

**The Relationship Between Corporate Governance Mechanisms
And Performance Of Firms Quoted On The Nairobi Stock
Exchange.**

UNIVERSITY OF NAIROBI
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DECLARATION

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

SIGNED



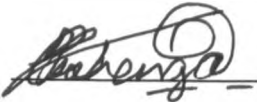
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DATE

12-1-05

This project has been forwarded for examination with my approval as the university supervisor.

SIGNED



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DATE

12-1-05

DEDICATION

First to God for he has done it all, then to my parents Faith & Benjamin Kiara for their tender loving care, support and enduring responsibilities of bringing me up to what I am today.

Also to my sisters Rose, Lilian, Pauline, Jane, and my friend Joyce who all have been inspirational in my endeavour to pursue knowledge and excel in the things I do in life.

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ABSTRACT

The objectives of the study were to investigate the relationship between corporate governance mechanisms and firm performance in Kenyan publicly quoted firms and also to document the corporate governance mechanisms present in these companies. In order to achieve these objectives, both descriptive statistics analysis and cross sectional multiple regression analysis are done for 44 companies quoted on the Nairobi stock exchange in the period of 1999-2003. The following major conclusions are drawn from the study.

The average board size of Kenyan listed firm is 8 and non-executives hold a significantly larger percentage of board seats (76%). In addition, 0.13% of the sample population have C.E.O. duality. With regard to ownership, the five largest shareholders in Kenyan listed firms account for 70% of the outstanding shares on average while Institutional investors, individual investors, foreign investors, financial institutions, and the state control 51%, 22%, 26%, 10% and 3.4% of the outstanding shares respectively.

Empirical results of the study show that both board size and C.E.O. duality have significant relationships only with stock market returns (RET). They have a positive and negative relationship respectively. No measure of firm performance has a significant relationship with the percentage of non-executive board members. With regard to ownership structure, state ownership is negatively related to return on assets (ROA) but has no significant relationship with RET and Tobin's Q ratio. State share ownership seems to lead to inefficiency and low profitability. Financial institutions ownership is positively related to Tobin's Q but has no significant relationship with RET and ROA. This supports the hypothesis that financial institutions have the skills and resources to monitor managers.

Ownership by top 5 shareholders, which depicts ownership concentration, is not significantly related to any of the performance measures. Also ownership by individuals and institutional investors are not significantly related to any of the performance measures. With regard to control variables, the use of leverage has a significant negative relationship only with ROA, While firm size is related positively only with RET.

The fact that different performance measures exhibit different results with various corporate governance mechanisms confirm why debate has ensued on which of the measures; stock market or accounting is "best" for studies about corporate governance without consensus.

CHAPTER 1: INTRODUCTION

1.1 AN OVERVIEW OF CORPORATE GOVERNANCE

Corporate governance has been a current and an ongoing issue in corporate finance literature. Before 1990's the emphasis had been primarily on stewardship issues, which is a logical consequence after the separation between ownership and management of a company. Directors were acting as agents who were replacing the owners and managing the firm according to owners' instructions. Because of this framework, as Laiten and Ruuhela (1997) notes, research concerning the relationship between owner and manager was concentrated on proper appropriation of funds by non-owner managers.

In the 1990s the emphasis moved to the other side of the coin, which is instead of controlling for misappropriation of funds, the issue is how to use corporate governance mechanisms in motivating managers to increase the wealth of the owners.

Many countries especially in Asia and other emerging markets have plunged into economic crisis due to weak legal environment and poor governance systems. This, as Sung (2003) comments has triggered discussions on the importance of corporate governance. Johnson et al (2000) show that countries with weak legal protections suffered greater exchange rate depreciation and severer stock market de-valuation during the economic crisis in Asia and other emerging markets. A lot of research has focused on the effects of corporate governance mechanisms during this economic crisis in Asia.

Good corporate governance practices have become a necessity for every country and business enterprises (Jebet, 2001). If countries are to reap the full benefits of the global capital market and if they are to attract long-term capital, their corporate governance arrangement must be credible and consistent with practices across borders.

In Kenya, the main concerns particularly in the early 1990 were on governance of the public sector (Ibid, 2001). The underlying reasons for these concerns were the realization that poor public governance had led to wastage and misuse of public resources. In the late 1990's we

see a shift of these concerns to corporate governance of private and public sector corporations.

There have been several workshops held in Kenya regarding corporate governance. In one such workshop organized by the Capital Market Authority (CMA) the then Minister of Finance is reported saying “Every economy depends on the drive, productivity and efficiency of its corporate sector. The effectiveness of the board of directors and Management of companies in discharging their responsibilities determines the level of corporate efficiency....” (CMA Annual report 1997).

Other workshops organized by the Private Sector Corporate Governance Trust, NSE, CBK, ICPAK, ACCA Kenya chapter have stressed the importance of corporate governance. Also these bodies have issued guidelines regarding good corporate practices such as board composition and Audit Committees. It is against this background that this study sought to examine the relationship between corporate governance mechanisms and firm performance or profitability.

1.1.1 Definition of corporate Governance

As management phrases do not have one definition so does corporate governance. To begin with the term governance is used to define the manner in which power is exercised in the management of economic and social resources for sustainable human development, (Wambua, 2001). Good governance requires accountability in the use of power and maintaining of a corporate framework within which interested parties can find innovative solutions to common problems.

Demb and Neubaur (2001) define corporate governance as the process by which corporations are made responsible to the rights and wishes of stakeholders. Shleifer and Vishny (1997) claim that corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment. Stiles and Taylor (1998) have also defined corporate governance as the means through which companies are influenced to respond to society’s interests and desires.

Corporate governance also refers to the manner in which the power of a corporation is exercised in the running of the corporation's total portfolio of assets and resources with the objective of maintaining and increasing shareholders' long-term value while taking into account the interest of other stakeholders (C.M.A, 2002). Corporate governance seeks to ensure that leaders act in the best interests of the corporation and its stakeholders. Good corporate governance enhances effectiveness, competitiveness and sustainability of the corporation.

Corporate governance highlights the relationship between corporate managers, directors, people and institutions that save and invest their capital to earn returns. Therefore under corporate governance, as Wambua (2001) notes, we are seeking to address who is in the best position to make decisions and if such a person has necessary authority. Of central concern is whether execution of decisions is in the interest of stakeholders.

Three important concepts are vital in illustrating the nature of corporate governance and they are separation of ownership and control, agency relationships and corporate governance mechanisms

1.1.2 Separation of ownership and control

In some way, corporate governance has been associated with separation of company shareholders and control. Okatch (2003) asserts that corporate governance refers to mechanisms that effectively manage the separation of ownership and control as far as management of business concerned. He adds that just as democratic management of a government calls for separate legislative, judiciary and executive so does corporate governance in modern management.

Various academic studies suggest that managers have enormous discretion about firms' decision and may not act in the best interests of the owners. Claims that managers can ignore interests of shareholders are often deduced from the fact that ownership is widely dispersed and as a consequence, it is often claimed that individual shareholders cannot control management. Jensen and Meckling (1976) and Fama and Jensen (1983) argue that the diffusion of ownership has an important impact on the validity of the profit-maximising goal

of corporations because the separation of control may enable corporate managers to pursue their own interests.

‡

Jaffe (1990) however terms this as simplistic. Why then should external investors give the money to managers? The answer to this question has to do with corporate governance. There exist several managerial disciplining mechanisms, like block holder monitoring, the market for corporate control (threat from the), pay-for-share price performance remuneration schemes, managerial labour markets, legal protection, ownership structure (large shareholders and creditors), the use of leverage and takeovers etc., which curb managerial opportunistic behaviour (De Jong et al 2002; Tirapat 2001). Corporate governance thus ensures separation of power is maintained, profitable activities are carried on and eventually the shareholders get their dividends and value of investments.

1.1.3 Agency Relationships

‡

An agency relationship is a contract under which one or more people (the principal) hire another person (the agent) to perform service on their behalf and delegate some decision-making authority to them.

The business is usually a nexus of many parties and individuals with diverse interests and financial claims. Okatch (2003) say that contractual relationship of all these parties and individuals is well explained by corporate governance. There are many claimants of cash inflows and outflows in diverse ways.

The basic problem addressed by the agency theory is the question of whether or not managers of a firm (the agents) will take actions that are in the best interest of the firm's security holders and stockholders (Kidwell and Paterson, 1990).

Wambua (2001) notes that corporate governance seeks to find appropriate mechanism for governing relationships of constituents groups within a company in order to generate value. This therefore calls for classification of each party's responsibility for purpose of planning, implementing, control and evaluation.

‡

1.1.4 Corporate Governance Mechanisms

There are many mechanisms of controls that the investors can use such as ownership structure (large shareholders and creditors), the Board of Directors, the company secretary, use of External auditors the (threat from the) market for corporate control, pay-for-share price performance remuneration schemes, managerial labour markets, the use of leverage, legal protection etc. Some of these mechanisms are discussed as under.

(i) Shareholders and Ownership Structure

As far as corporate governance is concerned, shareholders are the main investors in firms. They have final claim on a firm's assets in the event of liquidations. Further, take note that shareholders generally fall under two categories. These are ordinary shareholders and preferential shareholders. The later have fixed amount of claim on a firm, as far as dividends and liquidations are concerned.

The shareholders apart from providing capital do also appoint board of directors to manage on their behalf. In most cases, the shareholders are too many to manage the company and therefore elect and appoint the directors to manage it on their behalf (Okatch, 2003). Subject to the articles of association, the directors are appointed or elected at an annual general meeting of the shareholders.

It has been argued that shareholders may be effective in controlling the manager incentives by being large. The concentration of ownership can avoid the free rider problem. There are several findings supporting the notion that large shareholders play an active role in corporate governance. For example, in Germany, Franks and Mayer (1994) find that large shareholders are associated with higher turnover of directors. Gorton and Schmid (1996) document that block holdings by banks improve companies' performance.

In Japan, Kaplan and Minton (1994) find that companies with large shareholders are more likely to replace managers in response to poor performance than firms without them. In U.S., Morck, Shleifer, and Vishny (1988) find that there is nonlinear

relationship (inverted "U") between ownership and companies performance, as measured by their Tobin's Q.

According to Kitonga (2001), Kenyan shareholders have lacked the clout to make significant impact on corporate governance. He attributes this to two main reasons. One is that the Kenyan capital market has produced a breed of investors who are concerned with short-term benefits as opposed to long-term benefits. In this case they would rather dispose off their shares in a poorly performing company than go for the usual lengthy and strenuous exercise of dislodging its management team. Secondly, this kind of attitude has been attributed to the fact that shareholders are too diffuse to pool their weight and influence the management teams. Wambua (2001) also notes that it's not good enough that shareholders interest is just confined to self-interest per se.

Of late, the capital markets authority has suggested that shareholders form associations. Melly (2002) says this would promote good financial reporting through mobilization of necessary financial resources to carry out financial analysis, highlight major issues that are of relevance to investors during annual general meeting and promote good governance practices and shareholder's value. The Kenya shareholders association is in the process of being operationalised.

(ii) The Board of Directors

In corporate governance, directors have a responsibility to maintain duty of care. They are elected by shareholders to be jointly and severally responsible (Okatch, 2003). Their prime duty is to ensure that stakeholders' interests are upheld above every thing else. This is the major group that is expected to exercise good corporate governance and report periodically to shareholders on their stewardship. Indeed as Kitonga (2001) notes, controversy on the role of directors simply exists because of separation between shareholders and directors and hence the agency problem. Corporate governance has been suggested as one way in which agency problem between the two parties can be managed.

In the case of banks, as Okatch (2003) notes, directors' elections are tricky. The central bank must vet them to be "fit and proper". They need to exercise due care lest they are be jointly and severally sued in court of law if they act in "bad faith". The directors should not encourage insider trading. Also since cash is a valuable commodity, the directors are supposed to prevent fraud and any other preventable crime.

Also board committees should be established to deal with audit particularly internal audit, remuneration and nomination of board members. Wambua (2001) notes that being creatures of the board, it is assumed that good boards will give birth to good board committees.

(iii) The Company Secretary

In all corporate bodies operating under the companies act (cap 486) of laws of Kenya, it is mandatory that each company appoint a qualified company secretary as per section 20 of the certified public accountants act cap 534. Section 178A require each company to have a company secretary.

The company secretary is a critical person on matters of good corporate governance. The secretary plays a key role such as to impact the appointment and performance of the board members and thus sets the pace to the board and top management. If the board and top management exercise good corporate practices, so will the rest of staff and this will trickle down to stakeholders. The secretary should ensure proper appointment of directors, their induction and ensure unhindered information by all board committee members.

Also, the secretary should ensure compliance with all relevant statutory and regulatory requirements and ensure that due regard is paid to the specific business interest of the company. The secretary should therefore act as a point of contact for institutional and other stakeholders especially with regard to matters of corporate governance.

(iv) External Auditors

External auditors safeguard the assets of shareholders and also provide shareholders with external and objective check on the directors' financial statements, which form the basis of their report to shareholders (Wambua, 2001). Appointment of the auditors is by shareholders and there are elaborate procedures of removing them because of their elaborate duties.

However (Choto, 2002) says that the importance of auditors has not been fully realized especially in the current supervisory set up of banks and other financial institutions. He says that central bank has been liaising with external auditors to implement the international accounting standards (IAS) since these promote market discipline through more extensive disclosure requirements.

External auditors should execute their duties diligently, fully and without fear or favor. External audits enhance corporate governance and also by being bold enough to point out irregularities, one would have played their role in corporate governance and this would enhance value and reliability of information available to the public on the performance and solvency of institutions as well as instill discipline.

(v) The Use of Leverage

The creditors can exercise some control over firm's decisions. Jensen (1986) notes that using leverage reduces the agency cost of free cash flow by reducing the cash flow available for spending at the discretion of managers. By using debt managers bond their promise to distribute future cash flows. Stulz (1988) and Harris and Raviv (1988) examine the relationship between leverage and managerial control of voting rights. They suggest that management can change the fraction of the votes it controls through capital structure (leverage) changes.

(vi) Legal Protections

It is common that external financing has legal protection. If managers violate the contract, then the shareholders or creditors have the right to appeal to the courts. The most important legal right shareholders have is the right to vote and elect the boards.

Like shareholders, creditors also have legal protections. These may include the right to possess the collateral, the right to liquidate the assets, the right to reorganization, and in some case the right to remove managers.

However, these legal protections may not be effective in some circumstance, so there have to be other mechanisms to ensure the good governance.

1.2 RESEARCH PROBLEM

As studies in other parts of the world have shown, there is need for good governance for economic development of any nation (Tirapat, 2001). Given the globalization of markets and need to attract foreign investors in our country, it's evident that there is need to address and evaluate mechanisms and structures of promoting good corporate governance of companies in our economy (Johnson et al 2000; Sung 2003).

In the recent past institutions have suffered losses and others have collapsed leading to adverse effects in our economy. For example in the financial sector Obiero (2002) reports that there has been a total of 39 bank failures in the period of 1984 to 2001. Choto (2002) notes that history of bank failures in Kenya shows that micro factors as opposed to macro factors are what has actually fuelled macro problems of high level of non-performing loans. Corporate governance is one of the micro factors.

Theoretical and empirical studies in different parts of the world suggest inconclusive and conflicting findings regarding the relationship between corporate governance characteristics and firm performance (De Jong 2002; Dalton et al 1998). They have suggested positive, negative or no relationship at all between corporate governance characteristics and performance. This shows how inconclusive this area is and thus the need for further research.

In Kenya several studies have been carried out in the area of corporate governance (Jebet 2001; Mucuvi 2002; Mwangi 2002; Wang'omibe 2003). The emphasis in all these studies is on identification of corporate governance practices in different sectors of the economy. These studies do not link corporate governance characteristics with firm performance. Oltetia

(2002) studies ownership structure and financial performance of quoted companies using Chi-square test for independence and accounting based measures of performance. His study is however not conclusive regarding identity of shareholders and it does not control for firm size and use of financial leverage.

Also no local study has examined the effect of board composition and leadership structure on firm performance. Therefore there is need for further research in this area of corporate governance mechanisms. This paper sought to find out the relationship between corporate governance mechanisms and different types of firm performance measures while controlling for factors such as firm size and use of financial leverage.

1.3 OBJECTIVES OF THE STUDY

- The study investigates the relationship between corporate governance mechanisms and performance of firms quoted at the Nairobi stock exchange.
- It documents the corporate governance mechanisms present in the publicly quoted companies.

1.4 IMPORTANCE OF THE STUDY

- The study is important to regulatory bureaucrats seeking to evaluate the level of compliance with guidelines issued regarding good corporate governance practices.
- The study is of help to shareholders and investors, as it will illustrate the relationship between corporate governance mechanisms and firm profitability.
- To fellow academicians the study is a basis for further research regarding corporate governance and firm performance in Kenya.

CHAPTER 2: LITERATURE REVIEW

There are certain elements that have been widely identified in literature as having an impact on the ability of owners to effectively monitor managers and thereby improve corporate performance. These factors collectively define the corporate governance mechanisms or structure of any given country.

According to Gedallovic and Shapro (1998) these elements include extent of ownership dispersion, ownership identity, shareholders powers, composition of the board of directors as well as leadership structure. Most of studies have focused on one of the factors identified above as having impact on corporate governance and performance of an organization. This study focuses on the two widely used mechanisms namely Ownership structure and the board of directors

2.1 RELATIONSHIP BETWEEN OWNERSHIP STRUCTURE AND FIRM PERFORMANCE

The relation between ownership structure and performance has been the subject of an important and ongoing debate in the corporate finance literature. The debate, as noted by Demsetz and Villaloga (2001) goes back to Berle and Means' (1932) thesis, which suggests that an inverse correlation should be observed between the diffuseness of shareholdings and firm performance.

A large number of studies spanning a few decades have investigated the relationship between ownership structure and corporate performance, but have not yielded clear-cut results. The studies have focused mainly on two dimensions of ownership structure namely ownership concentration or dispersion and shareholder identity.

2.1.1 Ownership Concentration and Firm Performance

According to De Jong et al (2002), it has been argued that as ownership concentration increases the incentives and the abilities of shareholders to properly monitor managers increase too. This creates beneficial effects for firms in the sense that performance or profitability improves. On the other hand, there are studies, which find that higher

ownership concentration, lead to detrimental effects for corporations as large block holders and managers can collude to extract rents from small shareholders.

Xu and Wang (1997) investigate whether ownership structure significantly affects the performance of publicly listed firms in China and if so, in what way. They use the recent literature on the role of large institutional shareholders in corporate governance as a theoretical base. They find that ownership is heavily concentrated: the five largest shareholders accounted for 58 percent of outstanding shares in 1995, compared with 57.8 percent in the Czech Republic, 42 percent in Germany, and 33 percent in Japan.

Their empirical analysis shows that the mix and concentration of stock ownership do indeed significantly affect a company's performance:

- There is a positive, significant correlation between concentration of ownership and profitability.
- The effect of concentrated ownership is greater with companies dominated by institutions than with those dominated by the state.
- The firms' profitability is positively correlated with the fraction of legal person (institutional) shares; it is either negatively correlated or uncorrelated with the fraction of state shares and with tradable shares held mostly by individuals.
- Labor productivity tends to decline as the proportion of state shares increases.

They therefore conclude that Institutional shareholders seem to have a positive impact on corporate governance and performance; state ownership seems to lead to inefficiency; and an overly dispersed ownership structure can create problems in the Chinese setting.

Pohl and Claessens (1997) say that the Czech Republic's mass-privatization scheme improved the management of privatized firms by concentrating ownership. And contrary to expectations, banks with an (indirect) equity stake in a privatized firm have a positive influence on the firm's corporate governance. Also they note that The Czech Republic's mass-privatization scheme changed the governance of many firms in a short time. They show that mass privatization was effective in improving firm management because of the concentrated ownership structure that resulted.

From a cross section of 706 firms for the period 1992-95, they find that the more concentrated the firm's ownership, the higher the firm's market valuation and profitability. Large ownership through bank-sponsored investment funds and strategic investors appears to be particularly important in improving corporate governance and turning firms around.

They find no evidence that market valuation or profitability were lower for firms in which investment funds sponsored by a firm's main bank represented a large ownership stake. It is often argued that the firm's main bank having (indirect) ownership control could represent a conflict of interest. The empirical analysis here shows, quite the contrary, that such indirect ownership control has a significant positive influence. On balance, banks that had an (indirect) equity stake in a firm have a positive influence on the firm's corporate governance.

Alba et al (1998) study the corporate financing and governance structures of firms in Thailand. Their contention is that the weak financing and corporate governance structure of large firms contributed to the depth and length of the 1997 financial crisis. Using data of firms listed on the Stock Exchange of Thailand (SET), they examine the structure of financing, the efficiency of investments, and the effectiveness of current corporate governance mechanisms and compare them with those in other countries.

Concerning the financing structure, they find that during the 1994-1997 there were signs of deterioration in corporate performance: the ratios of EBITDA to interest expenses declined from 5.78 to 1.49, the number of firms with interest expenses exceeding profits increased six-fold from 18 to 114 firms. With respect to the corporate governance, they suggest that there have been five interrelated problems: concentrated ownership; high level of diversification; weak incentives; poor protection of minority shareholders; and weak information standards.

It is pointed out that one of the important features of the corporate sector in Thailand is the dominance of family control over business operations. Thai firms are generally held and managed by majority (family) interests. The three largest shareholders own about

45% of the shares held by ten largest non-financial private firms. The protection of minority shareholder and creditor rights is inadequate due to a weak judicial system.

The quality of legal protection as reported by La Porta et al. (1997, 1998) indicates that the quality of judicial enforcement is weaker in Thailand than in Malaysia, India and in four out of six Latin American countries. They also study various relationships between ownership concentration, leverage, and corporate profitability. It is found that ownership concentration is positively related to profitability in 1992 and turns negative by 1996.

Gedajlovic and Shapiro (1998) set out to determine whether the relationship between ownership and profitability varies across five countries: the US, Britain, Germany, France and Canada. They noted that in the USA and Britain, shares are relatively widely held, largest shareholders were mainly institutional investors particularly, pension funds who invest on behalf of individuals. The boards of directors in these two countries were mainly composed of managers of the companies themselves. Shareholders involvement in their companies is minimal.

The level of take over in these countries was very high due to the inability of the owners to effectively monitor managers. Given these facts they hypothesized that in these countries higher ownership of shares by a single party will be positively related to profitability. This is because a party with greater ownership will be able to monitor managers effectively.

On the other hand, shareholders that are less widely dispersed characterized France, Germany and Canada. In Germany the main shareholders are companies and banks. In Canada the dominant shareholders in most corporations are often families whereas in France, the main shareholders are non-financial institutions and the state. Such shareholders are willing and actively interact with management.

Using ownership data of shares held by largest shareholders and the independent variable and performance as measured by return on assets as dependent variable, they found out that there was a positive and significant relationship between ownership concentration and profitability in the USA. In Britain however, this relationship was positive only at very high

levels of ownership concentration. In France and Canada their findings were that there was no relationship between ownership concentration and profitability. However this relationship was found to be positive for companies in Germany. They concluded that profitability – ownership relationship differed across countries.

In Kenya few studies have been carried out to show the extent of ownership dispersion and performance. One such study is by Jebet (2001). Her study established that share ownership of companies is not widely dispersed. Using a sample of companies quoted in the Nairobi Stock exchange she reached a conclusion that, in 84% of the sample companies, the largest shareholders controls over 15% of the shares. Except in one company these shareholders were able to control board of directors by virtue of their voting rights. Her study was however not conclusive in relation to performance

Kitonga (2001) differs with this and says that shareholders have lacked a clout to make significant impact on corporate governance. He attributes this to two main reasons. One is that the Kenyan capital market has produced a breed of investors who are concerned with short-term benefits as opposed to long-term benefits. In this case they would rather dispose off their shares in poorly performing company than go for the usual lengthy and strenuous task of dislodging its management team. Secondly, this kind of attitude has been attributed to the fact that shareholders are too diffuse to pool weight and influence the management teams.

2.1.2 Identity of Shareholders and Firm Performance

Another dimension of ownership structure is concerned with the identity of shareholders, which also has implications for corporate governance and firm performance. Demsetz and Lehn (1985) point out that individuals and families, financial institutions and corporations may have different objectives, monitoring skills as well as different monitoring incentives. Individual block holders are usually strongly involved with the events of a firm, and their monitoring can significantly enhance firm performance.

Financial institutions have the skills and resources to monitor managers, but they can also align with managers in order to foster their other interests in the firm. Brickley, Lease, and

Smith (1988) indicate that, large institutional investors have a more intense interest in the firm than the average investor. This implies that optimal monitoring expenses will allow them to uncover management entrenchment strategies and to ensure that management follows strategies that are in the interest of shareholders.

Few studies have been done in Kenya focusing on identity of shareholder and effect on performance. Ogeto (1994) for example, compared the financial performance of public enterprises and privately owned companies to find out whether there were significant differences in their performance. Public enterprises are those whose main or only shareholder is the government.

He studied the financial results of 28 companies from public sector and 28 from private sector. Using these results (of 1985 to 1992) he compared ratios such return on Equity, Return on capital employed, basic earning power and Debt to Equity ratio. He found that public enterprises performed poorly compared to private companies. This difference in performance was attributed to the fact that the government did not pursue profitability as aggressively as private owners. Generally, the managers of these public enterprises were not free from political interferences. They were appointed for various political interests at the expense of their companies.

Although this study was not specifically focused on corporate governance it did make an important contribution. The earlier studies reviewed suggest that to ensure good governance, companies need to have a large shareholder who has the power to appoint representatives to the board of directors and can generally ensure good corporate governance. In Kenya there are cases where the government has substantial shareholding in companies and is able to considerably influence some companies and appoint the board of directors and even top management team. The government should be able to enforce good governance but has not done so.

2.2 RELATIONSHIP BETWEEN BOARD COMPOSITION ATTRIBUTES AND FIRM PERFORMANCE.

Corporate boards represent an institutional solution to agency-conflicts between shareholders and entrenched management. They have strategic decision making tasks that aid in resolving the share holder- management agency conflicts. Fama and Jensen (1983), in their article suggest the division of strategic decision making tasks into decision management (screening, selection, implementation of projects) and decision control (ratifying decisions and monitoring/evaluation of projects). Therefore, boards in general perform two main roles in their involvement in strategic decision making processes: the monitoring role and the service role (Ees and Postma, 2002).

Sometimes, they also have an initiating function (e.g. suggest a takeover) and a responsibility of decision-maker of last resort (decision management). This function of the board indicates that next to management, members of the board of directors also are actors in strategic decision-making processes. Several studies have found that the board's strategic involvement is significant for both the formation of new strategies and the evaluation of former strategic decisions (Judge and Zeithaml, 1992)

Good performance of the board will positively affect a firm's performance. Hayes and Lee (1997) examined the relationship between the quality of corporate boards of directors and the performance of companies. The sample used in this study included the 25 best board companies and 24 worst board companies in the U.S. identified by *Business Week's* November 25, 1996 issue. Because stock return data for one company from the 25 worst board companies were not available, only 24 companies are included in the sample as worst board companies. The 25 best and 25 worst corporate boards were identified by a survey of 265 professional stock portfolio and pension managers and 20 corporate governance experts.

They compared cumulative stock return and return on equity for these corporations over a one-year period. The results show that excess stock return over the market is significantly higher for companies with high quality boards of directors than for companies with low quality boards of directors. Companies with good boards of directors also reported higher

return on equity than the companies with low quality boards of directors. Price to book ratios of common equity were higher for good board of directors companies.

The findings of this paper are consistent with the argument that a good board of directors monitors the performance of management more effectively than a bad board of directors. Therefore, companies with better boards outperform companies with worse boards in both profitability and stock performance. This provides evidence about the link between the monitoring role of board and stock performance of companies.

On the other hand, board performance is determined by a set of characteristics of boards. Empirical studies in this field have focused on various board attributes such as: board size (the number of members on the board), board activity and the mix of inside directors (directors employed by, or affiliated with the organization) and outside directors. There is mixed evidence in the literature on the relationship between these composition attributes and performance.

2.2.1 Board Independence and Firm Performance.

The importance of outside or independent directors is widely debated in the literature of finance. There is conventional wisdom that suggests that boards principle task is to monitor management, and only independent directors can be effective monitors (Bhagat and Black, 2001). In contrast, an insider-dominated board is seen as a device for management entrenchment. Bhagat, Brickley, and Coles (1987); Fama and Jensen (1983), argue that outside directors promote the interest of shareholders. Their desire to maintain their reputation, as well as a fear of dissident stockholder lawsuits tends to ensure that they will properly monitor the actions of management.

Several academic studies have been examined the monitoring role of boards and the effect on corporate performance. For example, Laitinen and Ruuhela (1997) studied the relationship between corporate governance structure of a company and its managerial performance among Finnish listed companies. Companies were classified into three separate groups. The first group included companies with inside board since 1980 (majority of board members were executive directors). The second group included

companies with outside board since 1992 (majority of board members were non-executive directors). Remaining five companies changed from inside board to outside one during the research period. These five companies were excluded from the analysis.

Two remaining extreme groups were studied in detail. Managerial performance of these two groups was measured by four groups of financial ratios. The results were similar within every ratio categories. Profitability and capital structure measures indicated higher profitability and lower leverage when a company was governed by outside board. Similarly, companies with outside board tended to pay higher dividends measured as proportions of net income or book equity. Finally, company's success in stock market was better when a company had an outside board. As in most previous studies, the differences in averaged ratios were noticeable and rather consequent but not statistically significant.

Block (1999) sought to address the issue of the importance of independent, outside directors in monitoring the affairs of a firm. His hypothesis was based on the fact that there is much debate about whether nonaffiliated directors are more supportive of the shareholder-interest hypothesis or the management entrenchment hypothesis. In his study of 1,026 announcements of the appointment of independent outside directors between 1990-1994, he finds statistically significant Cumulative abnormal returns during the two-day window of the announcement.

However, the pattern of returns is non-monotonic in nature in regard to the outside directors already in place. Also he find out that after a critical mass of outside directors is assembled, the addition of another director is likely to produce little or nothing in the way of positive abnormal returns

Liang (1999) examines the board structure-firm performance relationship in a sample of 228 small private firms in Shanghai, China. Because of the nature of their small size and private ownership, board structure of such firms is believed to be firm performance enhancing, and the structure-performance relationship is easier to identify. His findings indicate that most of the private firms adopt an insider-dominated board structure, but the presence of outside

directors is positively associated with higher return on investment. Duality of titles and board size does not matter in firm performance.

Independent directors dominate the boards of directors of American public companies. Many commentators and institutional investors believe that a “monitoring board,” composed almost entirely of independent directors, is an important component of good corporate governance. Bhagat and Black (2001) study of whether the degree of board independence (proxied by the fraction of independent directors minus the fraction of inside directors on a company’s board) correlates with various measures of the long-term performance of large American firms. They find evidence that low-profitability firms respond to their business troubles by following conventional wisdom and increasing the proportion of independent directors on their boards.

There is no evidence, however, that this strategy works. Firms with more independent boards do not achieve improved profitability, and there are hints in their data that they perform worse than other firms. From this evidence they suggest that the conventional wisdom on the importance of board independence lacks empirical support. Board size also shows no consistent correlation with firm performance, though they find hints of the negative correlation found in other studies.

Whatever theory one subscribes to, there is ample room for discussion and debate about whether the actions of outside directors are more supportive of the stockholder-interest hypothesis or the management entrenchment hypothesis.

2.2.2 Board Size and Firm Performance.

Board size is another board composition attribute that has attracted debate in corporate governance studies, which have not yielded clear-cut results. Forbes and Milliken (1999) provide a useful starting point. In their view board size does affect board processes along the following lines.

- Larger boards are likely to have more knowledge and skills at their disposal.
- The abundance of perspective they assemble is likely to enhance cognitive conflict.

- The difficulty to coordinate the individual contributions of group members is likely to make it difficult to use knowledge and skills effectively.
- Larger boards have difficulty in building personal relationships; trust relationships, maintaining cohesion and strong norms.

The first two observations support a positive impact of board decision-making processes on the Independence of the board, the quality of board monitoring and eventually corporate Performance. On the other hand, the third and fourth observations underline a negative impact of board decision-making processes on the independence of the Board and hence affect firm performance. They suggest that board dependence initially increases with size and then suddenly starts to decrease with subsequent increase hence an inverse relationship between size and performance.

In the study of Judge and Zeithaml (1992) 114 board members were interviewed. The results indicated that board size and levels of diversification and insider representation were negatively related to board involvement, and organizational age was positively related to it. They also found that after controlling for industry and size effects, board involvement was positively related to financial performance.

Goodstein et al (1994) studied the effects of board size and diversity on strategic change. They found evidence that large and diverse board may have limitations in their strategic functions. Yermack (1996) suggested that small boards of directors are more effective. This was based on an inverse association between board size and firm value in his sample of 452 U.S. companies. Furthermore, he found that companies with small boards exhibited better values for financial ratios.

Corporate governance has also been a long time empirical issue in failure prediction research. The effect of board size and composition on failure prediction generated results already in 1980s. Chaganti et al (1985) studied using matched pair approach, 21 failed and non-failed retail companies. The results indicated that non-failed companies had larger boards and that the number of outsiders in the board was not varying between the groups. Anyhow Eilon (1986) discusses later in his comment the approach that was used by Chaganti

et al and concluded that in their analysis, the research problem was simplified too much. Despite of this caution a growing body of failure prediction research followed this approach.

2.2.3 Board Leadership Structure and Firm Performance.

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

Rechner and Dalton (1991) studied the effect of leadership stability on the performance of a firm using accounting-based measures of performance. They found that firms with separate CEO and Chairman outperformed those firms with joint structure. Pi and Timme (1993) found that for firms with separate titles had lower costs and higher return on assets. Nevertheless, the impact of joint structure on firm structure has not been equivocally established.

Baliga, et al (1996) found little evidence that separate titles lead to improved firm performance. Brickley et al (1997) studied 535 U.S. firms with combined and 93 U.S. firms with separated titles. Opposite to earlier findings they found no evidence that firms with same person, as CEO and Chairman are associated with inferior accounting and market returns. In addition to this, they find that changes in leadership structures have no systematic effects on stock-prices.

2.2.4 Other Board Attributes and Firm Performance.

Other studies have focused on attributes such as the frequency of board meetings. Vafeas (1999) for example conducts an interesting study on the frequency of board meeting and firm performance. It is documented that board meeting frequency is related to corporate governance and ownership characteristics in a manner that is consistent with agency theory. The meeting is inversely related to firm value: boards increase their meeting in bad times. In addition, it is found that the operating performance of firms in the sample improves following years of abnormal board activity.

Dalton et al (1998) carry out a review of research addressing the relationships between board composition, board leadership structure, and firm financial performance. They argue that, neither board composition nor board leadership structure has been consistently linked to firm financial performance. They provide meta-analyses of 54 empirical studies of board composition and 31 empirical studies of board leadership structure and their relationships to firm financial performance. These - and moderator analysis relying on firm size, the nature of the financial performance indicator, and various operationalizations of board composition - provide little evidence of systematic governance structure-financial performance relationships.

The conflicting and inconclusive empirical findings corporate board composition, according to Liang (1999), can be attributed to several factors. One is the complexity of the board structure-firm performance relationship itself. This is especially true in large firms, which are the focus of most board composition studies. The complexity of large firm may constrain the ability of the board to initiate changes and affect the direction of the firm. Also managers in large complex organizations are limited in their capacity as “influencers of events”.

A second factor is noise. The link between board composition and firm performance occurs concurrently with numerous other factors. First, firms with larger scale obviously have more going on within the organization. Second, there may also be so much going on with a company’s industry and its competitive position with the industry. Thus, it is difficult to keep these confounding events from overwhelming the effects of relatively small difference in board composition.

2.3 NATURE OF PERFORMANCE INDICATORS.

Extent research addressing corporate governance mechanisms and financial performance has relied on accounting based financial indicators; market based indicators; as well as combinations of both. According to Dalton et al (1998), the nature of a given financial performance indicator may be fundamental as there is some disagreement regarding the extent to which executive decisions may impact accounting vs. market based measures of financial performance.

Reliance on financial accounting measures has been frequently criticized. It has been argued, for example that such measures (1) are subject to manipulation; (2) may systematically undervalue assets; (3) create certain distortions due to the nature of depreciation policies elected, inventory valuation, and treatment of certain revenue and expenditure items; (4) differ in methods adopted for consolidation of accounts; and (5) lack standardization in the handling of international accounting conventions (Chakravanthy, 1986).

Also financial accounting returns are difficult to in the case of multi-industry participation by firms (Nayyar, 1992). It has been demonstrated, for example that, board members often compare firm performance relative to average industry performance when evaluating managerial decisions and performance (Morck, Shleifer and Vishny 1989). One can imagine how much more difficult this would be in a multi-industry, multinational context.

It is also notable that financial accounting measures do not normally account for shareholder investment risk (Dalton et al, 1998). Given the various imprecisions involved in measuring and interpreting financial accounting indices, perhaps it is not surprising that observers have suggested that such measures may be seen as more fully under management control (Hambrick and Finkelstein, 1995).

Despite the above criticisms De Jong et al (2002) claim that accounting performance measures have an advantage because they are backward looking. Further, Sung (2003) says that most studies have focused on this measure to predict financial distress because firms accounting profitability is directly related to survivability of a firm.

Market-based returns on the other side are reported to have a number of advantages. They do reflect risk-adjusted performance and are not adversely affected by multi industry or multinational contexts (Nayyar, 1992). The issue however, may be that market-based performance indicators are often affected by forces beyond management's control (Hambrick and Finkelstein, 1995). Also Sung (2003) argues that because of the market inefficiencies associated with both the developed and developing countries, stock prices are not likely to reflect all available information.

The two types of metrics mentioned above have been combined to come up with hybrid-measures of performance. Tobin's Q is one such measure. It is probably the most widely used valuation measure in empirical corporate finance. It is named after the Nobel Prize winner Professor James Tobin from Yale University. Tobin Q Combines both stock market and accounting information and is defined as the ratio of market value to replacement value. As an approximation, the market value of assets is usually computed as market value of equity plus book value of assets minus book value of equity. The replacement value is taken as the book value of assets.

A Tobin's Q ratio greater than 1 indicates that the firm has done well with its investment decisions, that is, it has invested in positive net present value projects. In contrast, a value of Tobin's Q lower than 1 indicates that the company did not earn even its firm-wide cost of capital with its investment projects. The fundamental Tobin's Q requires the market value of all capital and the replacement costs of all assets. However, replacement costs are difficult to obtain for the purpose of large comprehensive studies.

Long discussions have ensued about which of the measures, stock market or accounting is "best" for studies about corporate governance and no consensus exists in the literature on the use of a reliable performance measure. It should be pointed out that almost all published empirical studies on the performance relation usually take one of the above performance measures.

CHAPTER 3: RESEARCH DESIGN

The study sought to investigate whether there exists any significant relationship between corporate governance mechanisms and firm performance. The study took an empirical approach to examine this relationship and it focused on firms quoted on the Nairobi Stock Exchange in the period of 5 years between 1999 and 2003. The research design can be elaborated under categories discussed below:

3.1 POPULATION AND SAMPLE

The population of interest for this study comprised of firms quoted at the Nairobi Stock Exchange as at 31st December 2003.

Since the study was concerned with performance of the companies from 1999 to 2003 a review of Audited reports of these firms was undertaken. Any firm which was not actively traded and had not been filing its annual reports and also if de registered was removed from the population. The remaining companies formed the sample for this study.

3.2 SOURCES OF DATA

The study made use of secondary data. Data regarding financial performance was obtained from the annual reports obtained from the Nairobi Stock Exchange since all quoted companies are required to file reports with the exchange.

Data regarding ownership structure was obtained from the Nairobi Stock Exchange. The exchange maintains Investor returns files containing ownership data. Also the annual reports filed with the Nairobi stock exchange were another source of data. The reports have data regarding top shareholders.

Data regarding the composition of the Board and the leadership-structure was obtained from the companies' Annual reports filed with the Nairobi stock exchange secretariat. The reports indicated the board size and if the directors are executive or non executive.

3.3 PERIOD OF STUDY

The period of study was from 1999 to 2003.

3.4 METHOD OF DATA ANALYSIS

The study sought to establish whether there is any relationship between corporate governance mechanisms and performance of companies quoted at the Nairobi Stock Exchange.

3.4.1 Hypothesis.

The hypothesis was therefore stated as follows.

Ho: There is no significant relationship between corporate governance mechanisms and performance of firms quoted at the Nairobi Stock Exchange.

Ha: There is a significant relationship between corporate governance mechanisms and performance of companies quoted at the Nairobi Stock Exchange.

3.4.2 Definition of Variables

The variables used in the analysis were classified into three categories: corporate governance mechanisms, control variables and performance measures.

(1) Independent Variables

Corporate governance characteristics, which form the independent Variable, were grouped under board structure and ownership structure categories. The total number of directors sitting on the board was used to calculate the board size variable (BRDSIZE). Also all directors were classified as either internal or external. The variable board fraction external (BRDEXT) is the percentage of external board members at the end of each year. The variable of C.E.O dummy depicts board leadership structure and has a value of one in case the chairperson of the board is the C.E.O.

The size of block ownership (BLOCK), which depicts ownership concentration, was computed as the percentage of shares owned by Top 5 Shareholders. Also additional variables relating to the identity of share ownership were constructed. The percentages of shareholdings by financial institutions including banks and insurance companies (FINAN), individuals and family members (INDIV), largest shareholder (LARGES.H), government

(STATE), foreigners (FOREIGN), and Holding companies (HOLDING) were computed separately.

(2) Dependent Variables.

Performance measures formed the dependent variables and three different measures of performance were examined. The return on assets, which is a purely accounting-based measurement, was computed from company financial statement data. Each firm's annual earnings before interest and taxes were divided by the book value of total assets and this variable is denoted as ROA.

The second performance measure was the Tobin's Q-ratio (TQ), which is hybrid. It is measured by dividing the sum of the market value of equity and the book value of debt by the book value of total assets. The last performance measure used was the annual stock return (RET), which is a capital market-based performance measure. It was computed from annual changes in share price plus dividends, divided by previous year's share price. Stock return is considered to be a purely forward-looking benchmark.

It should be pointed out that almost all published empirical studies on the performance relation usually take one performance measure. Since no consensus exists in the literature on the use of a reliable performance measure, these three variables were therefore expected to reflect company performance in a robust way.

(3) Control Variables.

Prior studies have shown that both firm size and use of leverage are two determinants of firm performance (Dalton et al 1999; De Jong et al 2002). As the size of the firm increases, so does complexity. This limits the ability of corporate governance mechanisms such as those of the board due to complexity involved with large firms.

The book value of total assets (BVTA) was used, as a proxy for firm size. Natural logarithm of the book value of total assets was used in the regression analysis to account for inherent skewness of this variable. Use of Leverage (LEV) was presented by the percentage of total assets financed by total debt (in Book Value terms). Appendix 1 gives a summary of the above variables.

3.4.3 Model specification

In order to establish whether there is any relationship between performance variables and corporate governance variables, the following multiple regression model equations were used to estimate the relationship.

(1) Performance = f (corporate governance variables, Control variables)

$$(2) \text{ROA}_{it} = \alpha + \beta_1 \text{BRDSIZE}_{it} + \beta_2 \text{BRDEXT}_{it} + \beta_3 \text{BLOCK}_{it} + \beta_4 \text{FINAN}_{it} + \beta_5 \text{INDV}_{it} + \beta_6 \text{HOLDING}_{it} + \beta_7 \text{FOREIGN}_{it} + \beta_8 \text{LARGE.SH}_{it} + \beta_9 \text{STATE}_{it} + \beta_{10} \text{SIZE}_{it} + \beta_{11} \text{LEV}_{it} + \text{C.E.O dummy} + E_{it}$$

$$(3) \text{RET}_{it} = \alpha + \beta_1 \text{BRDSIZE}_{it} + \beta_2 \text{BRDEXT}_{it} + \beta_3 \text{BLOCK}_{it} + \beta_4 \text{FINAN}_{it} + \beta_5 \text{INDV}_{it} + \beta_6 \text{HOLDING}_{it} + \beta_7 \text{FOREIGN}_{it} + \beta_8 \text{LARGE.SH}_{it} + \beta_9 \text{STATE}_{it} + \beta_{10} \text{SIZE}_{it} + \beta_{11} \text{LEV}_{it} + \text{C.E.O dummy} + E_{it}$$

$$(4) \text{TQ}_{it} = \alpha + \beta_1 \text{BRDSIZE}_{it} + \beta_2 \text{BRDEXT}_{it} + \beta_3 \text{BLOCK}_{it} + \beta_4 \text{FINAN}_{it} + \beta_5 \text{INDV}_{it} + \beta_6 \text{HOLDING}_{it} + \beta_7 \text{FOREIGN}_{it} + \beta_8 \text{LARGE.SH}_{it} + \beta_9 \text{STATE}_{it} + \beta_{10} \text{SIZE}_{it} + \beta_{11} \text{LEV}_{it} + \text{C.E.O dummy} + E_{it}$$

where i , t and E_{it} represent the number of observations, the five time periods and the error term respectively. A correlation matrix was constructed to evaluate the level of relationship between the various variables, while T-statistical test was carried out to establish the level of statistical significance. All this analysis was carried out using the S.P.S.S and Microsoft excel statistical packages.

CHAPTER 4: DATA ANALYSIS AND DISCUSSION OF FINDINGS

The objectives of the study were to investigate the relationship between corporate governance mechanisms and firm performance in Kenyan quoted firms and also to document the corporate governance mechanisms present in the publicly quoted companies. In order to achieve these objectives, statistical analysis was done for 44 companies quoted in the period of 1999-2003.

4.1 DESCRIPTIVE STATISTICS

Appendix 2 reports descriptive statistics for corporate governance characteristics, firm performance measures and control variables. Note that the number of observations for each variable is 44. The mean total assets of listed firms in the sample is Kshs. 9.5 billion while the average leverage ratio in the sample is 50.92 %.

The average board size of Kenyan listed firm is 8, which is similar to that for Dutch and UK firms, as reported by De Jong et al (2002). Mwangi (2004) also reports the same findings in Kenya. However other authors have reported higher sizes in other parts of the world. Sizes of 10, 12 and 21 have been reported for Belgium, US and Japan respectively (Bhagat and Black 2001; De Jong et al 2002; Dalton and Kresner 1987).

Non-executives hold a significantly larger percentage of board seats (76%). Bhagat and Black (2001) report 60% in the US While De Jong et al (2002) reports 75%, 64% and 43% for Belgian, Netherlands and U.K. firms respectively. Few companies still have C.E.O. duality, that is the Chairman of the board being the same as the C.E.O. Corporate governance guidelines 2002 issued by the Capital Markets Authority (C.M.A) discourage this practice. 0.13% of the firms in the sample population have C.E.O. dualities. This is in contrast to the findings of Mwangi (2004) who did not find any case where C.E.O. is the same as the Chairman of the board.

With regard to ownership structure, the study establishes that listed firms have, on average, a significantly heavy ownership concentration. The five largest shareholders in Kenyan listed

firms account for 70% of the outstanding shares, which is high as compared with 58 % in China, 57.8 % in the Czech Republic, 42 % in Germany, and 33 % in Japan (Xu and Wang, 1997). De Jong et al (2002) reports a concentration of 59% in Belgium, 46% for Dutch firms and 26% for U.K. On average the largest shareholder in Kenyan listed firm controls 47% of the outstanding shares.

Institutional investors and holding companies also have a high stake in listed companies. They control 51% of the outstanding shares. Ownership by individual investors is 22%, closer to the findings of Oltetia (2002) who reports individual ownership of 17%. Foreign investors, who are also a part of the ownership structure of Kenyan listed firms, on average control 26% of the outstanding shares.

Shareholdings by financial institutions in Kenya is low. On average, financial institutions control 10% of the outstanding shares. This percentage compares well with ownership by financial institutions in Belgium and the Netherlands where ownership for both countries is 11%. The State also has a stake in listed firms though minimal. It controls an average of 3.4% of the outstanding shares.

Appendix 2 also reports summary statistics of the three performance measures used in the study. The mean Return on Assets (ROA) of the sample of listed firms is very low at 6.59%. The Tobin's Q ratio (TQ) and Stock returns (RET) are 1.06 and 23.39% respectively. A summary of other descriptive statistics such as mode, range and standard deviation is also given in this appendix.

4.2 EMPIRICAL FINDINGS

The Pearson correlation matrix on appendix 3 illustrates the correlation coefficients (degree of association) of corporate governance mechanism, control variables and performance measures. Note that only the use of leverage (LEV) and state ownership (STATE) have a significant association with return on assets (ROA). They are both negatively associated with ROA at 0.05 level of confidence. Other corporate governance mechanisms and control variables are not significantly associated with ROA.

The size of the firm (BVTA) and the board size (BRDSIZE) are both significantly positively associated with annual stock returns (RET) at confidence levels of 0.05 and 0.01% respectively, while C.E.O. duality is significantly negatively associated with annual stock returns (RET) at confidence level of 0.01. Other corporate governance mechanisms and control variables are not significantly associated with RET. Further, only financial institution ownership (FINAN) is significantly positively associated with Tobin's Q ratio (TQ) at the confidence level of 0.05. Other governance mechanisms and control variables are not associated significantly with TQ.

The correlation analysis statistics above portrays the degree of association between corporate governance mechanisms and performance variables. In addition to this, cross sectional multiple regression analysis is carried out to predict the relationship between corporate governance mechanisms and firm performance and also to indicate the contribution of each predictor variable (corporate governance mechanisms and control variables) to the response variable (performance measures).

The table below extracted from appendix 4 shows a summary of regression coefficients and other statistics of performance measures regressed on corporate governance mechanisms and control variables.

Table 1: summary of beta coefficients (β) (denoting the relationships of performance measures and corporate governance mechanisms), the intercept and the coefficient of multiple determinations (R^2).

	ROA	RET	TOBIN'S Q
Intercept	-2.308	-79.271	2.256
LEV	-0.478*	-0.101	0.271
BVTA	0.201	0.158*	-0.509
BRDSIZE	0.136	0.396**	0.381
C.E.O.	-0.194	-0.230*	0.281
BRDEXT	-0.096	-0.142	-0.159
STATE	-0.269*	-0.083	0.055
LARGE.SH	-0.214	-0.182	0.11
BLOCK	0.281	0.470	0.232
FINAN	0.227	0.104	0.406*
INDIV	0.146	0.239	-0.036
HOLDING	-0.079	-0.115	0.099
R^2	0.366	0.370	0.401

* Significant at the 0.05 level of significance (2 tailed)

** Significant at the 0.01 level of significance (2 tailed)

Note that foreign ownership (FOREIGN) is highly correlated with ownership by holding companies (HOLDING) and was removed from the model due to the problem of multicollinearity. Further, the results of the cross sectional regression analysis are discussed in the next sections.

4.2.1 Corporate Governance Mechanisms and Return on Assets (ROA)

The estimated relationship between corporate governance mechanisms and return on assets (ROA) as the performance measure (as modeled in section 3.4.3 equation 2) is as follows:

$$\text{ROA} = -2.308 + 0.136\text{BRDSIZE} - 0.096\text{BRDEXT} + 0.281\text{BLOCK} + 0.227\text{FINAN.} + 0.146\text{INDV} - 0.079\text{HOLDING} - 0.214\text{LARGE.SH} - 0.269\text{STATE} + 0.201\text{SIZE} - 0.478\text{LEV} - 0.194\text{C.E.O}$$

From the extracts in section 4.2 above, the coefficient on multiple determination (R^2) for ROA on corporate governance mechanisms and control variables is 36.6%. This means that the proportion of the variation in ROA that is explained by the set of explanatory variables (corporate governance mechanisms and control variables) is 36.6%. 63.6% of the variation in ROA is explained by other factors.

The coefficients for state ownership (STATE) and use of leverage (LEV) are significantly negative. Basing on this, we therefore reject the null hypothesis advanced in section 3.4.1 and conclude that state ownership and use of leverage are significantly related to return on assets (ROA). These findings are consistent with those of Xu and Wang (1997) who conclude that state share ownership seem to lead to inefficiency of Chinese listed companies.

Also the findings of Ogeto (1994) suggest that there are cases where the Kenyan government has substantial shareholding in companies and is able to considerably influence some companies and appoint the board of directors and even top management team. The government has however failed to enforce good governance leading to poor firm performance. The finding on of leverage (LEV) are consistent with those of De Jong et al

(2002) who finds a significant negative coefficient with ROA in Belgium, Netherlands and U.K.

The coefficients for other corporate governance mechanisms and control variables are not significant enough to reject the null hypothesis and we therefore conclude that there is no significant relationship between them and ROA.

4.2.2 Corporate Governance Mechanisms and Stock returns (RET)

The estimated relationship between corporate governance mechanisms and stock market returns (RET) as the performance measure (as modeled in section 3.4.3 equation 3) is as follows:

$$\text{RET} = -79.271 + 0.396\text{BRDSIZE} - 0.142\text{BRDEXT} + 0.47\text{BLOCK} + 0.104\text{FINAN.} + 0.239\text{INDV} - 0.115\text{HOLDING} - 0.182\text{LARGE.SH} - 0.083\text{STATE} + 0.158\text{SIZE} - 0.101\text{LEV} - 0.23\text{C.E.O}$$

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

The coefficient for C.E.O. duality is significantly negative while those for board size and firm size are significantly positive. We therefore reject the null hypothesis in section 3.4.1 and conclude C.E.O. duality (CEO), board size (BRDSIZE), and firm size (BVTA) are significantly related with RET.

The findings on C.E.O. duality are in line with the strong sentiment among board reform advocates, most notably public pension funds and shareholder activists groups that the C.E.O. should not serve simultaneously as chairperson of the board (Dalton et al 1998). The preference for the separate board leadership structure is largely grounded in agency theory concerns regarding the potential for management domination of the board. The results are in line with those of Rechner and Dalton (1991) and Pi and Timme (1993) but differ with

those of De Jong et al (2002) and Brickley et al (1997) who do not find systematic effects on stock-prices in US, Belgium, Netherlands and UK.

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

The coefficients for other corporate governance mechanisms and control variables are not significant enough to reject the null hypothesis and we therefore conclude that there is no significant relationship between them and RET.

4.2.3 Corporate Governance Mechanisms and Tobin's Q Ratio (TQ)

The estimated relationship between corporate governance mechanisms and Tobin's Q ratio (TQ) as the performance measure (as modeled in section 3.4.3 equation 4) is as follows:

$$\text{TQ} = 2.256 + 0.381\text{BRDSIZE} - 0.159\text{BRDEXT} + 0.232\text{BLOCK} + 0.406\text{FINAN.} - 0.036\text{INDV} - 0.099\text{HOLDING} + 0.11\text{LARGE.SH} + 0.055\text{STATE} - 0.159\text{SIZE} - 0.271\text{LEV} + 0.281\text{C.E.O}$$

The coefficient on multiple determination (R^2) for TQ on corporate governance mechanisms and control variables is 40%. This means that the proportion of the variation in TQ that is explained by the set of explanatory variables (corporate governance mechanisms and control variables) is 40%. 60% of the variation in TQ is explained by other factors.

With TQ, only the coefficient financial institution ownership (FINAN) is significantly positive. We therefore reject the null hypothesis and conclude that financial institution ownership is positively related to Tobin's Q (TQ) in a significant way. It is hypothesized that financial institutions have the skills and resources to monitor managers, but they can also align with managers in order to foster their other interests in the firm De Jong et al (2002).

These findings compare well with those of Pohl and Claessens (1997) who conclude that, banks with equity stake in privatized firms in the Czech Republic have a positive influence on the firm's corporate performance. De Jong et al (2002) however observe that large shareholdings by financial institutions and corporations in the U.K. seem to reduce corporate performance.

The coefficients for other corporate governance mechanisms and control variables are not significant enough to reject the null hypothesis in section 3.4.1 and we therefore conclude that there is no significant relationship between them and Tobin's Q ratio.

CHAPTER 5: SUMMARY, CONCLUSIONS, LIMITATIONS AND RECOMMENDATIONS

5.1 SUMMARY AND CONCLUSIONS

The objectives of the study were to investigate the relationship between corporate governance mechanisms and firm performance in Kenyan quoted firms and also to document the corporate governance mechanisms present in the publicly quoted companies. In order to achieve these objectives, statistical analysis was done for 44 companies quoted in the period of 1999-2003.

The average board size (BRDSIZE) of Kenyan listed firm is 8 and non-executives (BRDEXT) hold a significantly larger percent of board seats (76%). Few companies still have C.E.O. duality, that is the Chairman of the board being the same as the C.E.O. Corporate governance guidelines 2002 issued by the Capital Markets Authority (C.M.A) discourage this practice. 0.13% of the firms in the sample population have C.E.O. dualities. This shows that some companies, though few, are yet to fully embrace guidelines on good corporate governance practices issued by the Capital Markets Authority (C.M.A) in 2002.

With regard to ownership the study establishes that listed firms have, on average, a significant heavy ownership concentration. The five largest shareholders in Kenyan listed firms (BLOCK) on average, account for 70% of the outstanding shares. Institutional investors and holding companies (HOLDING) also have a high stake in listed companies. They control 51% of the outstanding shares.

Ownership by individual investors (INDIV) is 22% while foreign investors (FOREIGN), who are also a part of the ownership structure of Kenyan listed firms, on average control 26% of the outstanding shares. Shareholding by financial institutions (FINAN) in Kenya is low. On average, financial institutions control 10% of the outstanding shares. The State also has a stake in listed firms though minimal. It controls an average of 3.4% of the outstanding shares.

The mean total assets of listed firms in the sample is Kshs. 9.5 billion while the average leverage ratio in the sample is 50.92 %. With regard to performance measures used in the study, the mean Return on Assets (ROA) of the sample of listed firms is very low at 6.59%. The Tobin's Q ratio (TQ) and Stock returns (RET) are 1.06 and 23.39% respectively.

The empirical results of the study show that board size has a significant positive relationship only with stock market returns (RET). Other performance measures do not have any significant relationship with board size. The same case applies for C.E.O. duality, which has significant negative relationship with RET but has no significant relationship with ROA and Tobin's Q.

The findings on board size are in contrast with those of Goodstein et al (1994) and Yermack (1996) who suggest that small boards of directors are more effective and exhibited better values for firm performance ratios. The findings however in line with those of De Jong et al (2002) who find a positive significant relationship with RET. With C.E.O. duality the findings are in agreement with those of Rechner and Dalton (1991) and Pi and Timme (1993) but differ with those of Brickley et al (1997)

No measure of firm performance has a significant relationship with the percentage of non-executive board members. Though the importance of independent directors should not be put to doubt, the outcomes of this study conflict with conventional wisdom that suggests that the board's principle task is to monitor management, and only independent directors can be effective monitors.

The study supports the finding of Bhagat and Black (2001) who argue that the current focus on board independence as a core measure of board quality could detract from other perhaps more effective strategies for addressing poor firm performance. They say that at least, corporate governance advisors and institutional investors should support efforts by firms to experiment with different board structures and be more tentative in their advice that other countries should adopt American style monitoring boards.

With regard to ownership structure, state ownership (STATE) is negatively related to ROA but has no significant relationship with RET and Tobin's Q. State share ownership seems to lead to inefficiency and low profitability. Financial institution ownership (FINAN) is positively related to Tobin's Q but has no significant relationship with RET and ROA. This supports the hypothesis that financial institutions have the skills and resources to monitor managers

Ownership by top 5 shareholders (BLOCK), which depicts ownership concentration, is not significantly related any of the performance measures, Also ownership by individuals and family members (INDIV), largest shareholder (LARGE.SH), and Holding companies (HOLDING) are not significantly related any of the performance measures. The findings compare well with those of Demsetz and Villalonga who find no statistically significant relationship between ownership structure and firm performance.

With regard to control variables, use of leverage (LEV) has a significant negative relationship only with ROA while firm size (BVTA) is related positively only with RET. The fact that different performance measures exhibit different results with various corporate governance mechanisms confirm why debate has ensued on which of the measures, stock market or accounting is "best" for studies about corporate governance without consensus.

The insignificant relationship of various corporate governance mechanisms and performance nature might have something to do with the level of efficiency of the Kenyan capital market, limited sample size, short measurement period and limited control variables

5.2 LIMITATIONS OF THE STUDY

1. One of limitations encountered in the study was limited sample size. There are less than 50 listed companies in the Kenyan stock market and therefore the findings cannot be generalized.
2. Short measurement period due to time limits was another limitation. This affects the significance of the findings.

3. The Kenyan stock market has been found to be of weak form efficiency. This might affect stock market based measures of performance, which work well with higher levels of market efficiency.
4. The study used Annual reports and investor returns from the companies themselves, but filed with Nairobi stock exchange secretariat. The reports have limitations in that they only disclose what is required of them by various regulatory bodies.

5.3 RECOMMENDATION FOR FURTHER STUDY

The study focused on the relationship between corporate governance mechanisms as reflected by ownership structure and the board of directors. Other mechanisms can be used as a proxy for corporate governance e.g. Managerial compensation schemes, market for corporate control (threat from the), managerial labour markets and the use of legal protections among others.

Also the study focused mainly on the relationship between demographic characteristics of corporate governance and corporate performance. Studies could be carried out to investigate for example the relationship between board strategic decision-making activities (of Initiation, Ratification, Implementation and Control) and firm performance.

With regard to identity of shareholders, studies could be carried to investigate the effect of managerial and insider ownership on corporate performance. Other areas that need to be investigated regarding corporate governance in Kenya are how audit committees and board procedures (agenda setting, code of conduct, and frequency of meetings) affect corporate performance.

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APPENDIX 1

DEFINITION OF VARIABLES.

Common corporate governance characteristics		
BRDSIZE	Board size	Total number of board members
BRDEXT	Board fraction external	Percentage of external board members
BLOCK	Top 5 block holdings	Percentage of common shares owned by Top 5 Shareholders holders
FINAN	Financial block holdings	Percentage of common shares owned by Institutional investors
INDIV	Individual & family Block holdings	Percentage of common shares owned by individuals
HOLDING	Holding companies Block holdings	Percentage of common shares held by holding companies
LARGE.SH	Largest shareholding	Percentage of shares owned by largest Shareholder
FOREIGN	Foreign shareholding	Percentage of share owned by foreign Investors
C.E.O	C.E.O duality	Chair of the board is the same as C.E.O of the Company

Performance measures		
ROA	Return on assets	(Earnings before interest and taxes) / (Book value of total assets %)
Q	Tobin's Q	(Market value of equity + book value of debt)/ (Book value of total assets)
RET	Stock return	(Annual stock return %)

Control Variables		
BVTA	Firm size	Book Value of total Assets
LEV	Leverage	Book Value of total debt/Book value of total assets.

APPENDIX 2

DESCRIPTIVE STATISTICS

	ROA	RET	TQ	LEV	AVBVTA	BVTA	BRDSIZE	C.E.O	BRDEXT	STATE	LARGE.SH	BLOCK	FINAN	FOREIGN	INDIV	HOLDING
Mean	6.60	23.39	1.07	50.93	9493161.123	14.8405	7.7955	0.1364	76.2945	3.4041	47.7243	70.1923	10.8066	26.5311	22.4416	51.0139
Standard Error	0.92	4.64	0.08	3.98	2595458.246	0.2542	0.3388	0.0523	1.3233	1.4302	2.6493	2.1339	1.5311	4.2436	2.0949	4.1058
Median	6.91	18.03	0.96	46.74	2777473.6	14.8239	8	0	76.39	0	46.91	71.375	8.36	13.465	20.755	58.32
Standard Deviation	6.13	30.79	0.53	26.39	17216322.32	1.6865	2.2473	0.3471	8.7775	9.4866	17.5738	14.1547	10.1565	28.1490	13.8960	27.2347
Sample Variance	37.55	948.01	0.28	696.56	2.96402E+14	2.8442	5.0502	0.1205	77.0446	89.9952	308.8371	200.3559	103.1536	792.3689	193.0977	741.7286
Kurtosis	-0.34	-0.17	15.60	-1.15	8.562017007	-0.2480	-0.8632	2.9492	0.8579	7.6152	-0.7917	-0.9691	2.3366	-0.9212	0.8557	-1.4376
Skewness	0.03	0.47	3.33	0.23	2.931967542	-0.0968	0.0228	2.1948	-0.7594	2.8907	0.2685	-0.0473	1.5603	0.7328	0.8646	-0.2517
Range	26.34	127.99	3.43	96.19	79126031.4	7.3531	8	1	40.91	40.43	66.99	51.98	44.18	89.97	60.52	85.09
Minimum	-6.78	-27.05	0.33	7.09	50968.6	10.8256	4	0	50	0	21.24	43.2	0	0	3.08	6.71
Maximum	19.56	100.94	3.76	103.28	79177000	18.1787	12	1	90.91	40.43	88.23	95.18	44.18	89.97	63.6	91.8
Sum	290.30	1029.20	46.87	2240.77	417699089.4	652.9798	343	6	3356.96	149.78	2099.87	3088.46	475.49	1167.37	987.43	2244.61
Count	44.00	44.00	44.00	44.00	44	44	44	44	44	44	44	44	44	44	44	44
Confidence Level(95.0%)	1.86	9.36	0.16	8.0240	5234236.804	0.5127	0.6832	0.1055	2.6686	2.8842	5.3429	4.3034	3.0878	8.5581	4.2248	8.2801

**APPENDIX 3
CORRELATION MATRIX**

		ROA	RET	LEV	TQ	BVTA	BRDSIZE	C.E.O	BRDEXT	STATE	LARGE.SH	BLOCK	FINAN	FOREIGN	INDIV	HOLDING
ROA	Pearson Correlation	1	.368(*)	-.363(**)	.423(**)	-0.058	0.071	-0.088	-0.011	-.334(*)	-0.048	-0.028	0.239	0.103	0.119	-0.167
	Sig. (2-tailed)		0.014	0.016	0.004	0.709	0.646	0.571	0.943	0.027	0.756	0.856	0.118	0.505	0.44	0.278
	N	44	44	44	44	44	44	44	44	44	44	44	44	44	44	44
RET	Pearson Correlation	.368(*)	1	0.184	0.054	.377(*)	-.446(**)	-.377(*)	-0.142	0.027	0.009	-0.016	0.091	0.181	0.086	-0.231
	Sig. (2-tailed)	0.014		0.232	0.728	0.012	0.002	0.012	0.357	0.861	0.953	0.918	0.555	0.24	0.578	0.131
	N	44	44	44	44	44	44	44	44	44	44	44	44	44	44	44
LEV	Pearson Correlation	-.363(*)	0.184	1	0.014	.563(**)	-.442(**)	-.445(**)	-0.148	-.456(**)	-0.099	-0.161	-0.005	0.066	-0.033	-0.052
	Sig. (2-tailed)	0.016	0.232		0.926	0	0.003	0.002	0.338	0.002	0.522	0.296	0.747	0.669	0.833	0.736
	N	44	44	44	44	44	44	44	44	44	44	44	44	44	44	44
TQ	Pearson Correlation	.423(**)	0.054	0.014	1	-0.217	-0.021	0.24	-0.131	-0.079	0.145	0.257	.317(*)	0.089	-0.217	0.019
	Sig. (2-tailed)	0.004	0.728	0.926		0.157	0.894	0.117	0.398	0.612	0.349	0.092	0.036	0.565	0.157	0.905
	N	44	44	44	44	44	44	44	44	44	44	44	44	44	44	44
BVTA	Pearson Correlation	-0.058	.377(*)	.563(**)	-0.217	1	.778(**)	-.455(**)	0.009	.474(**)	-0.033	-0.28	-0.024	0.247	0.007	-0.259
	Sig. (2-tailed)	0.709	0.012	0	0.157		0	0.002	0.952	0.001	0.833	0.066	0.875	0.106	0.964	0.089
	N	44	44	44	44	44	44	44	44	44	44	44	44	44	44	44
BRDSIZE	Pearson Correlation	0.071	-.446(**)	-.442(**)	-0.021	.778(**)	1	-.440(**)	0.154	.306(*)	-0.127	-.350(*)	0.217	0.127	0.071	-0.167
	Sig. (2-tailed)	0.646	0.002	0.003	0.894	0		0.003	0.317	0.044	0.411	0.02	0.158	0.412	0.649	0.278
	N	44	44	44	44	44	44	44	44	44	44	44	44	44	44	44
C.E.O	Pearson Correlation	-0.088	-.377(*)	-.445(**)	0.24	-.455(**)	-.440(**)	1	-0.048	-0.144	0.059	0.216	-0.068	-0.111	-0.119	0.175
	Sig. (2-tailed)	0.571	0.012	0.002	0.117	0.002	0.003		0.755	0.35	0.705	0.158	0.661	0.475	0.441	0.255
	N	44	44	44	44	44	44	44	44	44	44	44	44	44	44	44
BRDEXT	Pearson Correlation	-0.011	-0.142	-0.148	-0.131	0.009	0.154	-0.048	1	0.14	-0.192	-0.295	0.279	-0.029	0.003	0.029
	Sig. (2-tailed)	0.943	0.357	0.338	0.398	0.952	0.317	0.755		0.366	0.211	0.052	0.067	0.851	0.984	0.852
	N	44	44	44	44	44	44	44	44	44	44	44	44	44	44	44
STATE	Pearson Correlation	-.334(*)	0.027	-.456(**)	-0.079	.474(**)	.306(*)	-0.144	0.14	1	-0.25	-0.192	0.053	-0.192	0.03	0.183
	Sig. (2-tailed)	0.027	0.861	0.002	0.612	0.001	0.044	0.35	0.366		0.102	0.212	0.73	0.212	0.849	0.236
	N	44	44	44	44	44	44	44	44	44	44	44	44	44	44	44
LARGE.SH	Pearson Correlation	-0.048	0.009	-0.099	0.145	-0.033	-0.127	0.059	-0.192	-0.25	1	.673(**)	-.327(*)	-.417(**)	-.438(**)	-0.207
	Sig. (2-tailed)	0.756	0.953	0.522	0.349	0.833	0.411	0.705	0.211	0.102		0	0.031	0.005	0.003	0.177
	N	44	44	44	44	44	44	44	44	44	44	44	44	44	44	44
BLOCK	Pearson Correlation	-0.028	-0.016	-0.161	0.257	-0.28	-.350(*)	0.216	-0.295	-0.192	.673(**)	1	-.308(*)	0.222	-.673(**)	0.114
	Sig. (2-tailed)	0.856	0.918	0.296	0.092	0.066	0.02	0.158	0.052	0.212	0		0.042	0.148	0	0.463
	N	44	44	44	44	44	44	44	44	44	44	44	44	44	44	44
FINAN	Pearson Correlation	0.239	0.091	-0.05	.317(*)	-0.024	0.217	-0.068	0.279	0.053	-.327(*)	-.308(*)	1	-0.023	0.057	-0.006
	Sig. (2-tailed)	0.118	0.555	0.747	0.036	0.875	0.158	0.661	0.067	0.73	0.031	0.042		0.884	0.712	0.97
	N	44	44	44	44	44	44	44	44	44	44	44	44	44	44	44
FOREIGN	Pearson Correlation	0.103	0.181	0.066	0.089	0.247	0.127	-0.111	-0.029	-0.192	-.417(**)	0.222	-0.023	1	-.311(*)	-.875(**)
	Sig. (2-tailed)	0.505	0.24	0.669	0.565	0.106	0.412	0.475	0.851	0.212	0.005	0.148	0.884		0.04	0
	N	44	44	44	44	44	44	44	44	44	44	44	44	44	44	44
INDIV	Pearson Correlation	0.119	0.086	-0.033	-0.217	0.007	0.071	-0.119	0.003	0.03	-.438(**)	-.673(**)	0.057	-0.311(*)	1	-0.188
	Sig. (2-tailed)	0.44	0.578	0.833	0.157	0.964	0.649	0.441	0.984	0.849	0.003	0	0.712	0.04		0.222
	N	44	44	44	44	44	44	44	44	44	44	44	44	44	44	44
HOLDING	Pearson Correlation	-0.167	-0.231	-0.052	0.019	0.259	-0.167	0.175	0.029	0.183	-0.207	0.114	-0.006	-.875(**)	-0.188	1
	Sig. (2-tailed)	0.278	0.131	0.736	0.905	0.089	0.278	0.255	0.852	0.236	0.177	0.463	0.97	0	0.222	
	N	44	44	44	44	44	44	44	44	44	44	44	44	44	44	44

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

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

APPENDIX 4

ESTIMATION OF THE RELATIONSHIP BETWEEN CORPORATE GOVERNANCE MECHANISMS AND FIRM PERFORMANCE

PANEL A : SUMMARY REGRESSION OUTPUT WITH ROA

<i>Regression Statistics</i>	
Multiple R	.605(a)
R Square	0.366
Adjusted R Square	0.149
Standard Error	5.6676
Durbin-Watson	1.9710
Observations	44

ANOVA					
	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>Sig F</i>
Regression	11	591.583	53.78	1.682	.123(a)
Residual	32	1023.089	32.1213		
Total	43	1614.672			

Coefficients(a)									
	Coefficients		<i>SE</i>	<i>t Stat</i>	<i>Sig</i>	<i>Lower 95%</i>	<i>Upper 95%</i>	Collinearity Statistics	
	<i>Unstandardized</i>	<i>Beta</i>						<i>Tolerance</i>	<i>VIF</i>
Intercept	-2.308		24.598	-0.094	0.926	-52.411	47.796		
LEV	-0.111	-0.478	0.046	-2.431	0.021	-0.204	-0.018	0.513	1.95
BVTA	0.73	0.201	1.11	0.657	0.516	-1.532	2.991	0.212	4.713
BRDSIZE	0.372	0.136	0.696	0.534	0.597	-1.047	1.79	0.304	3.294
C.E.O	-3.425	-0.194	3.025	-1.132	0.266	-9.587	2.736	0.674	1.483
BRDEXT	-6.71E-02	-0.096	0.119	-0.566	0.575	-0.308	0.174	0.687	1.455
STATE	-0.174	-0.269	0.126	-2.382	0.027	-0.43	0.082	0.522	1.914
LARGE.SH	-7.46E-02	-0.214	0.075	-0.988	0.33	-0.228	0.079	0.423	2.364
BLOCK	0.122	0.281	0.125	0.973	0.338	-0.133	0.377	0.237	4.224
FINAN	0.137	0.227	0.102	1.345	0.188	-0.07	0.344	0.698	1.434
INDIV	6.42E-02	0.146	0.099	0.646	0.523	-0.138	0.267	0.39	2.565
HOLDING	-1.78E-02	-0.079	0.038	-0.464	0.646	-0.096	0.06	0.681	1.467

a Predictors in the Model: (Constant), HOLDING, FINAN, LEV, INDIV, BRDEXT, C.E.O, STATE, BRDSIZE, LARGE.SH, BLOCK,
b Dependent Variable: ROA

PANEL B : SUMMARY REGRESSION OUTPUT WITH RET

<i>Regression Statistics</i>	
Multiple R	.608(B)
R Square	0.37
Adjusted R Square	0.153
Standard Error	28.3364
Durbin-Watson	1.767
Observations	44

ANOVA					
	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>Sig F</i>
Regression	11	15070.125	1370.011	1.706	.117(b)
Residual	32	25694.506	802.953		
Total	43	40764.631			

Coefficients(a)									
	Coefficients		<i>SE</i>	<i>t Stat</i>	<i>Sig</i>	<i>Lower 95%</i>	<i>Upper 95%</i>	Collinearity Statistics	
	<i>Unstandardized</i>	<i>Beta</i>						<i>Tolerance</i>	<i>VIF</i>
Intercept	-79.271		123.27	-0.643	0.525	-330.363	171.822		
LEV	-0.118	-0.101	0.229	-0.515	0.61	-0.583	0.348	0.513	1.95
BVTA	2.886	0.158	5.564	2.401	0.012	-8.448	14.22	0.212	4.713
BRDSIZE	5.429	0.396	3.49	1.908	0.002	-1.68	12.537	0.304	3.294
C.E.O	-20.37	-0.23	15.159	-2.344	0.012	-51.247	10.507	0.674	1.483
BRDEXT	-0.499	-0.142	0.594	-0.84	0.407	-1.709	0.711	0.687	1.455
STATE	-0.268	-0.083	0.63	-0.426	0.673	-1.552	1.016	0.522	1.914
LARGE.SH	-0.318	-0.182	0.378	-0.842	0.406	-1.088	0.452	0.423	2.364
BLOCK	1.023	0.47	0.627	1.631	0.113	-0.255	2.301	0.237	4.224
FINAN	0.316	0.104	0.509	0.619	0.54	-0.722	1.353	0.698	1.434
INDIV	0.529	0.239	0.498	1.062	0.296	-0.486	1.543	0.39	2.565
HOLDING	-0.13	-0.115	0.192	-0.678	0.503	-0.522	0.261	0.681	1.467

a Predictors in the Model: (Constant), HOLDING, FINAN, LEV, INDIV, BRDEXT, C.E.O, STATE, BRDSIZE, LARGE.SH, BLOCK,
b Dependent Variable: RET

PANEL C : SUMMARY REGRESSION OUTPUT WITH TOBINS Q

Regression Statistics	
Multiple R	.633(a)
R Square	0.401
Adjusted R Square	0.195
Standard Error	0.473
Durbin-Watson	2.257
Observations	44

ANOVA					
	df	SS	MS	F	Sig. F
Regression	11	4.789	0.435	1.946	.070(a)
Residual	32	7.158	0.224		
Total	43	11.947			

	Coefficients(a)							Collinearity Statistics	
	Coefficients		SE	t Stat	Sig	Lower 95%	Upper 95%	Tolerance	VIF
	Unstandardized	Beta							
Intercept	2.256		2.058	1.096	0.281	-1.936	6.447		
LEV	5.42E-03	0.271	0.004	1.42	0.165	-0.002	0.013	0.513	1.95
BVTA	-0.159	-0.509	0.093	-1.715	0.096	-0.348	0.03	0.212	4.713
BRDSIZE	8.93E-02	0.381	0.058	1.532	0.135	-0.029	0.208	0.304	3.294
C.E.O	0.426	0.281	0.253	1.684	0.102	-0.089	0.941	0.674	1.483
BRDEXT	-9.58E-03	-0.159	0.01	-0.966	0.341	-0.03	0.011	0.687	1.455
STATE	3.06E-03	0.055	0.011	0.291	0.773	0.018	0.024	0.522	1.914
LARGE.SH	3.29E-03	0.11	0.006	0.521	0.606	-0.01	0.016	0.423	2.364
BLOCK	8.65E-03	0.232	0.01	0.826	0.415	-0.013	0.03	0.237	4.224
FINAN	2.11E-02	0.406	0.009	2.476	0.019	0.004	0.038	0.698	1.434
INDIV	-1.38E-03	-0.036	0.008	-0.166	0.869	-0.018	0.016	0.39	2.565
HOLDING	-1.91E-03	-0.099	0.003	-0.594	0.556	-0.008	0.005	0.681	1.467

a Predictors in the Model: (Constant), HOLDING, FINAN, LEV, INDIV, BRDEXT, C.E.O, STATE, BRDSIZE, LARGE.SH, BLOCK,
b Dependent Variable: TQ

APPENDIX 5
SUMMARY OF VARRIABLES USED IN THE STUDY (5 YEAR AVERAGES 1999-2003)

	Company	ROA	RET	TQ	LEV	BVTA	BRDSIZE	C.E.O	BRDEXT	STATE	LARGE.SH	BLOCK	FINAN	FOREIGN	INDIV	HOLDING
1	A. Baumann & Co. Ltd Ord 5.00	(1.69)	(23.83)	0.33	23.60	12.92	5.00	0	80.00	-	52.27	66.29	4.36	53.14	21.69	25.17
2	Athi River Mining Ord 5.00	6.79	70.39	0.90	39.12	14.09	8.00	0	62.50	-	47.82	67.47	4.41	5.04	63.60	31.36
3	B.O.C Kenya Ltd Ord 5.00	12.20	48.30	1.05	21.78	14.05	7.00	0	85.71	-	65.38	77.16	13.37	66.16	12.24	21.60
4	Bamburi Cement Ltd Ord 5.00	9.72	66.97	1.50	30.11	16.51	11.00	0	72.73	-	73.26	92.75	19.33	73.31	4.59	22.11
5	Barclays Bank Ltd Ord 10.00	5.93	46.53	1.15	86.84	18.18	12.00	0	75.00	-	68.50	71.42	2.15	68.56	23.05	8.39
6	British American Tobacco Kenya Ltd Ord 10.00	19.56	92.03	1.87	35.38	15.72	10.00	0	70.00	-	60.00	82.90	26.36	60.10	10.28	29.61
7	Brooke Bond Ltd Ord 10.00	6.59	(7.25)	0.98	33.96	15.60	8.00	0	87.50	-	88.23	92.29	5.20	89.97	3.23	6.71
8	C.F.C Bank Ltd ord.5.00	7.04	49.18	0.96	79.63	16.16	8.00	0	75.00	-	45.66	90.23	0.39	0.40	7.81	91.80
9	Car & General (K) Ltd Ord 5.00	10.92	4.13	1.03	54.24	13.20	7.00	0	71.43	-	31.70	84.00	9.33	1.62	11.97	86.41
10	Carbacid Investments Ltd Ord 5.0	16.92	11.58	0.91	13.81	13.46	5.00	0	60.00	-	22.61	57.76	4.49	4.72	57.83	37.44
11	City Trust Ltd Ord 5.00	7.69	4.14	0.84	12.67	11.92	4.00	1	75.00	-	49.79	72.30	0.78	7.27	23.32	69.42
12	CMC Holdings Ltd Ord 5.00	7.75	60.99	0.68	54.29	15.36	9.00	0	77.78	-	24.02	50.98	7.76	2.13	29.28	68.57
13	Crown Berger Ltd Ord 5.00	9.74	100.94	0.71	39.77	13.72	6.00	0	83.33	-	50.14	69.46	10.42	13.63	31.04	55.32
14	Diamond Trust Bank Kenya Ltd Ord 4.00	6.54	29.78	1.03	80.00	15.64	9.00	0	88.89	-	22.73	43.20	11.12	48.98	36.36	14.67
15	Diudop Kenya Ord 5.00	11.60	29.03	0.88	41.04	12.09	6.00	0	83.33	-	37.99	74.73	30.25	7.61	22.54	69.86
16	E.A. Cables Ltd Ord 5.00	6.43	8.63	0.92	25.62	12.72	5.00	0	80.00	-	75.37	82.83	6.28	3.09	17.75	79.17
17	E.A. Portland Cement Ltd Ord 5.00	(0.80)	50.84	1.02	77.86	15.80	8.00	0	62.50	25.00	27.00	91.81	7.15	29.31	3.08	67.20
18	Eaagads Ltd Ord 1.25	(0.15)	(10.15)	1.12	18.35	12.20	4.00	1	75.00	-	61.72	95.18	7.86	19.16	12.06	68.78
19	East African Breweries Ltd Ord 10.00	16.70	59.89	1.04	35.44	16.57	12.00	0	83.33	1.05	41.76	57.96	15.70	13.30	18.99	67.71
20	Express Ltd Ord 5.00	(1.12)	(13.57)	0.86	77.84	13.66	7.00	0	71.43	-	56.87	73.02	3.00	0.06	34.72	65.22
21	Firestone East Africa Ltd Ord 5.00	15.22	6.88	1.41	27.02	14.80	5.00	0	60.00	-	61.05	77.01	9.01	17.31	4.64	78.05
22	Housing Finance Co Ltd Ord 5.00	7.26	10.41	0.97	89.76	16.28	7.00	0	71.43	7.00	30.09	54.88	14.81	30.49	34.93	34.59
23	I.C.D.C Investments Co Ltd Ord 5.00	11.80	32.34	0.85	7.09	1.73	9.00	0	88.89	-	24.17	57.11	13.99	0.23	41.99	57.78
24	Jubilee Insurance Co. Ltd Ord 5.00	3.79	42.39	0.84	65.02	15.46	9.00	0	77.78	-	37.98	47.13	37.94	51.27	39.72	9.01
25	Kakuzi Ord 5.00	1.92	(20.65)	0.67	39.14	14.87	7.00	0	85.71	-	26.06	60.36	17.43	32.61	17.01	50.38
26	Kapchoria Tea Co. Ltd Ord Ord 5.00	2.50	15.07	1.38	28.09	13.32	5.00	1	80.00	-	39.56	85.54	2.04	32.15	8.98	58.86
27	Kenya Airways Ltd Ord 5.00	9.34	5.57	0.68	65.21	16.90	11.00	0	81.82	18.40	26.00	55.03	6.04	29.73	32.36	37.91
28	Kenya Commercial Bank Ltd Ord 10.00	3.51	24.76	0.95	89.32	18.01	10.00	0	80.00	35.00	35.00	48.23	9.41	4.53	38.36	57.10
29	Kenya Power & Lighting Ltd Ord 20.00	(6.78)	13.47	1.12	86.82	17.13	10.00	0	90.00	40.00	40.43	57.48	26.79	2.49	17.26	2.24
30	Limuru Tea Co. Ltd Ord 20.00	16.62	(19.27)	3.76	31.42	10.83	4.00	1	75.00	-	52.00	80.92	26.36	0.67	22.41	76.92
31	Marshall's (E.A.) Ltd Ord 5.00	(4.32)	(27.05)	0.95	73.78	14.00	8.00	0	75.00	-	65.60	85.74	2.99	3.60	10.54	85.86
32	Nation Media Group Ord. 5.00	16.40	29.86	1.64	32.63	14.97	11.00	0	90.91	-	44.73	57.92	8.86	45.20	32.34	22.47
33	National Bank of Kenya Ltd Ord 5.00	3.58	40.96	0.96	91.86	17.02	10.00	0	80.00	22.50	48.05	71.90	-	-	24.17	75.84
34	National Industrial Credit Ltd Ord 5.00	8.28	25.96	0.96	72.18	15.96	9.00	0	77.78	-	26.87	46.66	17.67	1.15	33.88	64.84
35	Pan Africa Insurance Holdings Ltd Ord 5.00	0.53	32.01	0.85	59.46	14.84	8.00	0	75.00	-	46.00	70.08	10.12	0.90	15.20	83.93
36	Rea Vipingo Plantations Ltd Ord 5.00	5.07	8.76	0.73	47.79	13.69	5.00	0	80.00	-	36.46	64.81	8.99	58.94	22.55	18.50
37	Sasini Tea & Coffee Ltd Ord 5.00	0.96	(19.62)	0.58	13.13	14.65	8.00	1	75.00	-	41.84	61.62	5.19	0.50	10.49	89.02
38	Standard Chartered Bank Ltd Ord 5.00	8.06	63.29	1.23	89.37	17.80	10.00	0	50.00	-	73.81	77.30	2.68	74.30	16.68	9.01
39	Standard Newspapers Group Ord 5.00	0.46	45.12	1.84	103.28	13.35	8.00	0	62.50	-	57.86	75.86	0.84	70.36	6.63	23.01
40	Total Kenya Ltd Ord 5.00	10.62	13.01	1.09	63.31	15.79	5.00	0	80.00	-	72.16	87.84	2.72	78.29	6.33	15.38
41	Tourism Promotion Services Ltd Ord 5.00	7.03	20.98	0.88	49.46	14.46	8.00	0	75.00	-	76.46	80.37	0.59	0.11	19.82	80.07
42	Uchumi Supermarket Ltd Ord 5.00	9.42	9.06	1.63	61.98	14.67	11.00	0	81.82	0.40	21.24	55.80	44.18	9.34	19.08	71.59
43	Unza Group Ltd Ord 5.00	(3.27)	0.39	0.62	45.68	15.20	7.00	0	71.43	-	56.78	63.90	4.82	2.68	33.97	63.55
44	Williamson Tea Kenya Ltd Ord 5.00	3.94	(3.05)	0.60	26.62	14.67	7.00	1	71.43	-	56.85	71.33	12.31	52.96	32.66	14.38

APPENDIX 6

COMPANIES INCLUDED IN THE STUDY

- 1 A.Baumann & Co.Ltd Ord 5.00
- 2 Athi River Mining Ord 5.00
- 3 B.O.C Kenya Ltd Ord 5.00
- 4 Bamburi Cement Ltd Ord 5.00
- 5 Barclays Bank Ltd Ord 10.00
- 6 British American Tobacco Kenya Ltd Ord 10.00
- 7 Brooke Bond Ltd Ord 10.00
- 8 C.F.C Bank Ltd ord.5.00
- 9 Car & General (K) Ltd Ord 5.00
- 10 Carbacid Investments Ltd Ord 5.00
- 11 City Trust Ltd Ord 5.00
- 12 CMC Holdings Ltd Ord 5.00
- 13 Crown Berger Ltd Ord 5.00
- 14 Diamond Trust Bank Kenya Ltd Ord 4.00
- 15 Dunlop Kenya Ord 5.00
- 16 E.A.Cables Ltd Ord 5.00
- 17 E.A.Portland Cement Ltd Ord 5.00
- 18 Eaagads Ltd Ord. 1.25
- 19 East African Breweries Ltd Ord 10.00
- 20 Express Ltd Ord. 5.00
- 21 Firestone East Africa Ltd Ord 5.00
- 22 Housing Finance Co Ltd Ord 5.00
- 23 I.C.D.C Investments Co Ltd Ord 5.00
- 24 Jubilee Insurance Co. Ltd Ord 5.00
- 25 Kakuzi Ord.5.00
- 26 Kapchorua Tea Co. Ltd Ord Ord 5.00
- 27 Kenya Airways Ltd Ord 5.00
- 28 Kenya Commercial Bank Ltd Ord 10.00
- 29 Kenya Power & Lighting Ltd.Ord 20.00
- 30 Limuru Tea Co. Ltd Ord 20.00
- 31 Marshalls (E.A.) Ltd Ord 5.00
- 32 Nation Media Group Ord. 5.00
- 33 National Bank of Kenya Ltd Ord 5.00
- 34 NIC Bank Ltd Ord 5.00
- 35 Pan Africa Insurance Holdings Ltd
- 36 Rea Vipingo Plantations Ltd Ord 5.00
- 37 Sasini Tea & Coffee Ltd Ord 5.00
- 38 Standard Chartered Bank Ltd Ord 5.00
- 39 Standard Newspapers Group Ord 5.00
- 40 Total Kenya Ltd Ord 5.00
- 41 TPS Ltd Ord 5.00 (Serena)
- 42 Uchumi Supermarket Ltd,Ord 5.00
- 43 Unga Group Ltd Ord 5.00
- 44 Williamson Tea Kenya Ltd Ord 5.00