund manager achieved the return by market timing, by buying low capitalization stocks and by buying undervalued stocks. A poor sense of corporate governance will stress investment returns thus undermining investor's confidence (Governance Journal of ICPSK, 2015) and therefore high cost of long term investment.

For public traded firms the most commonly discussed benefit of good governance is the effect on share value, liquidity and investor portfolio composition (IFC, OECD and GCGF, 2009). Black, Jang and Kim (2006) have contributed to the growing number of empirical evidence by identifying that well-governed corporations receive higher market valuations. These firms are perceived as investor-friendly thus creating investor's confidence that their investment is going to generate returns without abusing shareholder rights (IFC, OECD and GCGF, 2009).

1.1.4 The Nairobi Securities Exchange, Capital Markets Authority and Unit Trusts

The Nairobi Securities Exchange (NSE) was founded as a voluntary association of stakeholders in 1954 having been registered under the societies Act. It is licensed and regulated by the capital markets authority (CMA). It's mandated to provide a trading floor for listed firms securities and playing the oversight role for its member firms (Maina, 2011). The CMA plays a critical role in a given financial system. The CMA was established in 1989 through an act of parliament (Cap 485A laws of Kenya) (Maina, 2011). In January 1990 the authority was constituted and its inauguration done on 7th

march 1990. The authority's mandate is to regulate, facilitate and promote development of an orderly, fair and efficient capital markets in Kenya (CMA Act 2002).

A gazette notice No.3362 of the year 2002, held guidelines on corporate governance practices that the CMA issued for Kenya's public traded corporations to adhere to. In it covered was the scope of principles of good governance practices that companies use to formulate virtues and foundation (Maina, 2011). They include; boards, chairman's role and that of chief executive; shareholders; accountability and audit and general guidelines on company secretaries and auditors, chief financial officers and disclosure.

According to African Alliance publication, a unit trust is an investment that enables the pooling of money amongst investors who have similar investment objectives. Experienced investment managers, such as African Alliance, then invest this pool of money in a wide range of financial assets. Unit trust is a convenient and low cost way of investing in financial markets otherwise difficult to access by retail investors. Furthermore it constitutes an umbrella scheme whose shares are split into a number of different class schemes or sub-schemes, each of which is managed by or on behalf of a common promoter (CMA).

The latest registration of Centum Unit Trust Fund made the number of approved collective investment schemes to be 18 (Kangethe, April 9 2014). Only unit trusts schemes that are approved by the Capital Markets Authority may be offered for sale to the Kenyan public. Such schemes must comply with the Capital Markets Act Cap 485 A and also the Capital Markets (Collective Investment Schemes) Regulations 2001.The existence of a unit trust is justified by a deed or indenture regulating the rights, powers,

and duties of the parties to the arrangement (Harman, 1987). Ordinarily Unit Trust funds available in Kenya today include: equity, money market, balanced, fixed income, bond fund, managed retirement and growth fund.

In 2010 the fund management industry reported profits after tax of Sh3.3 billion from Sh446 million with British American Asset Managers (BAAM) being the market leader in the industry measured by assets under management (CMA, 2011). The value of assets under management in the same year increased by 68 per cent due to gains in share price at the stock market and increased purchase of treasury bonds (Maiyo, 2007).

In the same year the total assets of Unit Trusts increased by Sh11 billion to Sh28 billion from Sh16.8 billion in 2009 (CMA, 2011). Total revenue that includes unrealized gains on securities, increased more than four times to Sh3.8 billion compared to the 2009 level of Sh868 million.

1.2 Statement of the Problem

The World Bank report explains corporate governance to be a framework for creating trust between company and its stakeholders (World Bank, 2008). The IFC, OECD and GCGF (2009) propose that code of good governance covers provisions on: confidentiality, conflicts of interest, privileged information usage, gifts donations and acceptance, basic principles of good conduct, accounting and administrative transparency, protection of minority shareholder rights etc. Researchers are in dispute over the direct link between performance and governance with some arguing that there is no universal framework to ascertain how corporate governance mechanism influence corporate performance. Limitations include: the difficulties in defining and measuring

corporate governance improvements and success attribution, since superior corporate governance may not be the sole catalyst for better performance by a particular firm (IFC, OECD and GCGF, 2009).

In Kenya the number of collapsing firms and those being put under statutory management has been on the increase (Governance Journal of ICPSK, 2015). A survey conducted by Ernest and Young (E&Y) between December 2014 and January 2015 confirmed that more than fifth of Kenyan executives admit to the existence of financial report manipulation (Business daily June, 2015). This puts to the spotlight the current state of corporate governance in the East Africa's largest economy. A selection of fund performance determinants that researchers base on include: asset allocation, investment style, systematic risk, fund size (Indro et al. 1999); research and trading costs and type of fund Management Company (Ombongi, 2014). All these determinants are left to the decisions of BOD's and executive management in consensus with stockholders/unit holders.

The existing conflict in empirical evidence on fund performance managed by different types of financial institutions can never be ignored. Frye (2001) found out that bank-managed bond funds were equally superior relative to their counterparts from non-banks.

McTague (1994) argued in support that this is due to banks conservative investment style which may lead to less transaction costs than their non-bank counterparts. Other researches prior to the 1990s indicated weak performance of bank funds relative to nonbank counterparts (Bauman & Miller, 1995). Manyuru (2005) in his study on corporate governance and organizational performance: a case of companies listed at NSE

made an opinion that the level of corporate governance was either high or very high, indicating how corporations deem it important. Kimanzi (2009) did a study on corporate governance practices and the performance of Afya Sacco Society limited and concluded that there was a positive and significant relationship between corporate governance and gross margin and ROA. Oyoga (2010) researched on corporate governance and performance of financial institutions in the NSE and concluded a positive relationship between performance and board's composition, shareholding and compensation and shareholders rights.

Kasanga (2011) studied the determinants of performance of unit trusts in Kenya; with a focus on money market funds and equity. His literature review concentrated on macro-economic aspects ignoring the internal factors like corporate governance audits. Shikuku (2012) in his research on unit trusts was concerned with effects of behavioral aspect on investment decision making by fund managers only captured such behavioral aspect like: anchoring, herd instincts, overconfidence and representativeness.

Ombongi (2014) studied the determinants of financial performance of 16 approved unit trusts in Kenya and concluded that fund size to be an important determinant of financial performance. She acknowledged the need for CMA to ensure policy measures to control the size of unit trust funds in order to safeguard the interests of Investors. There is a realization that none or little studies have focused on corporate governance as a specific determinant factor in the performance of unit trusts in Kenya. Building upon this background, this study aims at answering the question: does corporate governance practices affect the financial performance of unit trusts in Kenya?

1.3 Objectives of the study

This study intended to establish and identify relationship between corporate governance practices and the financial performance of unit trusts in Kenya.

1.4 Value of the study

Little is explained about the application of corporate governance by fund managers in achieving their value proposition. The study will be of help to the following parties:

The Unit Trust Investors: The study will enable investors know whether fund managers apply corporate governance practices in adding value to their invested capital.

The Management: The study will be of importance to fund managers since it will be able to tell the relationship between corporate governance and performance. Thus help them decide the kind of corporate governance mechanism to employ.

The Capital Market Authorities: The study will largely benefit the Capital Market Authority and the Nairobi Stock Exchange as it will provide the relevant insight to enable superior policy formation and guidelines.

Scholars and Researchers: The study will form a basis for further research to the academicians and other interested bodies. The scholars and researchers who would like to debate or carry out more studies on corporate governance and unit trusts will find this study useful as a basis of carrying out more studies in Kenya.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter looks into empirical studies that have been conducted in the past in the array of corporate governance. The chapter also puts forward theoretical framework of the study, that is literature on theoretical framework of corporate governance and the study in general. It starts with addressing the theoretical literature and then empirical literature.

2.1.1 History of Corporate Governance

In the 19th century laws that existed in governing corporations gave corporate boards the ultimate rights to govern the affairs of business without the consent of the shareholders. With time the rights of individual owners and shareholders have increased. By investing in a unit trust, it means investors giving up control over the investment decisions of instruments such as bonds, shares and other assets to the fund manager who will be making such decisions for them. There has emerged the need for corporate governance reforms as shareholders concern over administration and management issues rise.

The infamous Wall Street crash of 1929 sent a number of legal scholars such as Adolf Augustus Berle, Edwin Dodd and Gardiner Means into times of pondering on the changing role of the modern corporation in the society. A monograph to the Modern Corporation and private property (Berle and Means, 1932) still notably continues to impact and influence on the conception of corporate governance in scholarly debates even today.

Fama and Jensen (1983) explained and propounded agency theory as a way in which corporate governance can be understood: the firm being viewed as a series of contracts. Eisenhardt (1989) elaborated the agency theory dominance. After the World War II the US witnessed up rise of multi-national corporations that created a managerial class. What followed was the witnessing of Harvard business school management scholars publishing articles investigating the managerial class prominence. They include: Myles Mace (entrepreneurship), Jay Lorsch (organizational behaviour), Alfred D., Chandler (business history) and Elizabeth Maclver (organizational behaviour) (Oyoga, 2010).

Since the late 1970s, corporate governance has become a subject of discussion around the globe and now in particular the emerging economies. There has been a necessity to reform corporate governance as shareholders want to exercise their rights of corporate ownership and increase wealth (Gatauwa, 2008). The East Asian financial crisis of 1997 that severely affected the economies of Thailand, Indonesia, South Korea, Malaysia and the Philippines resulted in the withdrawal of foreign capital after the collapse of property assets. This was blamed on the institutions inadequate corporate governance mechanism and in countering the crisis (Guha, 2003).

In Kenya, 1980's saw the collapse of the Rural Urban Credit Finances Company Ltd, Trust bank (1990s), in 2001 Delphi's Bank Ltd was placed under receivership, Euro Bank (2002) and Daima Bank (2003) was placed under statutory management. The profound symptoms associated with the fall of these institutions include: weak corporate governance practices, poor risk management strategies, insider lending and conflict of interest and lack of internal controls. Therefore the CMA has since come up with

guidelines and framework on good corporate governance as gazetted on May 31 2002. The guidelines were majorly aimed at addressing issues of listed firms on the NSE.

2.1.2 Unit Investment Trusts

The ever rising dominance and relevance of unit trusts as an investment instrument has motivated researchers to develop approaches to evaluate portfolio performance (Chia, 2000). So far the level of unit trusts' penetration and growth in Kenya reflects the extent of development of the economies financial sector. Unit trusts provide an investment opportunity for investors with modest means to trade in the stock market and those having relatively low risk tolerance (Chia, 2000).

Unit trusts are open-ended investment schemes, in that the investors have an immediate access to their fund. They also offer liquidity and diversity at affordable prices thus being attractive investments vehicle. The Capital Markets Authority Amendments Act (2000) identified the niche for Specific Investment Vehicles, with a focus on mutual funds and unit trusts thus creation of more opportunities for diversification by both retail and institutional investors (Wagacha, 2001).

2.2 Theoretical Review

Corporate governance is dynamic and diverse and the question that has been with every investment stakeholder has been whether in the modernity of business environment, corporate governance can be a tool for influencing a firm's financial performance thus its value proposition (Kihumba, 2015). Indeed there's no absolute direct evidence that supports a firms actual performance being influenced by the corporate governance process. In spite of the notable progress towards convergence there still remains a

divergence and differentiation on the bases of previous event studies. For instance there is an indication that a listed firm stock price will tend to depreciate with a more restrictive corporate governance structure (Jarrel and Poulsen, 1987).

Bhagat and Jefbrie (1991) argued that the adoption of certain charter amendments which business voluntarily elect to join, poison pills and presence of certain laws as statutory management or state takeover serve an example of restrictive aspects in corporate governance (Malatesta & Walkling, 1998). The inadequacy of management accountability to shareholders will lead to a restrictive governance structure (Oyoga, 2010). Evidently this will erode shareholders confidence in the firm's potential.

Traditionally there exist governance problems in two folds: that which is between shareholders and managers and the governance problem between minority shareholders and majority shareholders (Shleifer and Vishny, 1997). This has been regarded by scholars and practitioners as vertical and horizontal governance problems respectively with the consensus that the main governance problem in corporations is the horizontal type. This is witnessed when the majority shareholders work towards pushing out the minority (Clark, 1986). In the contemporary context however the vertical problem has emerged to be the major vice.

2.2.1 Agency Theory

Agency theory is concerned with integrating the interests of the owners of equity and managers (Fama and Jensen, 1983). It acknowledges the inherent conflict of interest between the firm's owners and its BOD's and managers. Adam smith in 1776 brought into light the existence of owners and management conflict. Later on the dynamism of

capitalism that was witnessed in the late 1800s and early 1900s created great distinction of the owners and the controllers in a firm. Managers who had knowledge and expertise on management were left with the majority power of control thus creating the possibility of pursuing self interest.

The relationship of agency theory and corporate governance comes in at the level of leadership structure and composition of the BODs. With incentive compensation, Singh (2005) argued that the interests of directors and managers are aligned with those of the shareholders. For instance the interest of the two parties are optimally aligned when managers are made to own part of the business. Therefore agency costs are inevitable (Jensen and Meckling, 1976). On the board composition, agency theory advocates for a good inclusion of non-executive directors who have the necessary skills, experience and courage to stand against an over-powerful CEO and other directors from the executive suite. Here self-interest actions will be managed. On leadership structure it includes key concern such as the duality of the CEO/Chairman role and how it affects firm's performance.

In a nutshell, the significance of agency theory on corporate governance and firm performance is that with a high level of non-executive directors sitting on the board a lot of self-interest risk would be addressed thus a high corporate performance (Nicholson and Kiel 2007). Better corporate governance reduces agency risk and the likelihood of minority shareholders' expropriation and possibly leads to higher dividends, making minority shareholders more willing to provide external financing (Center for Corporate Governance, 2012).

2.2.2 Stewardship Theory

Stewardship theory is built on the principle of social psychology, which looks at the behavior the board (Kerubo, 2011). It articulates with corporate governance theory and firms performance. First it perceives the executive management (the insiders) as stewards whose conduct must articulate with the objectives of the owners of equity. The managers are ordinarily expected to be committed and enthusiastic in attaining good performance. The primary motivation for managers is assumed to be their desire to accomplish a challenging task, practice authority, having a sense of responsibility and being recognized. These are non-financial gains and are man's intrinsic satisfaction.

According to Kerubo (2011) steward's behavior has higher utility than individualistic self-serving behavior, it is pro organizational and collectivistic and the steward seeks to attain the objectives of the organization. She also contends that with the shareholders wealth being maximized, the steward's utilities are maximized too. Stewards are engaged in addressing tensions between different interest groups. As Nicholson and Kiel (2007) put across, stewardship theory also argues for the focus on the proportion of insider managers sitting on the board. This essentially will be significant in identifying and accessing information, good decision making and thus improved firm's performance.

However empirical studies have produced conflicting finding on whether making a higher number of non-executive directors on the board adds value on performance front and vice versa. In dealing with scarce resource the fund providers expect the management and board to forego personal interest and put company's interest on the top agenda thus ensuring greater returns to the shareholders and interest groups. These thus make

stewardship theory a proposition for firm performance that aims at satisfying the demands of stakeholders.

2.2.3 Resource Dependency Theory

This school of thought identifies that resource constraints will limit the growth of a firm as necessitated by the need to balance goodwill, excess capacity and organizational slack.The general belief is that both the management and the board are entrusted to spearhead and direct the business towards accessing the limited resources. Therefore as Nicholson and Kiel (2007) examine having BODs that can produce critical links to a firm's important resources may influence the performance of that firm. They conducted a study of seven cases on which they found insignificant matching of the theory: negative correlation prevailed. For the matched case they discovered that low links within general business environment and low access to resources were symptoms of poor performance.

By linking the firm with external environmental factors this will see a reduced uncertainty and therefore the reduction of transaction cost associated with external linkage. Resource dependency theory supports the appointment of directors to multiple boards because of their exposure and privilege to gather information and network in various ways (Kerubo, 2011).

2.3 Determinants of Unit Trusts Financial Performance

There are a number of variables that are believed to determine the unit trusts' financial performance. These include: The expense ratio, fund size and portfolio management.

2.3.1 Expense Ratio

IMAS define expense ratio as the operating expenses of the fund expressed as a percentage of the fund's assets (http: //www.moneysense.gov.sg/.). Sharpe (1996) in his study support that fund with lower expenses exhibit better performance. According to Indro et al. (1999) passively managed funds incur lower costs and tend to outperform actively managed funds.

Actively managed funds incur numerous costs which are measured by the expense ratio, that include operating and research expenses. Empirical studies point out that funds with higher expenses, portfolio turnover and fees tend to earn high risk adjusted returns that offset the higher charges involved. Fund managers successful acquire and implement new information to offset their expenses.

2.3.2 Fund Size

Prior research papers suggest that there is an optimum fund size. Indro *et al.* (1999) conclude that fund managers need to attain a minimum fund size to achieve returns net of research expenses and other involved costs. They also note that marginal returns become negative after a fund exceeds its optimal size. Large funds do incur excessive costs resulting in diminished or even negative marginal returns (Ombongi, 2014). As commonly assumed, small unit trusts will perform better than large ones, based on a market liquidity theory which states that a large unit trust has difficulty in realizing its shareholdings without affecting the share price when it wants to change the balance of its portfolio. In practice fund managers may maximize fund size so as to increase their performance fees (Indro *et al.,* 1999).

2.3.3 Portfolio Management

Portfolio management is a process in line with the professional management of various securities that involves setting up investment policy, diversification and portfolio selection (Chandra, 2006).

2.3.3.1 Investment Style

Investors need to understand the investment style being adopted and objectives. Objectives are viewed in terms of risk and return (Chandra, 2006). The investment style ought to carry the identifiable objectives regarding expected investment returns and investors risk tolerance. It should state other constraints which could affect investment management. Such constraints include investor liquidity preference and investment horizon (period of time for investment) as projected by fund managers. Identifying investor's tolerance for risk is an important objective given that investors would like to earn the highest possible return (Ombongi, 2014).

2.3.3.2 Portfolio Selection and Diversification

The objectives and constraints will require that the fund manager specify asset allocation, that is, the percentage of portfolio to be invested in each of the asset categories: cash, bonds, stock, real estate, precious metals and others (derivatives) (Ombongi, 2014). As Chandra (2006) states, the basic proposition of asset mix is that; other things held constant, an investor with high risk tolerance should hold a portfolio that favors stocks and for the investor with low risk tolerance the portfolio should favor bonds. An investor with a longer investment horizon, other things being equal, should hold a portfolio in favor of bonds. For note, an investor should take into account the effect of taxes analyzing both taxable and tax- free securities when making investment decision. For

example the taxable bonds pay higher interest than tax-free bonds, however, one has to pay taxes on any income received (Gitman, 2007).

Pandey (2010) contends that diversification is a strategy that ensures the investor does not "put all the eggs in one basket." The fund manager will spread available capital among various investments anticipating that if one investment loses money, the other investments will make up for those losses. Having more securities in a portfolio will reduce the risk of individual securities in the portfolio (Pandey, 2010). Fund managers make it easy for investors to own a small portion of many investments.

2.4 Review of Empirical Studies

Tandelilin et al. (2007) study on the correlation among corporate governance, risk management and bank performance used a sample of 51 Indonesian banks for the period 1999 – 2004. They used a Triangle Gap Model with primary data analysis and secondary data analysis and concluded that bank ownership affects both the relationship of corporate governance and bank performance and corporate governance and risk management. They however found no linear effect of corporate governance on bank performance.

Rose (2007) examined the relationship between ownership and firm's performance, measured by Tobin's q. The study used a sample of all Danish firms listed at the Copenhagen Stock Exchange for the period 1998-2001 excluding banks and insurance companies. A cross sectional regression analysis proved that increased ownership by institutional investors had no effect on firm's performance. However ownership by banks had a positive significant impact on performance.

Barako and Tower (2007) investigated the association between ownership structure and bank performance in Kenya. Their empirical analysis included all financial institutions operating in Kenya and ran a multivariate regression with variables referring to ownership, bank size and ROA. The results provided a strong support that ownership structure influence bank performance. Board ownership was found to be significantly and negatively associated with performance. Institutional shareholders had no significant influence on performance and foreign ownership had a significant positive impact of bank's performance.

Abdullah (2009) investigated the performance of Malaysian unit trust investing in domestic versus international markets. He used Sharpe, Treynor and Jensen to measure the performance of 26 local funds and 23 internationally invested funds from 2004-2008. The results of Sharpe measure revealed that risk-adjusted performance of internationally diversified funds is not significantly different from the performance of well diversified domestic funds. However, investment of funds internationally was just conducted in 2005 hence longer period of data can be studied in the future to get more result.

Kagunda (2011) study of asset allocation by fund managers and the financial performance of unit trusts in Kenya established that asset allocation determine the difference in returns across time. He surveyed equity-based funds and schemes that deal with stocks traded in Kenya for the period 2005-2009. This restriction limited the number of funds available for evaluation. The study also found out that asset allocation and the financial performances of unit trusts is a comprehensive measurement and mitigation method used for various organizations hence much important if effectively implemented and utilized.

Dewi and Ferdian (2012) evaluated the performance of Islamic mutual funds in Indonesia and Malaysia from January 2006 to April 2009. They used 5 different performance measures: Sharpe, Treynor, Jensen, Snail Trail Methodology and Market Timing. The study showed that Indonesian Islamic mutual funds slightly outperform the Malaysian Islamic mutual funds in terms of the asset allocation funds. However, Sharpe index indicated that Malaysian asset allocation funds were relatively better diversified than their Indonesian counterpart. Fund managers in both countries were found to have no market timing ability to increase the funds' return as a whole.

Yong and Jusoh (2012) studied relationship between fund characteristics and fund performance: evidence of Malaysian mutual funds. They focused on 69 Malaysian mutual funds between 2006 -2009. The results showed that higher risk provides higher return and management expenses do influence fund performance. They also found that young funds perform better than the old ones in the market. However, fund size and turnover ratios have no significant relationship with the fund performance.

Otieno (2012) examined corporate governance factors and financial performance of commercial banks in Kenya spanning five years. With a population of 44 commercial banks, a sample ratio of 0.3 was used to obtain sample. 13 CEOs from the sampled banks were served with questionnaires. SPSS was used together with Spearman correlation coefficient and multiple regression analysis. Corporate governance was found to support bank stability, performance and bank's ability to provide liquidity in difficult market conditions. From the findings, corporate governance factors accounted for 22.4 % of the financial performance of commercial banks.

Ombongi (2014) investigated the determinants of financial performance of unit trusts in Kenya. She studied registered unit trusts with money markets, equity, fixed income, bond, growth, and balanced funds categories for the period 2008-2012. For the determinants of financial performance she used fund size, expense ratio, equity fund allocation ratio, fund type, diversification of funds and the minimum investment amount. Jensen's Alpha model was used to analyze variables. The study showed that only fund size is a critical determinant of performance. Diversification and minimum investment amount were found to be having an impact on overall fund performance.

In conclusion it seems evident that the determinants of performance of unit trusts do include: expense ratio, fund size, investment style and portfolio diversification (Ombongi, 2014). It is also evident that there are limited extensive empirical studies on determinants of performance of unit trusts in Kenya. Particularly there is lack of empirical studies on the relationship between corporate governance and performance of unit trust in Kenya. This study will seek to address this academic gap.

2.5 Summary of Literature Review

For note is that in literature, many researchers have investigated the relationship between firm performance and governance mechanisms. The results, however, are varied. Some researchers like Himmelberg et al. (1999) focused only on the relationship of a single governance mechanism on performance. Kee et al. (2003) support the argument that having a higher proportion of non-executive directors in the board impacts reducing the agency cost. Contrariwise, Coles et al. (2001) confirmed lack of significant relationship between non-executive directors' proportion and performance.

A Leadership Structure where there is the separation of the role of CEO and chairman as a sign of good governance has been advocated in the UK report. However past empirical studies fail to concur. Weir et al. (2002), and Weir and Laing (2000) find no visible relationship between firm performance and CEO duality. The U.K Code points out the essence of institutional holdings and how institutions should take an active role in governance, for a positive relationship with firm performance. Arguably empirical evidence does not support this thought as Faccio and Lasfer (1999) proved lack of a significant relationship for U.K firms.

Clearly prior studies have applied singled out, two or three corporate governance variables approach to examine the agency problem and have fell short of focusing on the corporate governance mechanisms scorecard approach that tends to be more comprehensive. Not much has been done in terms of research work on the Kenya's unit trust industry performance. Several studies have been aimed at investigating the investment in mutual funds relative to mutual fund returns, but an extensive study on the performance of active unit trusts based on the corporate governance is lacking. This study therefore intends to contribute to the debate by conducting a detailed study of the relationship and effect of corporate governance mechanisms on the performance of unit trust in Kenya.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter explains the research design of the study, population of interest, sample design, type of data to be used and source of data, data collection methods and analysis technique. In this academic research the perceived key corporate governance practices and the financial performance of unit trusts in Kenya between years 2010-2014 were investigated. Corporate governance was considered in terms of principles and practices while performance is to be quantified in terms of net asset value, average yield and total fund; equity fund allocation and initial investment amounts.

3.2 Research Design

A descriptive research design was adopted for this study since it permits a deeper search for factual information regarding the relationship between corporate governance and performance of unit trusts. Kothari (1985) explained that descriptive research will be ideal when there are specific objectives therefore presenting definite conclusions.

Descriptive research objective is to describe the state of affairs, as it exists at present. The research used the scorecard methodology which enables the researcher to evaluate corporate governance principles and practices in a systematic manner (Gitari, 2008). The degree of satisfaction of each governance principle variable was assessed by the respondent and awarded a score to the variable on a scale of 1 to 5.

3.3 Study Population

Mugenda and Mugenda (1999) explain population to mean a holistic take of individuals, events or objects possessing common observable characteristics. By the year 2009 there were twenty six approved CIS in Kenya, (Kenya Gazette April, 2009). Currently the population of unit trusts registered under the Capital Markets Authority Cap. 485A stands at 18 (Appendix I) (Kangethe, April 9 2014). To serve the research objective better a census survey will be ideal for this study. Each unit of the study will be served 2 questionnaires.

First given that the number of unit trusts is relatively small to render sampling unnecessary and second, it is a prudent approach to hedge on the anticipated non response as a result of unavailability of intended respondents (Ngige, 2012). Cooper & Schindler (2003) as cited by Ngige describe a census survey to mean a method where data is collected from all members of the population.

3.4 Data Collection

Both primary and secondary data was used for this study. The primary data was accumulated using a Likert scale questionnaire (Appendix ii) serving the respondents with the same set of structured questions. The questionnaire included governance variables being viewed as superior motivators in financial performance. The respondents to be served with questionnaires are the PR managers and company secretaries or senior managers. The total number of questionnaires issued out to the targeted unit trusts is 36. The questionnaire was designed to contain both closed and open ended questions and subject to a pilot test on three different unit trust companies for appropriateness.

The respondents are to feedback on the design, validity and content. A drop and pick method of distribution was used with an introductory letter accompanying the questionnaires. The respondent's answers were rated on a scale of 1 to 5. Whereby: 1 = Very Poor (20%), 2= Poor (40%), 3 = Fair (60%), 4 = Good (80%), 5 = Excellent (100%). Secondary data was accumulated from annual financial publications and reports sourced from the respective unit trust, NSE and CBK database. Data on performance of unit trusts included: ROE, net asset value, average yield, total fund and initial investment amount by unit trust; covering a four year period starting from 2010 to year 2014.

3.5 Data Analysis

Both quantitative and qualitative methods of data analysis were used. Both secondary and primary data were analyzed quantitatively through descriptive statistics that include percentages, frequencies and mean (Ngige, 2012). Data collected through the questionnaires was cleaned and checked for completeness and consistency.

Correctly filled questionnaires deemed fit for analysis were coded. Content analysis was done on questionnaire's qualitative data so as to compare the respondent's response on the effect of corporate governance in unit trust performance. To communicate a clear picture on the results the data was summarized and tabulated. ROE as an indicator of financial performance was analyzed in trend analysis in order to indicate the direction the financial performance has been taking.

Corporate governance being the independent variable was measured in the four levels as presented in the questionnaire. That is**:** corporate governance practices (CGPR), shareholders rights and responsibility (SRR), disclosure policies and practices (DPP) and

corporate governance policies (CGPO) (Otieno, 2012). Financial performance being the dependent variable was measured in terms of ratio of actual income performance over the budgeted revenue. And expenditure performance ratio: actual expenditure over budgeted expenditure (Otieno, 2012).

A multivariate regression model was used to express the relationship between the corporate governance factors and financial performance indicator (ROE) of unit trusts. Statistical tool ANOVA was used on the regression model and significance testing was done using *t*-test. Given that the study is a survey the researcher therefore worked with a significance level of .01.

3.6 Variable for Unit trust Financial Performance

The study sought to apply return on equity (ROE) as a sole variable for unit trust performance. This variable represents the unit holder's return on investment. It is a ratio of the profit earning to total shareholder equity as presented in a company's balance sheet (Otieno, 2012).

R.O.E = Net income

Shareholders' equity

The higher a company's R.O.E relative to industry average, the better.

3.7 Performance Equation

The equation below was applied to statistically illustrate the unit trust corporate governance mechanism/practices effect on ROE as an indicator of Unit Trust financial performance:

$$ROE = \beta 0 + \beta\ 1\ CGPR + \beta\ 2\ SRR + \beta\ 3\ DPP + \beta\ 4CGPO + \acute{\varepsilon}$$

Where:

CGPR - Corporate Governance Practices

SRR - Shareholders Rights and Responsibility

DPP - Disclosure Policies and Practices

CGPO - Corporate governance policies

$\acute{\varepsilon}$- Standard Errors

3.8 Test of Significance

A correlation matrix for various possible combinations of dependent (ROE) and independent (Corporate Governance) variables was done, Appendix III. It served to confirm if there is significant correlation between the variables and to identify if there is a linear relation (Otieno, 2012). The significance of the model was done using the *t*-test at 95% level of confidence. "ANOVA" table was applied to find the f-value and p-value (sig.): if p-value is smaller than alpha, then the model was deemed significant. The goodness of fit of the model was tested. R-square (coefficient of determination) measured the proportion or percentage of the total variation in Y explained by the regression model (Otieno, 2012). "Coefficients" table were used to interpret beta values. If there is no significance of the model, an interpretation on the variables were made saying either "corporate governance is of little help explaining ROE." or stating "no linear relationship between corporate governance and ROE."

CHAPTER FOUR

RESULTS AND DISCUSSION

4.1 Introduction

The chapter presents the study results that were obtained according to the response given from the questionnaires as well as the secondary data collected. The results are presented in table and chart formats where appropriate and interpretation of the results given after the presentation. Discussion of these findings is as well given under this chapter.

4.2 Descriptive Results

Under this section, the mean and frequency statistics are used to present the results obtained in data collection. The data presented is the mean response for the aspects of corporate governance practices, disclosure policies and practices, corporate governance policies and the shareholder right and responsibility. Data on the measure of financial performance (ROE) is also summarized and presented under this section. Table 4.1 presents the results on the corporate governance practices:

Table 4.1 Corporate Governance Practices

	Mean	SD
The number of board members currently serving is optimal and justifiable. All Board members have been appointed.	2.015	0.974
The company has nonexecutive directors who are independent serving.	2.101	1.782
There is potential conflict of interest between the company and the Board and Chairman.	3.221	0.999
The company has unequivocal list of shares owned by the members of the Board and Chairman.	2.002	0.895 2
The Board is responsible for vision, mission and Strategic plan. The Boards leadership is effective.	2.017	0.917
The company provides an internal nomination process for the Chairman.	3.001	1.012
The company has internal written policy regarding board members having recurrent positions as directors in other companies.	3.230	0.989
There is an independent committee mandated to deal with the determination of executive compensation and director's remuneration.	2.174	0.883
The Functioning of the board and its relations with executive management / role of directors are seamless.	2.215	1.156
The Board composition and structure is ideal for achieving its mandate.	2.193	1.005
The organization structure enables it to maintain corporate integrity, reputation and responsibility.	2.021	0.992
The organization structure is often reviewed by the Board.	3.002	0.731
The Board often reviews the values and strategies of the company	2.158	0.608
The company ensures a level of accountability, governance audits and transparency,	2.027	1.100
The company ensures compliance with relevant laws, regulations, and governance practices, accounting and auditing standards	2.005	0.593

The study results as presented in table 4.1 are in mean and standard deviations for the responses given on a scale of 1 to 5 where a mean value of 1.0 – 1.9 indicates a strong extent of agreement, 2.0 – 2.9 agree, 3.0 – 3.9 uncertain, 4.0 – 4.9 disagree and a mean value above 4.9 indicates a strong extent of disagreement.

According to the results, majority of the respondents agreed leading to a mean score in the interval of 2.0 -2.9 for the agreement for various aspects given. Thus, based on the scores, majority of the respondents reported that, in their organizations, the number of

board members currently serving is optimal and justifiable; all Board members have been appointed. The companies studied have nonexecutive directors who are independent serving. Findings as well show that majority of the companies have unequivocal list of shares owned by the members of the Board and Chairman.

From the table also, in majority of the companies, the Board is responsible for vision, mission and Strategic plan; the Boards leadership is effective. There is also an independent committee mandated to deal with the determination of executive compensation and director's remuneration in the companies considered. Findings also show that the Functioning of the board and their relations with executive management/role of directors are seamless in the companies considered.

According to the results also, the Board composition and structure is ideal for achieving their mandate in the studied companies. The organization structure for the companies enables them to maintain corporate integrity, reputation and responsibility. Results further indicate that the Boards often review the values and strategies of the companies. As well, the companies ensure a level of accountability, governance audits and transparency. The companies according to the results ensure compliance with relevant laws, regulations, and governance practices, accounting and auditing standards.

The respondents however did not give sufficient evidence in their agreement extent to the following aspects; there is potential conflict of interest between the company and the Board and Chairman, the companies provide an internal nomination process for the Chairman, the companies have internal written policy regarding board members having recurrent positions as directors in other companies as well that the organization structure

of the companies is often reviewed by the Boards. These obtained a mean value in the interval of 3.0 – 3.9 which is the interval for uncertain level of agreement indicating that the respondents neither agreed nor disagreed to the given aspects.

Table 4.2 Disclosure Policies and Practices

	Mean	SD
The company adopts disclosure policies and practices.	1.991	0.635
The Board communicates to stakeholders on disclosure policies and practices.	2.901	1.181
There is a high level of formalized governance policies: codes and guidelines.	3.231	0.707
The Board meets often as stipulated.	2.012	0.931
The company has an audit committee, compliance committee, risk management committee.	2.115	1.015
The company has code of corporate governance which covers the specification of; the rights of shareholder, duties of directors, rules of disclosure	3.531	1.212
The company has ensured board's balance of power so that it can exercise objective and independent judgment in making decisions and reporting to stakeholders.	2.021	0.492
The Board often asses its performance and effectiveness as a whole and that of individual members and CEO's.	2.102	0.691
The Board identifies the corporate internal and external stakeholders; agree on policies determining how the corporation should relate to, and with them.	3.006	0.735
The Board recognizes that it is in the corporation's enlightened self-interest to operate within the mandate entrusted to it by society and shoulder its social responsibility.	4.111	1.182
The Board often reviews the company's social responsibility concern.	2.521	0.592
Overall, the board's commitment to corporate governance is high.	2.002	0.488
The board recognize the shareholder rights and role; Strengthening of shareholders' rights and maintaining alignment.	2.015	0.973
The company's leadership structure provides for distinctiveness of the CEO and the chairman; the office holders are different persons.	2.101	0.844

Findings as presented in table 4.2 shows that, majority of the respondents agreed to the given aspects. Based on the mean response, the findings indicate that; the companies adopt disclosure policies and practices as this obtained the highest score of 1.991

indicating that the respondents strongly agreed to this. The respondents also agreed indicating that; the companies' Board communicates to stakeholders on disclosure policies and practices. Majority of the companies have an audit committee, compliance committee as well as risk management committee that meets often as stipulated.

According to the findings also, the companies studied have ensured board's balance of power so that it can exercise objective and independent judgment in making decisions and reporting to stakeholders. In these organizations, the respondents agreed indicating that the boards often asses their performance and effectiveness as a whole and that of individual members and CEOs'. The Boards often review the companies' social responsibility concern. The overall boards' commitment to corporate governance is also high as reported by majority of the respondents. Further, the study findings indicate that the companies' boards recognize the shareholder rights and role thus strengthening of shareholders' rights and maintaining alignment as well that the companies' leadership structure provides for distinctiveness of the CEO and the chairman; the office holders are different persons.

From the table also, the respondents neither agreed nor disagreed that; in the companies, there is a high level of formalized governance policies: codes and guidelines. Also, the respondents were undecided on the opinion that the companies had drafted code of corporate governance which covers the specification of; the rights of shareholder, duties of directors, rules of disclosure as well that the Boards identifies the corporate internal and external stakeholders; agree on policies determining how the corporation should relate to, and with them. However, the respondents disagreed indicating that the boards

does not recognize that it is in the corporation's enlightened self-interest to operate within the mandate entrusted to it by society and shoulder its social responsibility. This had a mean value of 4.111 and a standard deviation of 1.182 indicating that the respondents disagreed to this aspect.

Table 4.3 Corporate Governance Policies

	Mean	SD
The level of board ownership is ideal and justifiable.	2.897	0.769
The board recognizes and advocate for institutional holding.	2.276	0.881
The boards monitoring and control role is effective	2.711	0.609
The board's role in terms of access to resources, strategy-advice and counsel is effective.	2.109	0.929
The company provides equal access to information for shareholders and investment analysts.	2.001	0.615
The reports prepared for annual shareholders meeting contain not only basic information but sufficient details to enable investment analysts to assess the financial and non-financial performance of the company.	2.900	1.302
The company avail its financial results and management analysis for analysts.	2.121	0.832
The company posts its financial results and management analysis on the internet.	2.016	0.911
The board's inclusion in terms of committees and business risk management is effective.	2.092	0.559
The Board is effective in terms of delegation, skills, experience and knowledge.	2.114	0.724

As shown in table 4.3, the respondents agreed to all the aspects given as all the aspects obtained a mean response in the interval 2.0 – 2.9 indicating a moderate extent of agreement. Based on the results, the table shows that; in the studied organizations, the level of board ownership is ideal and justifiable. Also, the boards recognize and advocate for institutional holding. The boards also play their monitoring and control role effectively.

According to the respondents, the board's role in the organizations in terms of access to resources, strategy-advice and counsel is effective. Findings also indicate that the companies provide equal access to information for shareholders and investment analysts as well that the reports prepared for annual shareholders meeting contain not only basic information but sufficient details to enable investment analysts to assess the financial and non-financial performance of the company. These companies as well avail the financial results and management analysis for analysts. The financial results and management are as well posted on the internet. In the organizations, the board's inclusion in terms of committees and business risk management is effective. Further, in these organizations, the board is effective in terms of delegation, skills, experience and knowledge.

Table 4.4 Shareholder Right and Responsibility

	Mean	SD
Shareholders are encouraged to attend and vote during the AGM.	1.837	0.642
There is adequate opportunity for shareholders to receive and review the financial reports in order to ask for questions to be put on the agenda at the AGM.	2.006	0.711
There is a provision for adequate time given during the AGM for shareholders to ask questions.	1.901	0.803
The AGM decides the following items: appointment of Board, compensation of Board and appointment of external auditors	1.814	0.904

With regard to the shareholders' right and responsibility in the organizations, findings as shown in table 4.4 indicate a high extent of agreement to the given aspect as given by the mean values. A high extent of agreement was obtained for the aspects of; encouraging shareholders to attend the AGM (1.837), provision for adequate time for shareholders to ask relative questions during the AGM (1.901) and the decisions made during the AGM including appointment of Board, compensation of Board and appointment of external auditors (1.814).

The respondents also agreed that there is adequate opportunity for shareholders to receive and review the financial reports in order to ask for questions to be put on the agenda at the AGM. This had a mean response of 2.006 with a standard deviation of 0.711 indicating a moderate extent of agreement to this aspect.

Table 4.5 Financial Performance Summary

	Mean	Std. Deviation
Profitability (ROE)	.891	.795

According to the results as presented in table 4.5, the average organizational performance for the years 2010 to 2014 would be summarized as 0.891. This obtained a standard deviation of 0.795 showing there is less variance in the profitability margin of the companies studied from the average organizational performance measure.

4.3 Inferential Results

Inferential methods of correlation and regression analysis have been used in the study to test the association and the relationship between the study variables respectively.

4.3.1 Correlation Results

Table 4.6 presents the correlation test results which are based on the Pearson Coefficient correlation scale to measure the strength of the association. A significance level of 5% was used setting the significance coefficient at 0.025.

Table 4.6 Correlation Results

		Financial Performance	CGPR	CGPO	DPP	SRR
Financial Performance	Pearson Correlation	1	.716**	.759*	.636**	. 873*
	Sig. (2-tailed)		.001	.014	.007	.016
CGPR	Pearson Correlation	.716**	1	.737**	.888**	.334**
	Sig. (2-tailed)	.001		.000	.000	.001
CGPO	Pearson Correlation	.759*	.737**	1	.568**	.293**
	Sig. (2-tailed)	.014	.000		.000	.003
DPP	Pearson Correlation	.636**	.888**	.568**	1	.454**
	Sig. (2-tailed)	.007	.000	.000		.000
SRR	Pearson Correlation	. 873*	.334**	.293**	.454**	1
	Sig. (2-tailed)	.016	.001	.003	.000	

**. Correlation is significant at the 0.01 level (2-tailed).
*. Correlation is significant at the 0.05 level (2-tailed).

According to the findings in table 4.6, the financial performance has a strong positive correlation with the corporate governance practices. This had a correlation of 0.716 and a significance value of 0.001 which is less than 0.025 revealing the significance of the association. The association between financial performance and the corporate governance policies indicated a correlation of 0.759 which is a strong positive correlation significant at the 5% level as indicated by its p-value of 0.014. The disclosure policies and practices and financial performance had a correlation of 0.636 with a p-value of 0.007 revealing the significance of the association.

From the table also, a strong and positive correlation was found between the shareholder right and responsibility and the financial performance of the companies. This had a correlation coefficient of 0.873 which is the strongest correlation above the other associations and a p-value of 0.016 less than 0.025 the critical value at the 5% level of significance.

4.3.2 Regression Results

In this study, regression analysis was used to test the relationship between the dependent and independent variables. The relationship between the variables was tested at the 5% level where the R-square (coefficient of determination) was used to show the percentage of the changes in financial performance as explained by the independent variables. ANOVA was used to test the reliability of the model in presenting the relationship between the variables. Table 4.6 gives the regression model summary;

Table 4.7 Regression Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.897[a]	.889	.865	1.5201

a. Predictors: (Constant), corporate governance practices, corporate governance policies, disclosure policies and practices, shareholder right and responsibility

Findings as illustrated in Table 4.7 reveal that the coefficient of determination (R2) equals 0.889. This shows that holding other factors constant, the predictor variables in this study (corporate governance practices, corporate governance policies, disclosure policies and practices and the shareholder right and responsibility) explains 88.9% of the variation in the financial performance of the organizations reviewed. Thus, the variation due to other factors that were not considered in the study is 11.1% implying that the variables used command a significant variation in the financial performance.

The adjusted R Square in the table is 0.865 indicating that incase where the study population could have been used other than a sample, the study results could have varied by 13.5% from the current results. Therefore, the study results are 86.5% valid as shown by the adjusted R square value.

Table 4.8 Analysis of Variance (ANOVA)

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	43.420	1	43.420	4.912	.016[a]
	Residual	26.521	3	8.840		
	Total	69.941	4			

a. Predictors: (Constant), corporate governance practices, corporate governance policies, disclosure policies and practices, shareholder right and responsibility

b. Dependent Variable: Financial Performance

From the table, the significance value is 0.016 which is less than 0.025 the critical value at the 5% level in a 2-tailed test. This therefore shows that the model is statistically significant in predicting the financial performance of the organizations with the use of the variables selected. The F critical at 5% level of significance is 3.23 whereas from the table, the F calculated is 4.912 which is greater than the F critical. Thus, the overall model was significant in presenting the relationship between the variables.

Table 4.9 Regression Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.729	.454		1.014	.000
corporate governance practices	1.412	.416	1.021	1.146	.012
corporate governance policies	.942	.931	1.006	1.113	.004
disclosure policies and practices	1.809	.479	1.416	1.073	.021
shareholder right and responsibility	1.016	.025	.958	1.619	.000

a. Dependent Variable: Financial Performance

The coefficients in table 4.9 answer the regression equation relating the depended and the independent variables. Testing the significance of the coefficients at 95% significance level, the table indicates that all the variables had a significance value less than 0.05 thus confirming the significance of the results. Also, from the table, all the variables indicated

a positive coefficient indicating a positive relationship between the dependent and independent variables. Based on these coefficients, the regression model therefore becomes;

$Y = \alpha + \beta 1\ X1 + \beta 2X2 + \beta 3X3 + \beta 4X4$

Financial Performance (ROE) = 0.729 + 1.412 X1 + 0.942 X2 + 1.809 X3 + 1.016 X4

Thus, the model indicates that, holding the predictor variables constant, financial performance would be 0.729. From the results also, a unit growth in the corporate governance practices would result to 1.412 times increase in financial performance. The model also shows that, given a unit increase in corporate governance policies would experience 0.942 times increase in financial performance whereas a unit growth in disclosure policies and practices would result to 1.809 times increase in financial performance. Findings also show that given a unit increase in shareholder right and responsibility, the financial performance of the companies would experience a positive growth with 1.016 times.

4.4 Discussion of Findings

The study findings revealed that the financial performance of unit trusts has a strong positive correlation with the corporate governance practices. The correlation coefficient for this association was 0.716 which was found to be statistically at the 5% level with a significance value of 0.001. The study also indicated a strong positive correlation between financial performance and the corporate governance policies with a correlation coefficient of 0.759 and a p-value of 0.014. The disclosure policies and practices and

financial performance as well were found to have a positive and significant correlation of 0.636 with a p-value of 0.007.

The association between financial performance and shareholder right and responsibility had the strongest correlation of 0.873 with a p-value of 0.016. Thus the study results on testing the association between corporate governance practices and financial performance indicated a positive and significant association between these variables. These results were contrary to the findings of a study done by Tandelilin et al. (2007) on the correlation among corporate governance, risk management and bank performance. Their study concluded that bank ownership affects both the relationship of corporate governance and bank performance and corporate governance and risk management. However, they found no linear effect of corporate governance on bank performance which is contrary to the current findings.

Testing whether there is a linear relationship between corporate governance practices and financial performance of the companies, regression analysis was conducted. Findings reveal that the corporate governance practices accounts for 88.9% changes in the financial performance of the unit trusts holding other variables constant. The linear model relating these variables was also proved to be statistically significant and reliable through the ANOVA test which gave a F-value of 4.912 and a significant value of 0.016 at the 5% level. In line with these, Otieno (2012) in his study on corporate governance factors and financial performance of commercial banks found out corporate governance supported bank stability, performance and bank's ability to provide liquidity in difficult

market conditions. His study revealed that corporate governance factors accounted for 22.4 % of the financial performance of commercial banks.

The relationship between corporate governance practices and financial practices was found to be a positive relationship which is significant at the 5% level of significant. Findings showed that financial performance and corporate governance practices could be related in the liner model; **Financial Performance (ROE) = 0.729 + 1.412 X_1 + 0.942 X_2 + 1.809 X_3 + 1.016 X_4.** This showed that holding the predictor variables constant, financial performance for the unit trusts would be 0.729 in which a unit growth in the corporate governance practices leads to 1.412 times increase in financial performance. The model also shows that, given a unit increase in corporate governance policies would lead to 0.942 times increase in financial performance whereas a unit growth in disclosure policies and practices would result to 1.809 times increase in financial performance. Findings also showed that given a unit increase in shareholder right and responsibility, the financial performance of the companies would experience a positive growth of 1.016 times. These findings as well support the findings of Indro et al. (1999) which illustrated that passively managed funds incur lower costs and tend to outperform actively managed funds. Their findings further suggested that fund managers need to attain a minimum fund size to achieve returns net of research expenses and other involved costs.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents a summary of the findings; conclusions that were made based on the results as well the recommendations given for the policy improvement. It also gives the limitations encountered in the study and the suggested areas for a further research with respect to these limitations.

5.2 Summary of the Findings

The study's main objective was to establish and identify relationship between corporate governance practices and the financial performance of unit trusts in Kenya. The dependent variable for the study was financial performance of unit trusts whereas the independent variables were the corporate governance practices, corporate governance policies, disclosure policies and practices and the shareholder right and responsibility. Both descriptive and inferential statistics were used to study the variables.

The study found out that the financial performance has a strong positive correlation with the corporate governance practices. The correlation coefficient for this association was 0.716 which was found to be statistically at the 5% level with a significance value of 0.001. The study also indicated a strong positive correlation between financial performance and the corporate governance policies with a correlation coefficient of 0.759 and a p-value of 0.014. The disclosure policies and practices and financial performance as well were found to have a positive and significant correlation of 0.636 with a p-value of 0.007. The association between financial performance and shareholder right and

responsibility had the strongest correlation of 0.873 with a p-value of 0.016. Thus the study results on testing the association between corporate governance practices and financial performance indicated a positive and significant association between these variables.

Testing whether there is a linear relationship between corporate governance practices and financial performance of the companies, regression analysis was conducted. Findings reveal that the corporate governance practices accounts for 88.9% changes in the financial performance of the unit trusts holding other variables constant. The linear model relating these variables was also proved to be statistically significant and reliable through the ANOVA test which gave a F-value of 4.912 and a significant value of 0.016 at the 5% level.

The relationship between corporate governance practices and financial practices was found to be a positive relationship which is significant at the 5% level of significant. Findings showed that financial performance and corporate governance practices could be related in the liner model; **Financial Performance (ROE) = 0.729 + 1.412 X_1 + 0.942 X_2 + 1.809 X_3 + 1.016 X_4.** This showed that holding the predictor variables constant, financial performance for the unit trusts would be 0.729 in which a unit growth in the corporate governance practices leads to 1.412 times increase in financial performance. The model also shows that, given a unit increase in corporate governance policies would lead to 0.942 times increase in financial performance whereas a unit growth in disclosure policies and practices would result to 1.809 times increase in financial performance. Findings also showed that given a unit increase in shareholder right and responsibility,

the financial performance of the companies would experience a positive growth of 1.016 times.

5.3 Conclusion

The study findings and discussion presented above leads to the conclusion that; there is a strong positive and significant association between financial performance of unit trusts in Kenya and the corporate governance practices. A positive linear relationship between the financial performance and corporate governance practices also exists in the unit trusts in Kenya.

With regard to the corporate governance practices, board members are appointed by the shareholders alongside whose tasks are the nonexecutive directors who are independent serving. The Board is responsible for vision, mission and Strategic plan which is facilitated by the effectiveness of the Boards' leadership. These units also have independent committees mandated to deal with the determination of executive compensation and director's remuneration in the companies considered. As a result, the mandate of the board as well as their effectiveness leads to increased financial performance of the unit trusts in Kenya.

The unit trusts in Kenya have generally adopted disclosure policies and practices. The Boards communicates to stakeholders on disclosure policies and practices. Towards effective corporate governance, these unit trusts have established audit committees, compliance committee as well as risk management committees that meet often to review the mandate of the board and the board effectiveness. These unit trusts have high concern on their corporate social responsibility in the country where the boards highly support

this. Thus, corporate governance policies greatly affect financial performance of the unit trusts in Kenya.

According to the study results, the level of board ownership in the unit trusts in Kenya is ideal and justifiable. These boards recognize and advocate for institutional holding as well they play their monitoring and control role effectively which result to financial performance. The boards effectively ensure accessibility to resources, strategy-advice and counsel the management of these organizations. There is equal access to information for shareholders and investment analysts as the reports prepared for annual shareholders meeting contain both basic information and sufficient details to enable investment analysts to assess the financial and non-financial performance of the company. These practices enhance the financial performance of these organizations.

The financial performance of the unit trusts as well has a positive relationship with shareholders right and responsibility. Shareholders are encouraged to attend the AGM in which adequate time is provided for them to pass their queries. The shareholders are also involved in decision making regarding the critical aspects of management including appointment of the Board, compensation of Board and appointment of external auditors. They are as well offered the opportunity to receive and review the financial reports in order to ask for questions to be put on the agenda at the AGM. This facilitates their increased involvement in management of the unit trusts thereby leading to the increased financial performance.

5.4 Recommendations

The study therefore based on the findings and conclusions made recommends that:

The unit trust boards need to be efficient in all their responsibilities towards increased profitability of the organization. Since a positive relationship exists between corporate governance practices and financial performance of these organizations, the shareholders should exercise genuine and participative selection criteria in appointing the board members which determine the ability of the board to effectively manage the operations.

There board management also need to be effective in monitoring all the operations of the unit trusts to ensure progressive performance through ensuring that the resources are available where required as well as providing other support services necessary. This would facilitate increased profitability with maximum resource utilization in the organizations.

Shareholders should also be availed with financial and other vital reports for the organizations so as to keep them informed of the progress in the firms' operations. Through this, the shareholders will be in a position to evaluate the board effectiveness in playing its role as well as reviewing the suitable personnel to hold positions in the board for effectiveness of the organization.

5.5 Limitations

The study was successfully conducted which led to its achievement of the targeted objective. However, the study was limited due to the limited time available for the researcher to undertake all the activities in the field. The study was also limited due to the utilization of secondary data. The data which was collected from some financial reports

of the unit trust might not have given the correct value since these reports were prepared for other purposes and might have been altered to suit the purposed reason. The study was also limited to the unit trusts in Kenya only which limits the generalization of the findings to other sectors of the economy.

5.6 Suggestion for Further Areas of Research

Due to the limitations encountered while undertaking the study, the researcher recommends further studies to be undertaken on other sectors in Kenya considering the situation in the private sector organizations as well. A study should also be undertaken to evaluate the best practices in social responsibility played by the unit trusts and the significance of these practices to the society and economic development.

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APPENDICES

APPENDIX I: APPROVED UNIT TRUSTS

UNIT INVESTMENT TRUSTS OPERATIONAL IN KENYA

1. African Alliance Kenya Unit Trust Scheme
2. Old Mutual Unit Trust Scheme
3. British American Unit Trust Scheme
4. Stanbic Unit Trust Scheme
5. Commercial Bank of Africa Unit Trust Scheme
6. Zimele Unit Trust Scheme
7. Suntra Unit Trust Scheme
8. ICEA Unit Trust Scheme
9. Genghis Capital Unit Trust Fund
10. Centum Unit Trust fund
11. Madison Asset Unit Trust Funds
12. Standard Investment Trust Funds
13. CIC Unit Trust Scheme
14. Dyer and Blair Unit Trust Scheme
15. Amana Unit Trust Funds Scheme
16. CFC Unit Trust Fund
17. Diaspora Unit Trust Scheme
18. First Ethical Opportunities Fund

Source: CMA

This is the number that is currently licensed by CMA operational and making the necessary reporting in the local dailies.

APPENDIX II

QUESTIONNAIRE

Dear Respondent,

Kindly answer the questions below and submit the questionnaire. Print your comments in another sheet of paper (provided) if the space provided is not adequate and attach it to this questionnaire. All responses and comments will be treated in confidence.

Your answers for ratings are on a scale of 1 to 5.

1 = Very Poor (20%),

2= Poor (40%),

3 = Fair (60%),

4 = Good (80%),

5 = Excellent (100%)

Thank you for your Cooperation.

Hudson Kidisa Ingaiza

Student of the University of Nairobi, School of Business

1) Position in the organization ……………………………….
2) Duration of employment…………………………………...

SECTION A: CORPORATE GOVERNANCE PRACTICES (CGPR)

Indicate your level of agreement with the following statements by ticking at the appropriate box.

Use the ratings criteria below.

Strongly Agree (SA), Agree (A), Uncertain (U), Disagree (D), Strongly Disagree (SD)

	Questions	1.SA	2.A	3.U	4.D	5.SD
	The number of board members currently serving is optimal and justifiable. All Board members have been appointed.					
	The company has nonexecutive directors who are independent serving.					
	The company has unequivocal list of shares owned by					

	the members of the Board and Chairman.					
	The Board is responsible for vision, mission and Strategic plan. The Boards leadership is effective.					
	The company provides an internal nomination process for the Chairman.					
	The company has internal written policy regarding board members having recurrent positions as directors in other companies.					
	There is an independent committee mandated to deal with the determination of executive compensation and director's remuneration.					
	The Functioning of the board and its relations with executive management / role of directors are seamless.					
	The Board composition and structure is ideal for achieving its mandate.					
	The organization structure enables it to maintain corporate integrity, reputation and responsibility.					
	The organization structure is often reviewed by the Board.					
	The Board often reviews the values and strategies of the company					
	The company ensures a level of accountability, governance audits and transparency,					
	The company ensures compliance with relevant laws, regulations, and governance practices, accounting and auditing standards					

SECTION B: DISCLOSURE POLICIES AND PRACTICES (DPP)

Questions	1.SA	2.A	3.U	4.D	5.SD
The company adopts disclosure policies and practices.					
The Board communicates to stakeholders on disclosure policies and practices.					
There is a high level of formalized governance policies: codes and guidelines.					
The Board meets often as stipulated.					
The company has an audit committee, compliance committee, risk management committee.					
The company has drafted code of corporate governance which covers the specification of; the rights of shareholder, duties of directors, rules of disclosure					
The company has ensured board's balance of power so that it can exercise objective and independent judgment in making decisions and reporting to stakeholders.					
The Board often asses its performance and effectiveness as a whole and that of individual members and CEO's.					
The Board identifies the corporate internal and external stakeholders; agree on policies determining how the corporation should relate to, and with them.					
The Board recognizes that it is in the corporation's enlightened self interest to operate within the mandate entrusted to it by society and shoulder its social responsibility.					
The Board often reviews the company's social responsibility concern.					
Overall, the board's commitment to corporate governance is high.					
The board recognize the shareholder rights and role; Strengthening of shareholders' rights and maintaining alignment.					
The company's leadership structure provides for distinctiveness of the CEO and the chairman; the office holders are different persons.					

SECTION C: CORPORATE GOVERNANCE POLICIES (CGPO)

	Questions	1.SA	2.A	3.U	4.D	5.SD
	The level of board ownership is ideal and justifiable.					
	The board recognizes and advocate for institutional holding.					
	The boards monitoring and control role is effective					
	The board's role in terms of access to resources, strategy-advice and counsel is effective.					
	The company provides equal access to information for shareholders and investment analysts.					
	The reports prepared for annual shareholders meeting contain not only basic information but sufficient details to enable investment analysts to assess the financial and non-financial performance of the company.					
	The company avail its financial results and management analysis for analysts.					
	The company posts its financial results and management analysis on the internet.					
	The board's inclusion in terms of committees and business risk management is effective.					
	The Board is effective in terms of delegation, skills, experience and knowledge.					

SECTION D: SHAREHOLDER RIGHT AND RESPONSIBILITY (SRR)

	Questions	1.SA	2.A	3.U	4.D	5.SD
	Shareholders are encouraged to attend and vote during the AGM.					
	There is adequate opportunity for shareholders to receive and review the financial reports in order to ask for questions to be put on the agenda at the AGM.					
	There is a provision for adequate time given during the AGM for shareholders to ask questions.					
	The AGM decides the following items: appointment of Board, compensation of Board and appointment of external auditors					

APPENDIX III

Correlation Matrix

Correlation of financial performance & Corporate governance factors		Measure of Financial Performance (ROE)	CGPR	CGPO	DPP	SRR
Measure of Financial Performance (ROE)	Pearson Correlation					
	Sig. (2-tailed)					
	N					
CGPR	Pearson Correlation					
	Sig. (2-tailed)					
	N					
CGPO	Pearson Correlation					
	Sig. (2-tailed)					
	N					
DPP	Pearson Correlation					
	Sig. (2-tailed)					
	N					
DPP SRR	Pearson Correlation					
	Sig. (2-tailed)					
	N					