THE EFFECT OF BOARD PROFILE ON FINANCIAL PERFORMANCE OF THE FIRMS LISTED AT THE NAIROBI SECURITIES EXCHANGE

BY

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DECLARATION

This research project is my original work and, to the best of my knowledge, contains no materials previously published or written by another person, nor material which to a substantial extent, has been accepted for the award of any other degree or diploma at Nairobi University or any other educational institution.

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DEDICATION

To my siblings Joshua Mwangangi and Ann Mwangangi and Patricia Munyoki for their
encouragement and support.

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ANOVA	Analysis of Variance
BOD	Board of Directors
CEO	Chief Executive Officer
CFP	Corporate Financial Performance
CG	Corporate Governance
CMA	Capital Markets Authority
CSR	Corporate Social Responsibility
EPS	Earning Per Share
FP	Financial Performance
LSE	London Stock Exchange
MLR	Multiple Linear Regression
NSE	Nairobi Securities Exchange
OECD	Organization of Economic Co-operation and Development
ROA	Return on Assets
ROE	Return on Equity
ROS	Return on Sales

ABSTRACT

This study sought to establish the relationship between Board profile and financial performance of companies listed in the NSE. Specifically, it sought establish the effect of corporate governance on the financial performance of the firms listed at the NSE between 2008-2014 with emphasis on board profile. These characteristics of board were size, remuneration and independence. In order to achieve the established objective, the study adopted a descriptive study design. It was a census study in that all the companies listed in Nairobi Securities Exchange were studied. Secondary data obtained from the financial statement of the companies listed at the Nairobi Securities Exchange between 2008 and 2014 was used. Linear regression was used to describe the data and make inferences on the basis of the study result. It was found out that although the relationship between financial performance and the board size was positive, it was not statistically significant, In addition the relationship between financial performance and board of director's indepedence was not significant. Moreover, there was a negative and significant relationship between the remuneration of the board of directors and performance. This study recommends that the country need to strengthen policies to improve firm-level corporate governance in order to bolster financial performance and attract such investors. The regulatory authorities in Kenya need to strengthen the independence of board of directors by making it mandatory upon firms to ensure that boards of directors have sizeable representation of outside directors, as is the practice in other countries, and since the evidence from this study suggest the need for this.

CHAPTER ONE

INTRODUCTION

1.1. Background of the study

Board profile is one of the main aspects of corporate governance (CG) which concerns the system by which companies are directed and controlled. It is about having companies, owners and regulators become more accountable, efficient and transparent, which in turn builds trust and confidence (Kent 2010) Board profile is the key to how well an organization is governed, Well-governed companies carry lower financial and non-financial risks and generate higher shareholder returns. They also have better access to external finance and reduce systemic risks due to corporate crises and financial scandals according to the World Bank. Reliable financial reporting, timely disclosures, better boards and accountable management are key developing good capital markets as well as improve a Economies' ability to mobilize, allocate and monitor investments which in turn improve economic growth.

CG is aimed at detecting corporate inefficiencies and minimizing vulnerability to financial crises. CG consists of mechanisms to ensure that suppliers of finance to corporations will get a return on their investment (Carroll, 1999). In finance this means that the sole purpose of CG is to address agency problems between shareholders and managers or between majority shareholders and minority shareholders. This means that CG is intended to make sure investors get their money back which they have entrusted with someone else that is managers, who are the agents who make all the decisions about how the money is used after investors have parted with the money.

A lot of research work has been carried out on the CG both internationally and locally. Many scholars have sought to critically analyze the laws that protect investors which differ significantly across firm countries, economic blocks and regions.

Recent CG and financial reporting scandals in Kenya have led regulatory institutions and firms to realize the importance of sound CG for long term viability of companies. Mismanagement of Uchumi supermarket at a point led to its suspension from the NSE. The problem of Uchumi was attributed to laxity of its BOD. CMC holdings is another example of a failure of corporate governance which led to losses, suspension from NSE and loss of Several key franchises held by the firm like that of Land rover, Volkswagen and Case agriculture. There has been an unprecedented amount of governmental intervention to enforce order in this area, relevant authorities are in the process of restructuring the current regulations and enforcement capabilities within the framework of the best CG practices (Kell, 2005).

Firms improve investor protection by increasing disclosure, selecting well functioning and independent boards, imposing disciplinary measures to prevent management and controlling shareholders from engaging in exploitation of minority shareholders.

The subject of CG is broad some studies have focused on quantifying the relationship between firm-level CG and performance, either within individual countries or in cross-country settings. Causal relationship between CG and performance is not easy to establish because of several reasons which this study highlighted. According to gazette notice no. 3362 pursuant to the capital markets act (Cap. 485A) Every public listed company shall disclose, on an annual basis, in its annual report, a statement of the

directors as to whether the company is complying with these guidelines on CG with effect from the financial year ending during 2002, as prescribed under the Capital Markets and Securities Regulations, 2002 (Public Offers, Listing and Disclosures).

1.1.1. Board Profile

Board profile refers to the traits and activities touching on the members of the board of directors for a firm. In this study board independence, size and remunaration Board profile is key element in corporate governance which refers to the system by which corporations are directed and controlled. The governance structure specifies the distribution of rights, responsibilities and powers among different parties in the corporation which include the board of directors, managers, shareholders, creditors, auditors, regulators amongst other stakeholders and specifies the rules and procedures for making decisions in corporate affairs (Donalson, 1991).

A board which is properly profiled ensures that the business environment is fair and transparent by aligning the interests among the stakeholders and that a company can be held accountable for its actions. Conversely, weak Board leads to waste, mismanagement, and corruption. It is also important to remember that although CG has emerged as a way to manage modern joint stock corporations it is equally significant in state-owned enterprises, cooperatives, and family businesses. Regardless of the type of venture, only good governance can deliver sustainable good business performance, (Freeman 1984). Organizations with good corporate governance have the capacity to maintain high-quality services and to deliver improvement.

Poorly constituted or profiled board set the framework within which the organizational systems and processes fail to detect or anticipate serious service and financial failures.

(Baker 2007) observes that good governance in organizations, based on openness, clarity and honest accountability enhances public trust and civic engagement. To better appreciate the CG issues which mainly arise from principal agent relationship managers need to consider the risk-taking appetite of their shareholders and other stakeholders and make investment decisions based on that.

External governance factors also play a role in supporting good corporate governance. The external environment includes both the takeover mechanisms and the laws and regulations that enforce the rights of shareholders and other stakeholders, such as creditors, and a good external environment also includes appropriate oversight by government or other regulatory bodies like Central Banks and the Stock Exchange Markets Authorities. There are several approaches that can be used as indicators or measures of CG. A well known indicators of CG that can be locally associated with companies include the duality of CEO (or lack of it), independence of the board and the size of the board (Tilt, 2004) and Board of Directors remuneration.

1.1.2. Financial Performance

According to Bourguignon (1995) performance can be defined as achievement of organizational objectives. It has also been defined as anything which contribute to ameliorate value-cost couple and not only which contributes to cost decrease or value increase. Performance can be categorized into three categories namely; Market based measurements Accounting based measurement and Economic value added. The market-based measurement is characterized by its forward-looking aspect and its reflection of the expectations of the shareholders concerning the firm's future performance, which has its basis on previous or current performance The Tobin's Q ratio is used which is calculated

as the market value of a company divided by the replacement value of the firm's assets. Accounting-based measurement is generally considered as an effective indicator of the company's profitability and the business when compared to benchmark rate of return equal to the risk adjusted weighted average cost of capital. The accounting based measurement indicators to the profitability of firms on the short term in the past years such as (ROA), (ROE), (ROS), The profit measure is criticized for its backward-looking element and its partial estimation of future events in terms of depreciation and amortization.

Economic Value Added is a performance measurement system that aims to overcome the weaknesses of accounting and market based measures. Economic value added was developed by the US consulting firm Stern Stewart & Co, and it has gained widespread. Residual income economic value added is based on the residual income technique that has been used since the early 20th century. Residual income is a performance measure normally used for assessing the performance of divisions, in which a finance charge is deducted from the profits of the division. The finance charge is calculated as the net assets of the division, multiplied by an interest rate normally the company's weighted average cost of capital. According to Orlitzky et al. (2003), corporate financial performance is measured in three ways; market measurements, accounting measurements and survey measurements. He further explained that the first represents the appreciation of the shareholders; the second shows the efficiency of the management and the last provides a subjective estimation of its performance.

Boaventura et al. (2012), in their review on CG-CFP relationship reported that return on asset (ROA), is the financial performance measure most widely used, followed by return

on equity (ROE), sales growth, return on sales (ROS), contribution margin, Tobin's Q, market share, risk of the firm, ROCE, operational profit, cash flow and finally earning per share (EPS). This proposal will employ ROE as the measure of financial performance.

The classical view of financial performance is maximizing the wealth the shareholders (Dkhili et al. 2012). Most of the financial measures are obtain from company financial statement inside company annual report. Most researchers typically used accounting-based measures for example; Aras et al. 2010; Saleh et al. 2011; Sun, 2012; Bayoud et al. 2012; Iqbal et al. 2012, etc. The accounting measures provide most positive correlation result from analysis on relation between CG and CFP (Dkhili et al. 2012). This is due to accounting measure has the advantages of providing more relevant economic performance of the company and provides more reliable data on linkage between CG and CFP. However, accounting based measures are "susceptible to differential accounting procedures and managerial manipulation" (Karagiorgos, 2010). Return on Assets (ROA) and Return on Equity (ROE), two most popular measurements used by researchers, are accounting ratios which shows that how effectively and efficiently management use corporate asset and equity to enhance inventory turnover and sales to earn profit (Raza et al. 2012).

1.1.3. Effect of Board Profile on the Financial Performance

Previous studies have hypothesized and given rational theoretical justifications for negative, positive and neutral relationships between Board profile and financial performance. The rational for a negative relationship is named 'managerial opportunism hypothesis, proposing that when CG is strong, the managers will reduce the social activities, because they can increase the short-term profit and increase employee

compensation (Tilt, 2004). On the contrary, the managers will try to divert attention by spending on the social programs if CG is poor.

A neutral relationship is supported by the argument that the environment where firms and community undertake their respective activities is so complex such that a simple, direct, relationship between board profile and financial performance does not exist (Williams et al. 1999). In his study he further argues that a nonexistent relationship exists based on the supply and demand of the firm theory. There is an assumption that shareholder's wealth is maximized when a firm produces a level of profit-maximization.

The largest number of investigations found a positive relationship (Kang et al. 2012). However, Mwangi et al. (2013) suggest that because of the uncertainty of a corporate governance/board profile and financial performance link measuring CG is the problem. There are no many established theoretical foundations with a clear empirical prediction appearing for a board profile and financial performance relationship.

1.1.4. Nairobi Securities Exchange

The Nairobi Securities Exchange (NSE), like any other stocks market, provides the platform on which shares of companies can be transacted. Although the trading of shares in Kenya began in the 1920's, this process was not formalized until 1963, when the colonial government promulgated NSE as part of the London Stock Exchange (LSE) (Nyamongo et al. 2013). Since then, the institution has undergone a wide range of reforms. In 1999, the Capital Markets Authority introduced CG guidelines for all public listed companies in the Nairobi Stock Exchange. These guidelines derive their legal basis from the Capital Markets Authority Act under Section 12 which mandates the Capital Markets Authority to formulate rules guidelines and regulations as may be required for

the purpose of carrying out its objective to regulate activities in the stock market. Kenya has also adopted the of Organization of Economic Co-operation and Development's (OECD) principles of corporate governance to strengthen its regulation in the stock exchange

In Kenya, the CG principles in the capital markets are enforced through the "comply or explain" principle (CMA, 2011). In essence this principle is to the effect that listed companies are required to comply with the rules, regulations and laws laid down by parliament or the CMA, it being the regulatory body. Failure to comply, the company, through its directors must explain the reasons for non-compliance or risk facing serious sanctions. Moreover, the first attempt to bring into focus the CG framework in Kenya started in 1999 when the Centre for CG Kenya developed a framework which was voluntary for companies to adopt. The framework developed was further taken up by the Capital Markets Authority (CMA) in 2000 as draft CG practices for listed companies in Kenya.

In later years the CMA made it mandatory for the listed companies to adopt those CG practices. These CG practices mainly dealt with the issues of the board such as board composition, role of audit committee, separation of the role of Chief Executive Officer (CEO) and the chair. In addition, they focused on the rights of the shareholders. Although Kenya has made significant strides towards corporate governance, a lot still needs to be done. Owing to the importance of CG the Kenyan Government initiated some reforms at the Nairobi Stock Exchange aimed at transforming the exchange into a vehicle for mobilizing domestic savings and attracting foreign capital investments. Some of those reforms include the automation of NSE in the year 2002 and development of a corporate

governance blueprint for Kenya developed by the capital markets steering committee on corporate governance February 2014.

1.2. Research Problem

Corporate governance is aimed at detecting corporate inefficiencies and minimizing vulnerability to financial crises. According to Murigi et al. (2014), the separation of management and ownership of the modern corporation presents agency-related problems which include conflicts of interest and unethical management practices. Even though managers are well aware of the existence of legal and professional standards, these are more often viewed as barriers to be overcome in pursuit of self gain rather than as guides for appropriate professional conduct.

In Kenya there are concerns on whether all that effort to implement CG has borne any fruit. Companies have often been used to aid fraud, sending a wrong signal to domestic and international investors, Uchumi supermarkets, CMC holdings, Golden Berg and Anglo leasing are few examples of failure of corporate governance in Kenya in the recent past amongst others. Banking and insurance sector alone has witnessed in the past, the collapse of firms such as Kenya National Assurance Company, Euro Bank, Lake Star Assurance Company, Standard Assurance, Trade Bank, Stallion Insurance, Nyaga Stock Brokers and Blue Shield Insurance Company.

Ongore et al (2011) and Wanjiru (2013) carried out a study to establish the CG practices of firms and its relationship with the growth of Companies listed at the Nairobi Securities these study found a positive linear dependence of growth and Corporate Governance. All these finding are not agreeable to other scholars for example Mulili (2010) and Lekaram

(2014) who argue otherwise. Lekaram (2014) observes that in Kenya, the corporate governance principles in the capital markets are enforced through the "comply or explain" principle a term coined by Freeman (1999).

From the literature most studies concentrate on the developed countries whose approach and Corporate Governance systems are not similar to that of Kenya or most of the developing economies. The domestic environment both corporate and regulatory is quite different from that of developed countries. Much of this literature cannot be used to form a valid opinion in the local context. Literature from the developing countries for instance Kenya seems to be insufficient, there is no reliable and consistent data from the local institutions for example unlike the developed countries in Kenya we don't have a corporate governance index. This situation has led many studies to evade empirical study of the corporate governance for the whole economy. Again a more recent study encompassing all the aspects of CG and not a specific element and cutting across all sectors of our economy is missing. Conclusive empirical evidence on the relationship between CG & CFP in the Kenyan context is needed since some scholars have argued Negative relationship others Positive and some Neutral or no relationship at all. It is imperative that the gap be filled hence this study was set to answer the following question;

What if the effect of corporate governance on the financial performance of firms listed in the NSE especially focusing on the characteristics of the board?

1.3. Research Objective

To establish the effect of board profile on the financial performance of the firms listed at the NSE.

1.4. Value of the Study

This study would be invaluable to the various stakeholders in the Kenyan economy and other economies. The study will particularly add value to the policy makers and the regulator as they appreciate the findings on the impact of their effort. Further, it will also help and guide other researchers and academicians wishing to explore other countries in East Africa and Africa in general. Indeed, it will as well guide investors both domestic and foreign when investing in NSE and Kenya in general to make sound decisions.

The policy makers would obtain knowledge of the various firm dynamics and the responses that are appropriate; they will therefore obtain guidance from this study in designing appropriate practices that would regulate the shareholders participation in affecting the financial performance of the firms in Kenya. Indeed, the study will enable the future researchers and academicians to identify gaps which have never been covered by the previous researchers.

CHAPTER TWO

LITERATURE REVIEW

2.1. Introduction

This chapter is going to present the literature on various theories and models that provide explanations regarding the concept of corporate governance, review related studies in the field of the CG concepts studied and methodologies used and findings arrived at by different researchers and any shortcoming of such studies.

2.2. Theoretical Review

Many theories have been propounded on CG and CFP. However, not all the theories can be applied across the board. This study sought to use the theories that are relevant to the study topic; which include the agency theory, stakeholder theory and stewardship theory.

2.2.1. Agency Theory

Agency theory is defined as the relationship between the principals, such as shareholders and agents such as the company executives and managers, this theory was developed by Jensen and Meckling in 1976, in this theory, shareholders who are the owners or principals of the company, hires the agents to perform work. Principals delegate the running of business to the directors or managers, who are the shareholder's agents (Clarke, 2004). Agency theory suggests that employees or managers in organizations can be self-interested. The agency theory shareholders expect the agents to act and make decisions in the principal's interest. On the contrary, the agent may not necessarily make decisions in the best interests of the principals (Padilla, 2000). The agent may be

succumbed to self-interest, opportunistic behavior and falling short of congruence between the aspirations of the principal and the agent's pursuits

Agency theory is very relevant in this study because tries to explain the separation of ownership and control whereby a firm constitutes various owners (shareholders) who are dispersed and who are the principal and the management who is the agent acting on behalf of the shareholders. The likelihood of managers pursuing their own agenda at the expense of the shareholders there is a need to have checks and balances to control the managerial behavior and this is the main agenda of corporate governance. In our context this has been witnessed in the previous mentioned firms whereby Agents have lead to collapse and closure of firms.

Basically agency theory concludes that the value of a firm cannot or it is difficult to maximize because managers will strive to exploit the value for themselves. Even with performance based contracts the managers will find it easy to go against the will of the shareholders for their own benefits citing contingencies and changes of circumstances which were unforeseen before signing the contacts, complete contracts are technologically unfeasible (Mwangi et al. 2013). According to Nyachae (2014), Considering the growth in shareholder numbers and the complexity of organizational operations, the management team who are equipped with the relevant knowledge and expertise gain greater control placing them in compromising positions where they may be tempted to pursue their own interest at the expense of the shareholders. The separation of ownership of capital from its management marked the beginning of the agency problem and hence the need for corporate governance.

Although with such setbacks, agency theory was introduced basically as a separation of ownership and control (Sun, 2012). The agents are controlled by principal-made rules, with the aim of maximizing shareholders value. Hence, a more individualistic view is applied in this theory (Clarke, 2004). Indeed, agency theory is relevant because it can be employed to explore the relationship between the ownership and management structure. However, where there is a separation, the agency model can be applied to align the goals of the management with that of the owners. The model of an employee portrayed in the agency theory is more of a self-interested, individualistic and are bounded rationality where rewards and punishments seem to take priority (Jensen et al. 1976).

2.2.2. Stewardship Theory

A steward is defined by Davis et al. (1997) as one who protects and maximizes shareholders wealth through firm performance, because by so doing, the steward's utility functions are maximized. The theory was put forward by Davis in 1991. In its perspective, stewards are company executives and managers working for the shareholders, protects and make profits for the shareholders. Stewardship theory stresses not on the perspective of individualism, but rather on the role of top management being as stewards, integrating their goals as part of the organization. The stewardship perspective suggests that stewards are satisfied and motivated when organizational success is attained. Hence this theory opposes the agency theory arguing that the managers are capable of acting in good faith on their own. In conclusion this theory suggests that by offering financial benefits tied to performance, offering shares, executive compensation and other motivating incentives agency costs are reduced and performance induced.

Stewardship theory stresses on the position of employees or executives to act more autonomously so that the shareholders' returns are maximized. Indeed, this can minimize the costs aimed at monitoring and controlling behaviors (Daily et al. 2003). On the other end, Daly et al. (2003) argued that in order to protect their reputations as decision makers in organizations, executives and directors are inclined to operate the firm to maximize financial performance as well as shareholders' profits. In this sense, it is believed that the firm's performance can directly impact perceptions of their individual performance. Moreover, stewardship theory suggests unifying the role of the CEO and the chairman so as to reduce agency costs and to have greater role as stewards in the organization.

2.2.3. The Stakeholder Theory

Stakeholder theory can be defined as any group or individual who can affect or is affected by the achievement of the organization's objectives. It was propounded by Freeman and Lorange (1983) and consequently published in their book on strategic management with a stakeholder perspective in 1984. Stakeholder theorists suggest that managers in organizations have a network of relationships to serve – this include the suppliers, employees and business partners. And it was argued that this group of network is important other than owner-manager employee relationship as in agency theory. On the other end (Sundaram et al. 2004) contend that stakeholder theory attempts to address the group of stakeholders deserving and requiring management's attention.

By viewing a firm as a system of stakeholders operating within an economic system with necessary legal and market infrastructure the goal of all the stakeholders will be maximized by all the stakeholders if the voice of the stakeholders is enhanced and owner ship like incentives is provided to those participating (Blair 1995). Wheeler et al, 2002

argued that stakeholder theory was derived from a combination of the sociological and organizational disciplines. According to Lekaram (2014), the stakeholder theory also comments that the board should have a significant proportion of inside directors to ensure more effective and efficient decision making. This is because inside directors (Executive Directors) know the business better and thus make better decisions than outside directors (Non-Executive Directors). It is also assumed that enhanced firm performance is closely related with the decisions of inside directors as they work for the maximization of shareholders wealth. This theory is relevant to this study since it explains an attempt by the firm (Composed of stakeholders) trying to govern itself (Lekaram, 2014).

2.3. Determinants of Financial Performance

This sub-section presents the determinants of corporate financial performance which include the following: board independence, CEO duality, board size and remuneration of directors. The very last item in the sub-section glimpses into other determinants of CFP that were not included in the model for this study.

2.3.1. Board Independence
There is often assumption that the tendency of independent directors may not pursue private interest is higher. Director's independence is perceived to have a great effect to the firm performance due to the strong independent judgment. Board with more independent directors can perform monitoring roles effectively (Sun, 2012).The term independent directors are similar with outside directors. The relationship between the proportion of independent directors and firm performance is substantial. The independent directors perceived to minimize the opportunity for manager to misappropriate the resources of the shareholders. Furthermore, a number of independent directors on the

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board may contribute to the effectiveness of the board as a monitoring role and indirectly shall increase the performance of the firm (Muriithi, 2009; Lekaram, 2014). In addition, independent directors are more objective in making decision. Mwangi and Jerotich (2013) studied the relationship between the proportion of outside directors on the board and firm performance and the study found a significant positive relationship using accounting measures.

2.3.2. Board Size

Board size is another important governance mechanism that affects the performance of a company. Generally, board size is associated with the effectiveness of monitoring ability by the boards (Nyamongo and Temesgen 2013). Eshiwani characterizes typical non-performing boards in Kenya as having directors who are always present at company meetings, as executive remuneration takes the form of an allowance awarded for each meeting attended. Age-wise, the members of the board are typically elderly people and the discussion that takes place for the better part of the meeting has little to do with the objectives of the company. This is in line with Gustavson et al.'s finding that some executives perceive taking up a board position as being a form of semi-retirement. With this type of board where executive remuneration is not tied to firm performance, it is, almost inevitable that there will be misappropriation of company assets and a lack of strategy leading to underperformance of corporations as management will be able to prioritize their remuneration over company performance leading to underperformance and the possible collapse of corporations.

The collapse of Uchumi has been attributed to irrational expansion plans by the board coupled with a lack of risk management strategies (Musikali 2014). However, it is

suggested that every company should examine their own board so that the number of directors is sufficient to discharge their responsibilities, proactive involvement, and able to make decision for the good sake of the company. A minimum of seven or eight members of the board should be adequate to perform the board's role effectively (Sun, 2012). If the board is very huge though, it implies that the directors have to be paid hence negatively affecting the financial performance. Hence there is a need to strike a balance between the two.

2.3.3. Remuneration of Directors

Directors' remuneration is normally related to the firm performance. High remuneration paid to the directors perceived that the company is doing well, larger and complex business operation (Nyamongo et al. 2013). Directors' remuneration paid at the expense of shareholders thus to prevent excessive pay, there is a call to for the design of incentive compensation tied with the firm performance which is known as pay-for-performance theory. The directors will be more responsible, tend to utilize their resources efficiently and aware of the consequences of his actions thus will act effectively when the pay is linking to the firm performance (Muriithi, 2009). The firm size is one of the determinants of director's remuneration. Thus, the compensation setting committee sets the remuneration based on the firm size with a justification that larger firm is more complex and demanding tasks (Baker, 2007).

2.3.4. Other Determinants

Another significant determinant of CFP is the size of the firm. Firm size can be measure by total asset of the firm, market capitalization or the firm's sales. As the complexity and size of the firm becomes larger, the board size is also increase due to the needs of more

advice from experienced directors. Board size is correlated with the firm size (Kell, 2005). Larger and complex firm perceived to have more independent directors seat on their boards. The independent director claims to be more objective judgment, effective decision maker and more likely promote the shareholders" interest than self (Sun, 2012). However, the need to employ a qualified and experienced director is require much higher to pay. Mang'unyi (2011) found that the firm size is positively correlated with directors' remuneration.

Economic condition of the country can affect a firm's performance on multiple fronts. Cost of borrowings can negatively influence the firm's capability to generate finances and invest in projects (Dkhil et al. 2012). Prices of utilities, high costs associated with plant and machinery due to either deterioration of currency or import costs, high inflation rate and low income level of people can decrease the demand for industrial goods and hence negatively impact the firm's performance (Baker 2007). In addition, capital structure is a key determinant of CFP. According to Sun (2012), every industry requires a substantial amount of resources, whether it is land, labor or capital employment of all required finances. These finances can either be generated internally in terms of retained earnings or hired from outside sources such as loans and bonds. The decision of selection of the source of finance is based on the cost associated with them and the capital structure of firm. These costs can be monetary or non-monetary. Capital structure refers to the ratio of debt and equity financing. There should be an appropriate capital structure that generates the maximum profit for the organization, as too less equity financing increases the control of the owners to a large extent (Kell, 2005).

The other important determinant of CFP is the profile of the industry in which a firm operates. Mang'unyi's (2011) in his study he established that different industries perform differently. The risk level of a company also determines its performance (Dkhili et al. 2012). Risky firms tend to attract only risk taking investors. The relationship of risk and returns has to be managed so that the investors do get the return associated and expected with the risk they are bearing.

It has been argued that the presence of institutional investors may have a positive effect on corporate performance (Musikali 2014) there are both local and international institutional investors in Kenya. Kenya Airways is an example of a company which has both local and institutional shareholders it is expected that institutional investors will become more active as they are better informed. Evidence in the United Kingdom suggests that institutions are, behind the scenes, ready to put pressure on directors. Institutional investors in Kenya may, however, face some difficulties in being effective control mechanisms in corporate governance.

2.4. Empirical Review

This subsection presents the review of empirical studies that have been conducted in the area of CG and CFP. The section presents evidence at the international scene as well as the local setting which is in Kenya and the region.

2.4.1. International Evidence

Freeman (1999) in his study titled Stakeholders, social responsibility and performance he established that many CG codes explicitly allow for flexibility in a "comply or explain" framework Therefore, firms within the same country can offer varying degrees of protection/compliance to their investors, this means that there is no uniformity in the

application of CG in a country. This will happen mostly because of corruption especially in the developing countries.

According to Gompers (2001) in his study titled corporate governance and equity prices in US, dispersed ownership poses a big challenge to shareholders control over the management, each shareholder assumes that the other shareholder will act in controlling the management a problem he called 'free riding'. This situation leaves shareholders majority of them whore are minority shareholders with very little or no role to play at all in the governance or their firms. This is a situation that gives the management and advantage to advance their self interest even more. This study argument was more associated with the problem of dispersed ownership posing a challenge to corporate governance.

Beiner et al. (2004) studied the CG and firm valuation of publicly listed Swiss companies by using a broad CG index and additional variables related to ownership structure, board characteristics, and leverage to provide a comprehensive description of firm-level CG for a broad sample. An increase in CG index by one point caused an increase of the market capitalization by roughly 8.6%, on average, of a company's book asset value.

Zheka (2007) studied the effect CG on performance by constructing an overall index of CG and shows that it predicts firm level productivity in Ukraine. The results imply that a one-point-increase in the index results in around 0.4%-1.9% increase in performance; and a worst to best change predicts a 40% increase in company's performance.

Baker (2007) using a unique dataset from Alliance Bernstein, an international asset management company, with monthly firm-level and country-level governance ratings for

22 emerging markets countries over a five year period, report a significantly positive relation between firm-level (and country-level) CG ratings and market valuation, suggesting lower cost of equity for better governed firms.

Kyereboah (2007) in his study on the effect of CG on the performance of firms in Africa by using both market and accounting based performance measures found out that the direction and the extent of impact of governance is dependent on the performance measure being examined, He found out that large and independent boards enhance firm value and that combining the positions of CEO and board chair has a negative impact on corporate performance, CEO's tenure in office enhances a firm's profitability whiles board activity intensity affects profitability negatively. The size of audit committees and the frequency of their meetings have positive influence on market based performance measures and that institutional shareholding enhances market valuation of firms.

Heenetigala (2011) using descriptive statistics he discovered a significant increase in corporate governance practices between the board composition, board committees and corporate social responsibility reporting. As a result of the increased governance practices the study provided evidence in support of a positive relationship for separate leadership, board composition, board committees and firm performance based on return on equity in Sri-Lanka. Both board composition and board committees also had a significant relationship with performance measured by Tobin's Q However, corporate social responsibility reporting practices by the firms in Sri Lanka did not report any relationship to firm performance. In the study, the positive relationship between corporate governance structures, separate leadership, board composition, board committees and firm

performance indicate that firms have implemented corporate governance strategies, which have resulted in higher profitability and share price performance.

Gupta (2012) studied various Corporate Governance practices followed by companies in India, Japan and South Korea. A sample of five multinational companies from each country was studied based on the Corporate Governance practices that are followed by them. This included parameters like Board Constitution, Board Structure, Different Committees, Independent Directors and their roles, Conflict of interest and Disclosure of information. The study found that corporate governance practices have limited impact on both the share prices of the companies as well as on their financial performance.

Aggarwal et al. (2013) attempted to investigate the impact of corporate governance on corporate financial performance in an Indian context, using a sample of 20 companies listed on S&P CNX Nifty 50 Index. They carried out various tests like regression, correlation, and t-test and F-test using secondary data over a period of two years from 2010 2012 they found out that the governance ratings have positive and significant impact on corporate financial performance.

Ege (2014) in his study on on Internal Audit Function Quality Deterring Management Misconduct he establishes that a composite measure of Audit Function quality is negatively associated with the likelihood of management misconduct even after controlling for board, audit committee, and external auditor quality. These findings suggest that regulators, audit committees, and other stakeholders should consider ways to improve IAF quality. This study was conducted in United States

Keyes (2014) in his article titled top five corporate governance best practices; he came up with the following has the key to implementation on CG, building a strong, qualified board of directors and evaluating their performance, defining roles and responsibilities, emphasizing integrity and ethical dealing, evaluating performance and making principled compensation decisions and engaging in effective risk management.

Sharma et al. (2014) did a study on the impact of corporate governance practices on firm performance in Indian and South Korean companies it is seen in the study corporate governance practices do have an impact on the share prices of the companies. But it has a very limited impact and should not be seen in isolation of other factors affecting the share price and the financial performance.

2.4.2. Local Evidence

While most of the work in this literature has been done on developed countries, especially the US and UK, there is a rapidly growing strand of literature that focuses on comparing governance across countries in developing countries including Kenya. In a case study by Mwaura (2007) concludes that the initiatives adopted in order to make firms more efficient are inadequate and will not realize the intended objectives unless the government is committed to improve on regulatory and also enforce the laws strictly. It also contends that there is a need to streamline the multiple regulations that regulate firms and reform the corporate regulatory framework. This was a case study and no data was used. Hiring of parastatal chiefs competitively and enforcing performance contracts and giving the parastatal chiefs more autonomy was his recommendation. Mwaura's study highlighted the inefficiencies in the state corporation where governance is more of politics rather than pursuit of good performance.

Mulili (2010) in his study he explored how the agency theory and stewardship theory affect corporate governance practices. The focus of the paper was public universities in Kenya and he found out that the ideals of good corporate governance have been adopted by developing countries however developing countries differ from developed countries in a many ways therefore the need for developing countries to develop their own corporate governance models that consider the cultural, political and technological conditions This paper found challenges encountered by developing countries in the process of adopting the corporate governance ideals. This study found the corporate governance codes adopted in developing countries insufficient due to because they are not tailored for this environment. No data was tested empirically in this study and the study was only confined in public universities

Ongore and K'Obonyo (2011) in his study he found a significant positive relationship between foreign, institutional and diverse ownership forms, and firm performance. The relationship between ownership concentration and government, and firm performance was significantly negative the role of boards was also found to be of very little value, mainly due to lack of adherence to board member selection criteria. In the same study a significant positive relationship between managerial discretion and performance was discovered.

In Kenya, Wanjiru (2013) carried out a study to establish the CG practices of firms and its relationship with the growth of Companies listed at the Nairobi Securities Exchange using a causal comparative research design. The study focused on corporate communication, leadership and technology application. The study found a positive linear dependence of growth and Corporate Governance.

According to Choge (2013) in his study to establish the effect of board composition and ownership concentration on financial performance of firms listed in NSE he concluded that the board size, ownership concentration, board composition and sustainable responsible business all have a significant effect on the financial performance of companies listed at the NSE.

Lekaram (2014) observes that in Kenya, the corporate governance principles in the capital markets are enforced through the "comply or explain" principle a term coined by Freeman (1999). In essence this principle is to the effect that listed companies are required to comply with the rules, regulations and laws laid down by parliament or the CMA, it being the regulatory body. Failure to comply, the company, through its directors must explain the reasons for non-compliance or risk facing serious sanctions.

More recently, Murigi and Kamau. (2014) sought to describe some of the corporate scandals created as a result of poor CG practices and the effect this has had on the finances of the involved firms. In his study he highlighted the famous corporate scandal involving a leading public firm in United States of America by the name of Enron and In Kenya, the investors of Uchumi Supermarket and Cooper Motors Corporation (CMC) holdings witnessed in the last decade the suspension of the companies from trading at the Nairobi stock exchange primarily because of Agency related problems.

Manini et al. (2015) in his study he found out that audit committee size, board gender diversity and bank capital have no significant effect on bank profitability in his selected sample. The regression results indicated that board size negatively influences financial performance; whereas bank size is positively associated with financial performance. The

study suggests that banks with effective corporate governance mechanisms may improve financial performance depending on the measure used although not all corporate governance mechanisms are significant.

2.5. Summary of Literature Review

Overall, the preview of past literature indicates different and mixed results on CG mechanism to firm performance. Overall, the firm performance is relatively affected by the CG mechanisms. Consequently, a number of studies gave a significant and positive relationship between CG mechanisms and firm performance Beiner et al. (2004) Zheka (2007) Baker et al. (2007) Gompers, (2003) Kyereboah (2007) Wanjiru (2013) Choge (2013) Ongore et al. (2011). Therefore, it is expected that the variables of CG mechanisms are able to give effect on the firm performance in Kenya.

Other studies have found negative relationship between CG and CFP, these studies include; Mwaura (2007) Bathala et al. (1995) and Hutchinson, (2002). The following studies argued no relationship or neutrality of CG and CFP Freeman, (1999) Park et al, (2003) Prevost et al. (2002) Singh et al, (2003) Young, (2003). Another contradiction in different studies is the issue of CEO Duality, when a CEO doubles as board chair, it affords the CEO the opportunity to carry out decisions and projects without undue influence of bureaucratic structures and in this regard it is expected that CEO duality should have a positive relationship with performance Rechner et al. (1991). This study formed a clear conclusion on the effect of CG on CFP in Kenya using a more current and up-to-date data

CHAPTER THREE

RESEARCH METHODOLOGY

3.1. Introduction

This chapter outlines the research design that was used, the population that was studied, the sample size and the type of data that was used. This chapter also explains how the data was analyzed so as to answer the research questions or try and close the research gap

3.2. Research design

This study adopted a descriptive research design. According to Mugenda (2003), descriptive research is a process of collecting data in order to test hypotheses or to answer questions concerning the current status of the subjects in the study. A descriptive study explains the nature of relationships. The choice of the descriptive study design is based on the fact that the research is interested in the relationship between CG and financial performance. This study therefore was able to generalize the findings to a larger population. The main approach of this study was quantitative. However some qualitative approaches were used during data collection in order to gain a better understanding and possibly enable a better and more insightful interpretation of the results from the quantitative study.

3.3. Population

This was a census study and the population for this study was 64 companies listed in NSE as at December 2014. The list is provided in the appendix.

3.4. Data collection

This study used secondary data from the published financial statements from 2008 to 2014. Data on ROE was be obtained from the profit and loss accounts of the published financial statements. Information on the board that is independence and size was as well obtained from the companies' other reports accompanying the annual returns. Board remuneration was obtained from Profit and loss account as the director's remuneration expense.

3.5. Data Analysis

Various levels of analysis were applied. The first level was descriptive analysis. This included summarizing of the quantitative data into frequencies and sums that can be easily understood especially for the sake of comparisons as percentages or ratios. The second level of analysis was inferential analysis in which relationships between variables was investigated. The major approaches to this analysis were correlation analysis and regression analysis.

Under correlation analysis, three approaches were employed: bivariate analysis, multivariate analysis and cross tabulations. Bivariate analysis was used to compare only two variables at a time that is one independent variable and the dependent variable. Multivariate analysis involved the comparison of the relationship between all the independent variables with the dependent variable that is the financial performance and the CG variables related to board profile. Cross tabulations were used to investigate the statistical relationship between two variables (more variables were also cross tabulated) through contingency tables. It was expected to be an appropriate way of comparing the distribution of outcomes against categories of the other. Regression analysis was used to

determine the relative contribution of each independent variable to the changes in the dependent variable as well as the collective contribution of all the variable to the model.

To aid the application of the above methods of analysis, two main computer applications were used. These included the Statistical Package for Social Sciences (SPSS) and the Microsoft Excel. On the basis of these applications, various way of presentation of the results were employed, such as tables and other types of charts. Interpretation was informed by statistical knowledge and theoretical grounding against the objective of the study.

3.5.1. Analytical Model

The general function represented below was used:

$$ROE = \alpha + \beta_1 BIND + \beta_2 BSIZE + \beta_3 BREM + \beta_4 FSIZE + \varepsilon$$

Where;

FP = Financial performance measured from accounting perspective by profitability using Return on Equity (ROE) which is the ratio of profit to equity

BIND = Board Independence measured by the ratio of independent directors to the total number of board members

BSIZE = Board size measured by the number of directors in the boards of governance

BREM = Board Directors' Remuneration will be measured by Natural log of the salaries, allowances, fees and bonuses of the directors

FSIZE = Firm Size will be measured by Natural log of Firms assets

$\boldsymbol{\alpha}$ = Constant (Intercept) which measures the constant change not attributed to independent variables

$\boldsymbol{\beta}$ = Coefficient of the independent variable

ϵ= Error term

The above model simply shows that the financial performance of a company depends on the way the board governs it. Aspects of corporate governance, which are the independent variables, include the size of the board, remuneration of directors and the independence of the board (which are referred as characteristics of the board elsewhere in this study). It is important to note that in the above model, FSIZE is the control variable; it can be held constant and the effect of the 3 board profile variables (BIND, BSIZE, and BREM) assessed.

3.5.2. Tests of Significance

The following tests of significance were carried out. Analysis of Variance (ANOVA), in this case, was used to assess the impact of CG on financial performance of companies. For instance, ANOVA was used to determine whether there exists any significant differences between different levels of BREM (remuneration of board members) and financial performance (ROE). Hence, using SPSS, another variable was computed that categorizes BREM into high, moderate and low, and inspecting how each of the groups of companies' levels of remuneration affects financial performance. The second was, discriminant analysis, entailed the inspection of the co-efficient of determination (R^2) in a bid to assess what percentage variation in FP was accounted for by the independent variables in the model. For instance, 100%-R^2 represetns the percentage variation if financial performance that is not accounted for by the model variables. In all the cases, the correlation coefficient viewed together with significance values and the standard errors (where applicable) were used.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND INTERPRETATION

4.1. Introduction

This chapter presents the results obtained from the analysis of collected data as well as the discussions based on thise results. The presentation of the results takes into account the variables of the study, sectors from which the listed companies belong and the objectives of the study.

4.2. Descriptive Statistics

4.2.1. Preliminary Data Analysis

Before data was processed to answer the study objectives, preliminary tests were carried out. These included tests of normality and linearity. According to Mugenda and Mugenda (2003), normaility tests establish whether data in a variable is normality distributed. This was done using the Kolmogorov-Smirnov normality test in the SPSS. As the table 'Appendix II', the data for all the variables was normally distributed since all the Asymp.Sig values were >0.05. Appendix 6 further shows normal distribution curves for the study variables. On the other hand, linearity tests were carried out to determine whether the relationship between the independent variables and the dependent variable is linear or not. Since all the sig. deviation from linearity value were > 0.05 (appendix 5), it was concluded that there existed linear relationship between the independent variables and the dependnent variable hance the data set was considered valid for use.

4.2.2. Decriptive Analysis

As shown in the appendices (appendix 1), a total of 64 companies listed on the NSE were studied. It was established that the companies were categorized by sector. The figure below shows the sectorial distribution of companies listed in the NSE which were the focus of this study.

Figure 4.1: The percentage distribution of companies listed in NSE by sector
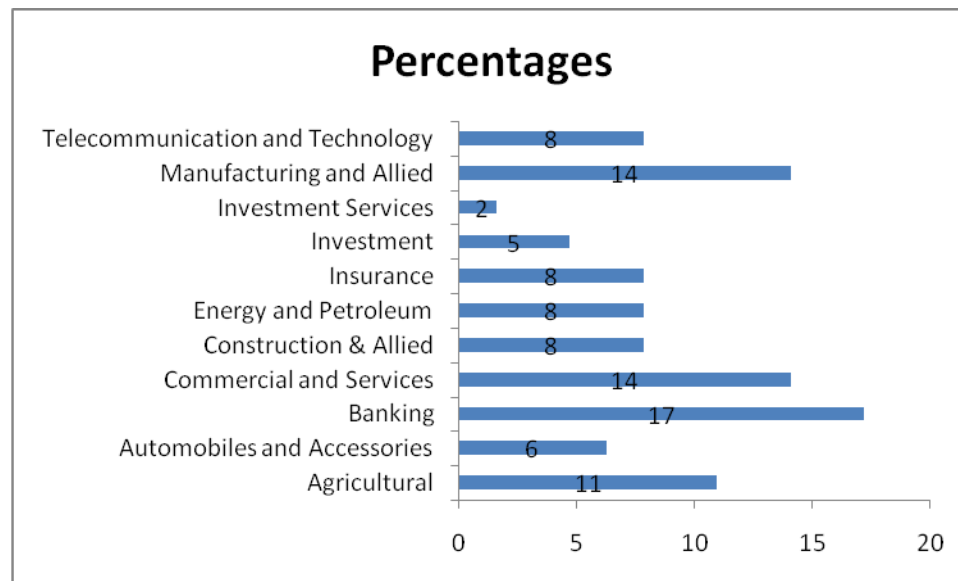
Source: Research Findings

As the above figure shows, most of the firms listed in the NSE and included in this tudy were from the banking sector (11 out of 64). This was followed by firms in the Commercial and Services sector and Agricultural sector. Nine firms across sectors either did not have data or were listed in the recent past (mid-2013 to 2014) such that they lacked historical data.

Out of the 64 firms that were studied, 55 had complete data on the variables of interest. ROE ranged from -0.70 to 0.92 with a mean of 16.6%. The least members in the board of

directors were 3 while the most number was 17. The mean ratio of the independent directors to board size was 0.155. Further, the means for FSIZE and BREM were 23.2 and 19.7 respectively (natural logarithms). This implies that on average, directors of firms listed in the NSE between 2008-2014 earned about Kshs 76 million per year and the average size of these firms was about Ksh. 11 billion (This can however be misleading since some companies have so huge asset base compared to others). This description is shown below.

Table 4.1: Descriptive statistics for all variables; skewness and kurtosis

	N	Minimum	Maximum	Mean	Std. Deviation	Skewness		Kurtosis	
	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic	Std. Error
ROE	55	-.70	.92	.1662	.19236	-.454	.322	1.588	.634
BSIZE	55	3	17	8.16	2.754	.441	.322	1.069	.634
BIND	55	.00	.56	.1550	.15350	.738	.322	-.268	.634
FSIZE	55	19.2	27.0	23.244	1.9441	.004	.322	-.600	.634
BREM	55	16.3	23.0	19.780	1.1444	-.074	.322	1.178	.634
Valid N (listwise)	55								

Source: Research Findings

From the above table, conclusions on normality can also be arrived at. As it is shown, the statistics for both skewness were and kurtosis show normal distribution (kurtosis lies between $-2 \leq X \leq 2$ while skewness lies between $-1 \leq X \leq 1$) hence in line with Kolmogorov-Smirnov normality test results. According to Mugenda and Mugenda (2003), the skewness statistics not exceed 2.5 times of their standards error hence the normality principle has not been violated. The same also applies to the kurtosis statistics (less then 2.5 of their standard error).

This stage of analysis was also concerned with establishing the general picture across sectors. A cross tabulation between the sectors and levels of of remuneration produced the following results.

Table 4.2: Directors' emuneration levels by sector

		REM Levels			Total
		Low	Medium	High	
Sector	Agricultural	4	3	0	7
	Automobiles and Accessories	1	3	0	4
	Banking	0	6	3	9
	Commercial and Services	1	5	2	8
	Construction & Allied	1	3	1	5
	Energy and Petroleum	0	4	1	5
	Insurance	0	3	1	4
	Investment	0	3	0	3
	Manufacturing and Allied	0	4	3	7
	Telecommunication and Technology	0	0	1	1
Total		7	34	12	53

Source: Research Findings

As the above results show, the lowest remuneration for directors was in the agricultural sector while the highest level of remuneration was in the banking and manufacturing and allied sectors. There was a strong relationship between sector type and level of remuneration (Phi=0.679). However, the relationship was not significant, implying that remuneration of directors was not necessarily caused by sector but other factors.

A cross tabulation of sector and size of board produced the output below.

Table 4.3: Board size by sector

		Size of Board			Total
		Few	Medium Size	Huge	
Sector	Agricultural	3	4	0	7
	Automobiles and Accessories	1	3	0	4
	Banking	0	7	3	10
	Commercial and Services	1	4	3	8
	Construction & Allied	2	2	1	5
	Energy and Petroleum	0	3	2	5
	Insurance	0	3	2	5
	Investment	0	3	0	3
	Manufacturing and Allied	1	4	2	7
	Telecommunication and Technology	0	0	1	1
Total		8	33	14	55

Source: Research Findings

The results show that generally, most sectors had a moderate size board (33 out of 55 with available data on board size). Most of those firms with few directors were in the agricultural sector while most of those with huge boards of directors were in the banking, commercial and services sectors (6 out of 14). Board independence was also studied against sectors.

Table 1.4: Board independence by sector

		Level of Independence			Total
		Low BIND	Medium BIND	High BIND	
Sector	Agricultural	7	0	0	7
	Automobiles and Accessories	2	1	1	4
	Banking	5	2	2	9
	Commercial and Services	6	2	0	8
	Construction & Allied	5	0	0	5
	Energy and Petroleum	4	1	0	5
	Insurance	0	2	1	3
	Investment	2	1	0	3
	Manufacturing and Allied	3	3	1	7
	Telecommunication and Technology	0	0	1	1
Total		34	12	6	52

Source: Research Findings

These results show that most firms had low board independence (34 out of 52). Just as above, most of the companies with the lowest independence of board were in the agricultural sector while most board independence was registered in the banking sector. Last, the distribution of ROE by sector was analysed and the results below recorded.

Table 4.5: ROE by sector

		Levels of ROE			Total
		Negative ROE	Low ROE	High ROE	
	Agricultural	0	3	4	7
	Automobiles and Accessories	0	2	1	3
	Banking	0	2	8	10
	Commercial and Services	0	4	4	8
	Construction & Allied	0	2	3	5
Sector	Energy and Petroleum	1	3	1	5
	Insurance	0	0	5	5
	Investment	0	3	0	3
	Manufacturing and Allied	1	2	3	6
	Telecommunication and Technology	0	0	1	1
Total		2	21	30	53

Source: Research Findings

For the sake of this study, ROE between 0-14% was considered low and ROE above 15% considered high. From the table above, it can be said that generally, between 2008 and 2014, most companies listed in the NSE (30 out 53) had a high ROE. A part from the investment sector (with 8 out of 64 firms) did not have a single company attaining high ROE. It was also noted that all the firms in the insurance sector (5 of them) attained high ROE. Only companies in two sectors (Manufacturing and Allied as well as Energy and Petroleum) attained negative ROE. It would be interesting to determine whether differential levels of ROE were related to board profile in the next section.

4.3. Inferential Statistics

This chapter will discuss all forms of statistical relationships amongst the variables ander the study both dependent and independent variables. Correlation and regretion analysis will be interpreted

4.3.1. Correlation Analysis

This step was to investigate the individual relationship amongst the independent variable and the dependent variable without controlling for any factor. Tests of significance were incorporated at this stage of analysis. The results of these correlations are shown in the table below.

Table 4.6: Correlations Matrix

Control Variables			ROE	BSIZE	BIND	BREM
FSIZE	ROE	Correlation	1.000	.338	.040	-.237
		Significance (2-tailed)	.	**.012**	.773	.085
		Df	0	52	52	52
	BSIZE	Correlation	.338	1.000	.146	.692
		Significance (2-tailed)	.012	.	.291	.000
		Df	52	0	52	52
	BIND	Correlation	.040	.146	1.000	.332
		Significance (2-tailed)	.773	.291	.	.014
		Df	52	52	0	52
	BREM	Correlation	.237	.692	.332	1.000
		Significance (2-tailed)	.085	.000	.014	.
		Df	52	52	52	0

Source: Research Findings

The relationship between model variables was also scrutinized. From the above correlations table, it appeared as if BREM was highly and significantly correlated to BSIZE (r=.692, p=0.000) and weakly but significantly correlated to BIND. Such relationships would otherwise cause a further weakening of the overall effect that board

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profile and firm size would have on corporate financial performance. Nevetherless, these two relationships were only spurious since tests of multicollinearity (see appendix 4) ruled out such a scenario. Specifically, the VIF factors for all the variables were $1 \leq X \leq 10$ confirming that correlation does not always lead to causation.

Regression analysis was also carried out to determine the predictive power of the model variables to the changes in the dependent variable.

4.3.2. Regression Analysis

As shown in the previous chapter, the regression model for this study was;

ROE = α+ β₁BIND + β₂BSIZE + β₃BREM + β₄FSIZE + ε

The model was run on the collected data using the statistical package for social sciences and the following output obtained.

It was found out that although the relationship between performance (ROE) and BSIZE was positive, it was not statistically significant (r=.374; p=0.05, sig. at 0.01 level). In addition, the relationship between ROE and BIND was not significant. The same was also found to be true between ROE and FSIZE. Moreover, there was a negative and significant relationship between the remuneration of the board of directors and performance; though the level of correlation was low (r=0.292; p=0.03, sig. level at 0.05).

The above results also show that when FSIZE is held constant, the size of the board of directors was also the sole variable whose relationship with financial performance was statistically significant (p<0.05). Importantly still, it is critical to highlight the negative association between BREM and financial performance meaning that if directors are highly remunerated, they reduce the net income as well as equity for shareholders.

Table 4.7. Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.377[a]	.142	.074	3.10612

Source: Research Findings

a. Predictors: (Constant), FSIZE, BIND, BSIZE, BREM

The above results indicate that board profile (size, remuneration and independence) and firm size were responsible for 14.2% of financial performance in the companies listed in the NSE between 2008-2014 (RSquare=0.142). In order to review the effect of FSIZE, regression was also run controlling for the variable. The resulting model summary is presented below;

Table 4.8: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.374[a]	.140	.090	3.07945	.140	2.772	3	51	.051

Source: Research Findings

a. Predictors: (Constant), BREM, BIND, BSIZE

As per the new model summary, the coefficient of determination has changed from 14.2% to 14.0%. This could imply that the size of the company may not have an effect in determining the what the other variables, BSIZE, BIND and BREM predict financial performance.

Without controlling for FSIZE, the model showed that the co-efficients of the all regression variables were not significant. However, when FSIZE was held constant, BSIZE emerged as the only significant factor that determined financial performance.

Table 4.9: Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-2.644	10.782		-.245	.057
	BSIZE	.444	.250	.379	1.776	**.039**
	BIND	.205	2.938	-.010	-.070	.065
	BREM	-.010	.629	-.004	-.016	.047

Source: Research Findings

a. Dependent Variable: ROE

From the above results, the regression equation became;

ROE= -2.644 + 0.444BSIZE +0.205BIND -0.010BREM

For every unit increase in board size, financial performance increased by 0.444 units (β_1=0.444). for every unit change in board indepedence, financial performance changes by 0.205 units (β_2=0.205) It was found out that for every unit increase in board remuneration, financial performance decreased by 0.010 units (β_3= -0.010). The relationship between board remuneration and financial performance is supported in literature (Murigi, 2011).The results also suggested that increased board independence led to increased financial performance but this, although supported in literature, was not statistically significant.

4.3.3. Analysis of Variance

The literature review chapter explains some of the other variables that determine financial performance; this is well related in the discussion section below. The regression results show that the model may not be effective in the prediction of financial performance. This is because as shown below, the level of significance is > 0.05.

Table 4.10: ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
	Regression	80.092	4	20.023	2.075	.098[b]
1	Residual	482.400	50	9.648		
	Total	562.492	54			

Source: Research Findings

 a. Dependent Variable: ROE

 b. Predictors: (Constant), FSIZE, BIND, BSIZE, BREM

Nevertheless, when FSIZE was controlled for, it was established that the model variables were significant predictors of performance as shown.

Table 4.11: ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
	Regression	78.860	3	26.287	2.772	**.041[b]**
1	Residual	483.633	51	9.483		
	Total	562.492	54			

Source: Research Findings

 a. Dependent Variable: ROE

 b. Predictors: (Constant), BREM, BIND, BSIZE

4.4. Interpretation of the Findings

Results indicate that board profile (size, remuneration and independence) and firm size were responsible for 14.2% of financial performance in the companies listed in the NSE between 2008-2014 (RSquare=0.142).

ROE= -2.644 + 0.444BSIZE +0.205BIND -0.010BREM

For every unit increase in board size, financial performance increased by 0.444 units (β_1=0.444). for every unit change in board indepedence, financial performance changes by 0.205 units (β_2=0.205) It was found out that for every unit increase in board remuneration, financial performance decreased by 0.010 units (β_3= -0.010)

There is need to compare the results of this study with what has already been found out in literature. There is no doubt that aspects of corporate governance have largely been associated with financial performance differentials (Manini & Abdillahi, 2015). Specifically, the characteristics of the board have a great role to play in predicting CFP. The fact that this study found that board size was associated with financial performance is in line with this already established knowledge. However, the non-significance of board indepence and board remuneration (when controlling for FSIZE) may have been occasioned by gaps in the data so-collected. By not controlling for FSIZE, the relationship between BREM and performance was also significant (and negative for that matter). This implies that the more the directors of the boards are remunerated for their services, the more negatively the financial position of the listed companies are affected.

The results obtained in the study were also viewed against the corporate governance guidelines of 2002. The Capital Markets Act (Gazette Notice 3362) outlines many principles of corporate governance among firms listed in the NSE. Only those that are of

interest to this study were considered. Indeed, only the first set of principles that were found relevant for this study since they address issues of directors and boards; and this study was based on board profile. The CG guidelines meet international standards since the task force committees compared CG practices in other countries such as the UK, Malaysia and institutions such as the Commonwealth Associaition and Organization for Economic Cooperation and Development (CMA, 2011). Several reasons justify why FSIZE was held constant. Murigi (2011) established that the size of the board and levels of directors' remuneration highly depend on the size of the firm. As the table below shows, FSIZE is highy positively correlated with BREM and the results are significant. Hence the exclusion of FSIZE in the regression model served two purposes. First, as the table below shows, it is expected that multicollinearity would have reduced the predictive power of the variables in the equation. Second, as earlier shown, it made the entire model significant.

When viewed against the corporate governance guidelines, the results of this study make sense. Clause 2(1) recognizes the role of the directors to boards as that of controlling the company. This is based on the agency problem described in literature review. Although managers are supposed to be good stewards (stewardship theory), they have their own interests as well hence the need to control them (agency theory). This, then, implies that ideally, a company whose management is well controlled by the board has potential to perform well. This was infact confirmed by the results of this study when it established that the size of the board was not only positively correlated with financial performce but was also played a key role in improving the significance of the regression model. Hence the relationship is supported by theory.

The study established that board size was positively correlated with financial performance measured by ROE. It appears that larger boards of directors contributed to the effectiveness of the way the firms are run. In addition, theory suggested that board size is complemented by board indepence and remuneration. Although ideally a board can only be effective it directors were well remunerated and board independence is high (Manini & Abdillahi, 2015), this study provides evidence that holding all other factors constant, board size alone has significant effect of corporate financial performance. This lies within what Korir and Cheruiyot (2014) desctibes as the supervisory role of the board; the more directors there are, the more financial oversight on the management team is done leading to better performance.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1. Introduction

This chapter presents a summary of the entire study as well as conclusions srawn from the study. It also presents recommensations based on the results obtained from analysis of data.

5.2. Summary

This study sought to establish the relationship between Board profile and financial performance of companies listed in the NSE. Specifically, it sought to establish how characteristics of the boards of directors were related to the returns on equity for the firms listed in the NSE between 2008-2014. These characteristics of board were size, remuneration and independence. In order to effectively define the research problem and set the study objective, literature was reviewed. Literauture review did not only explore past studies on the subject in Kenya but also inspected theories that are the basis for defining relationships among variables. In order to achieve the established objective, the study adopted a descriptive study design. It was a census study in that all the companies listed in NSE were studied. It used secondary data obtained from the financial statement of the companies listed in the NSE between 2008 and 2014. Various methods of analysis were used to describe the data and make inferences on the basis of the study result.

Generally, directors' remuneration has increased across all the sectors over the seven-year study period. The best sectors in terms of paying directors' remuneration were banking and manufacturing and allied sectors while the worst was the agricultural sector.

The average directors' remuneration for all the firms listed in the NSE was Ksh.76 million per annum. The high variation in standard deviation was an indication that while some companies remunerated directors very highly, some did do very poorly. The average size of the boards was 8.16 while the average independence of boards was 0.1550 (on a scale of 0-1).

5.3. Conclusions

Most literature shows that corporate governance has an effect on the financial performance hence, ideally, the need to introduce governance policies will improve the financial performance and performance efficiency. Many different claims by different authors explaining the impact of corporate governance on financial performance of firms listed at (NSE) have been explored and analyzed vis-à-vis the findings of the study. Competing explanations to the various arguments have also been shown. Specifically, the effect of the board characteristics was investigated. The study found out that only board size was a significant predictor of financial performance among companies listed in the NSE. Although literature shows that generally all board-related variables should have an impact on performance, gaps in data may have occasioned the findings of this study. Nevertheless, since the overall predictive power of board profile on financial performance was also low, it implies that other predictors of financial performance, as shown under literature review, exist.

From both the individual and sector analysis, board remuneration has generally been increasing over time but firm performance has tended to stabilise and in some cases declined. The regression analyses have shown mixed relationships between board remuneration and Return

on Equity with most being negative. The independence of directors is perceived to have a great effect to the firm performance due to the strong independent judgment. Board with more independent directors can perform monitoring roles effectively (Sun, 2012). The relationship between the proportion of independent directors and firm performance is substantial. The independent directors are perceived to minimize the opportunity for manager to misappropriate the resources of the shareholders. Furthermore, a number of independent directors on the board may contribute to the effectiveness of the board as a monitoring role and indirectly shall increase the performance of the firm (Muriithi, 2009; Lekaram, 2014). In addition, independent directors are more objective in making decision. Mwangi and Jerotich (2013) studied the relationship between the proportion of outside directors on the board and firm performance and the study found a significant positive relationship using accounting measures.

The other factor that determines CFP is board size. Generally, board size is associated with the effectiveness of monitoring ability by the boards (Nyamongo et al. 2013). Eshiwani characterizes typical non-performing boards in Kenya as having directors who are always present at company meetings, as executive remuneration takes the form of an allowance awarded for each meeting attended. The collapse of Uchumi has been attributed to irrational expansion plans by the board coupled with a lack of risk management strategies (Musikali 2014). However, it is suggested that every company should examine their own board so that the number of directors is sufficient to discharge their responsibilities, proactive involvement, and able to make decision for the good sake of the company. A minimum of eight members of the board should be adequate to perform the board's role effectively (Sun, 2012). If the board is very huge though, it

implies that the directors have to be paid hence negatively affecting the financial performance. Hence there is a need to strike a balance between the two.

High directors' remuneration is an indication that the company is doing well, larger and complex business operation (Nyamongo et al. 2013). Directors' remuneration is paid at the expense of shareholders thus to prevent excessive pay, there is a call to for the design of incentive compensation tied with the firm performance which is known as pay-for-performance theory. The directors will be more responsible, tend to utilize their resources efficiently and aware of the consequences of his actions thus will act effectively when the pay is linking to the firm performance (Muriithi, 2009).

The size of a firm is the other determinant of director's remuneration and consequent financial performance. Thus, the compensation setting committee sets the remuneration based on the firm size with a justification that larger firm is more complex and demanding tasks (Baker, 2007). Firm size in this case was measured by assets of the firms. As the complexity and size of the firm becomes larger, the board size is also increase due to the needs of more advice from experienced directors. Board size is correlated with the firm size (Kell, 2005).

5.4. Recommendations for Policy and Practise

From the above findings, the following recommendations are put forward; There is need to study and analyse corporate governance sectorwise for example corporate governance of the agricultural sector in Kenya is below avarage. Most of the CG negative extremes were found to be in the agricultural sector such as low independe of board, few board members and poorest remuneration of board members.

This study recommends that the country therefore needs to strengthen policies to improve firm-level corporate governance in order to attract such investors and bolster overall growth. The regulatory authorities in Kenya need to strengthen the independence of board of directors by for example making it mandatory upon firms to ensure that boards of directors have sizeable representation of outside directors, as is the practice in other countries, and since the evidence from this study suggest the need for this.

5.5. Limitations of the Study

One of the limitations of the study was the fact that some of the companies presently listed in the NSE were not listed in 2008. In the same way, some of those which were listed in 2008 have been delisted to-date. As it can be seen from the most outputs, N=55 implying that about 9 companies were listed in the last 1 to 2 years (or did not have data for that variable). Moreover, this did not affect the validity of the results as shown in the analysis.

The second limitation was resource limit in terms of time and finances which gave us only option of using secondary data, given enough resources this study should have included other factors forming board profile such as gender and professional experience

Another limitation of this study was it's narrowness in terms of scope, the study focused on the listed firms at NSE leaving out other private firms and gorvenment owned enterprises which form larger part of our economy. NSE may not necessarily reflect on the performance of Kenyan firms in general or corporate governance of of all firms.

5.6. Areas for Further Research

For further research, the study recommends the investigation of the relationship between corporate governance aspects and corporate financial performance in the private sector (companies that are not listed in the NSE).

Again this research will be crucial if it is carried out in the agricultural sector where from the research findings showed many aspects were skewed and not at par with other sectors.

Again a more compressive study needs to be carried out to obtain a data which can be used to construct a broad corporate governance index encompassing all aspects of board profile and other aspects of corporate governance such as Internal audit and audit committees

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APPENDICES

Appendix I: Companies Listed at Nairobi Security Exchange as at 31ˢᵗ December, 2014

Agricultural

1   Eaagads Limited

2   Kakuzi Limited

3   Kapchorua Tea Company Limited

4   Limuru Tea Company Limited

5   Rea Vipingo Sisal Estate

6   Sasini Tea and Coffee

7   Williamson Tea Kenya Limited

Automobiles and Accessories.

8   Car & General Kenya

9   Marshalls East Africa(Delisted in September 2011)

10 CMC Holdings

11 Sameer Africa Limited

Banking.

12 Barclays Bank of Kenya

13 CfC Stanbic Holdings

14 Diamond Trust Bank Group

15 Equity Group Holdings Limited

16 Housing Finance Company of Kenya

17 I&M Holdings Limited

18 Kenya Commercial Bank Group

19 National Bank of Kenya

20 National Industrial Credit Bank

21 Standard Chartered of Kenya

22 Cooperative Bank of Kenya

Commercial and Services.

23 Express Kenya Limited

24 Hutchings Biemer Limited

25 Kenya Airways

26 Longhorn Kenya Limited

27 Nation Media Group

28 Scangroup

29 Standard Group Limited

30 TPS Serena

31 Uchumi Supermarkets

Construction and Allied.

32 ARM Cement Limited

33 Bamburi Cement Limited

34 Crown-Berger (Kenya)

35 East African Cables Limited

36 East Africa Portland Cement Company

Energy and Petroleum.

37 Kengen

38 KenolKobil

39 Kenya Power and Lighting Company

40 Total Kenya Limited

41 Umeme

Insurance.

42 British-American Investments Company

43 CIC Insurance Group

Liberty Kenya Holdings Limited (formally CFC Insurance)

44 Jubilee Holdings Limited

45 Kenya Re-Insurance Corporation

46 Pan Africa Insurance Holdings

Investment.

47 Centum Investment Company

48 Olympia Capital Holdings

49 TransCentury Investments

Investment Services.

50 Nairobi Securities Exchange

Manufacturing and Allied.

51 A Baumann and Company

52 BOC Kenya

53 British American Tobacco Limited

54 Carbacid Investments Limited

55 East African Breweries

56 Eveready East Africa

57 Kenya Orchards Limited

58 Mumias Sugar Company Limited

59 Unga Group

Telecommunication and Technology.

60 Safaricom

AccesKenya holdings(Delisted in May 2013)

Growth Enterprise Market Segment.

61 Atlas Development & Support Services

62 Home Afrika

63 Flame Tree Group Holdings Ltd

64 Kurwitu Ventures

Source: *Capital Markets Authority website* <u>*https://www.nse.co.ke/listed-companies/list.html*</u>

Appendix II: Test of Normality

One-Sample Kolmogorov-Smirnov Test

		ROE	BSIZE	BIND	FSIZE	BREM
N		55	55	55	55	55
Normal Parameters[a,b]	Mean	.7512	8.16	.1550	23.244	19.780
	Std. Deviation	3.22746	2.754	.15350	1.9441	1.1444
Most Extreme Differences	Absolute	.470	.126	.207	.070	.063
	Positive	.470	.126	.207	.060	.062
	Negative	-.383	-.100	-.156	-.070	-.063
Kolmogorov-Smirnov Z		3.484	.935	1.538	.517	.467
Asymp. Sig. (2-tailed)		.053	.846	.078	.952	.981

Source: Research Findings

a. Test distribution is Normal.

b. Calculated from data.

Appendix III: Bivariate Correlations

Correlations

		ROE	BSIZE
ROE	Pearson Correlation	1	.374[**]
	Sig. (2-tailed)		.05
	N	55	55
BSIZE	Pearson Correlation	.374[**]	1
	Sig. (2-tailed)	.005	
	N	55	55

Source: Research Findings

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

Correlations

		ROE	BIND
ROE	Pearson Correlation	1	.062
	Sig. (2-tailed)		.654
	N	55	55
BIND	Pearson Correlation	.062	1
	Sig. (2-tailed)	.654	
	N	55	55

Source: Research Findings

Correlations

		ROE	BREM
ROE	Pearson Correlation	1	-.292[*]
	Sig. (2-tailed)		.030
	N	55	55
BREM	Pearson Correlation	.292[*]	1
	Sig. (2-tailed)	.030	
	N	55	55

Source: Research Findings

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

Correlations

		ROE	FSIZE
ROE	Pearson Correlation	1	.177
	Sig. (2-tailed)		.195
	N	55	55
FSIZE	Pearson Correlation	.177	1
	Sig. (2-tailed)	.195	
	N	55	55

Source: Research Findings

Appendix IV: Multicollinearity Tests

Coefficients[a]								
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	-1.460	11.369		-.128	.898		
	BSIZE	.470	.262	.401	1.791	.079	.343	2.917
	BIND	-.249	2.966	-.012	-.084	.933	.862	1.160
	BREM	.034	.647	.012	.052	.959	.326	3.064
	BREM	.034	.647	.012	.052	.959	.326	3.064

Source: Research Findings

Appendix V: Linearity Tests

ANOVA Table

			Sum of Squares	df	Mean Square	F	Sig.
ROE * BSIZE	Between Groups	(Combined)	.095	11	.009	.195	.997
		Linearity	.009	1	.009	.196	.660
		Deviation from Linearity	.086	10	.009	.195	.996
	Within Groups		1.903	43	.044		
	Total		1.998	54			

Source: Research Findings

ANOVA Table

			Sum of Squares	df	Mean Square	F	Sig.
ROE * BIND	Between Groups	(Combined)	.628	18	.035	.916	.566
		Linearity	.102	1	.102	2.666	.111
		Deviation from Linearity	.526	17	.031	.813	.668
	Within Groups		1.370	36	.038		
	Total		1.998	54			

Source: Research Findings

Appendix VI: Normal Distribution Curve for Board size

BSIZE

Mean = 8.16
Std. Dev. = 2.754
N = 55
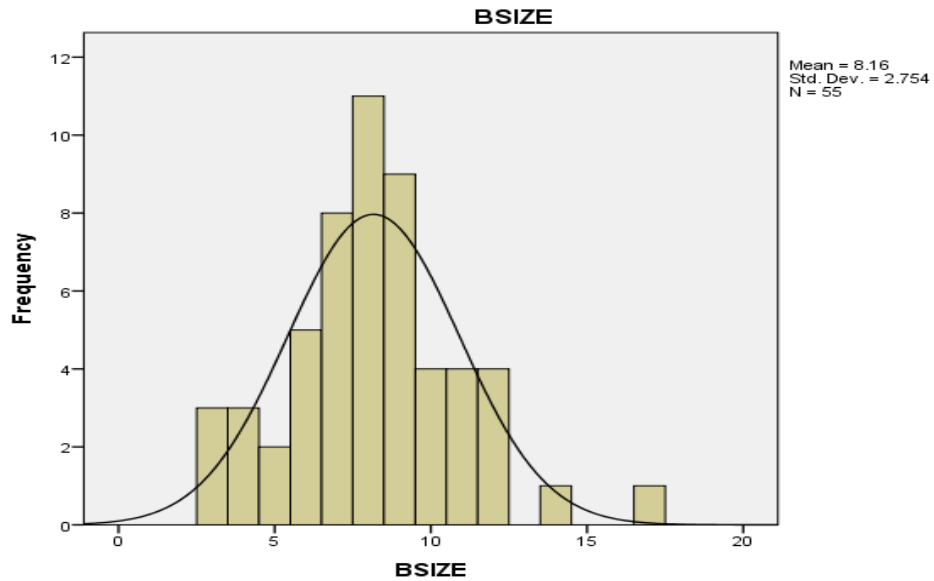
Source: Research Findings

Normal Distribution Curve for return on equity

ROE

Mean = .17
Std. Dev. = .192
N = 55
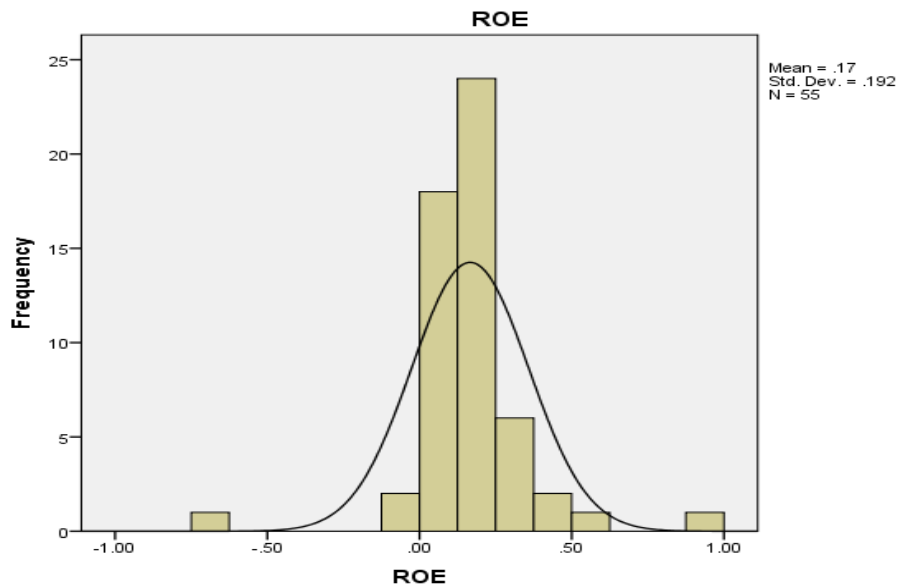
Source: Research Findings

Normal Distribution Curve for Firm Size

FSIZE

Mean = 23.24
Std. Dev. = 1.944
N = 55
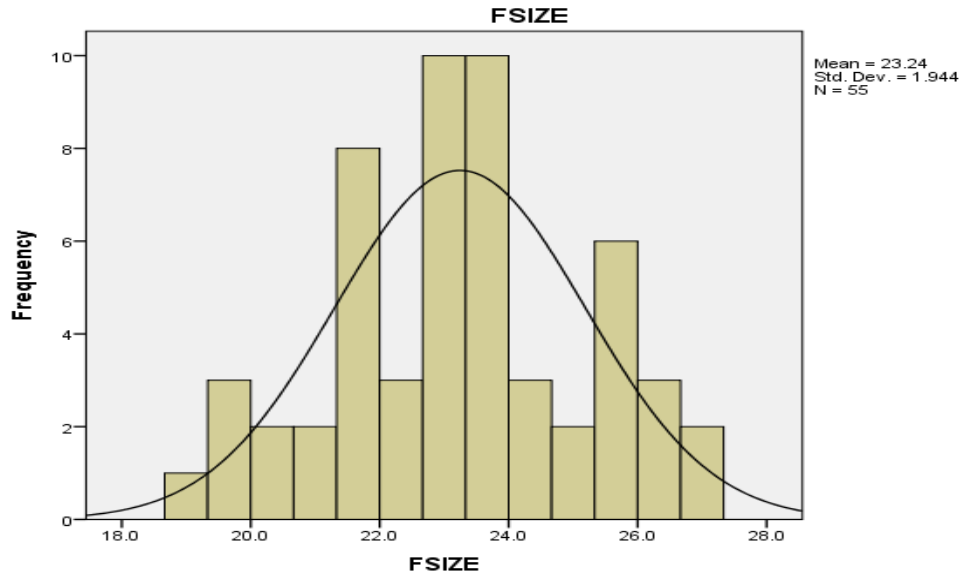
Source: Research Findings

Normal Distribution Curve for Board remuneration

BREM

Mean = 19.78
Std. Dev. = 1.144
N = 55

Source: Research Findings