THE EFFECT OF CORPORATE GOVERNANCE ON REVENUE COLLECTION IN KENYA REVENUE AUTHORITY

BY: CHARLES KIBET KEMBOI

D63/79224/2012

A RESEARCH PROJECT PROPOSAL SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENT FOR THE AWARD OF THE DEGREE OF MASTER OF SCIENCE IN FINANCE, SCHOOL OF BUSINESS, UNIVERSITY OF NAIROBI

OCTOBER, 2013

DECLARATION

This research project is my original work and has not been presented to any other University or Institution of Higher Learning for examination.

Signed …………………………… Date…………………….

CHARLES KIBET KEMBOI
D63/79224/2012

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

Signed …………………………… Date…………………….

Mr. ONDIGO HERICK OCHIENG
Department of Finance & Accounting,
School of Business,
University of Nairobi.

DEDICATION

My study is dedicated to my beloved wife Pamela Koima and son Shawn Kemboi.

Thank you for your love, inspiration and understanding during my studies. God bless you abundantly.

ACKNOWLEDGEMENT

This research project would not have been possible without the support of many people. First and foremost I would like to express my sincere gratitude to the Almighty God for life, good health, wisdom, strength and all that counts to undertake this project and my MSc studies.

I would like to offer my profound appreciation to my kind supervisor, Mr. Herrick Ondigo, who has supported me throughout my project with his patience and knowledge and having spared his time to go through this work and in the process rendered valuable advice and corrections which led to the realization of this research. I attribute the level of my Masters degree to his encouragement and effort and without him this project, too, would not have been completed or written. Special gratitude also goes to my moderator Mr. Cyrus Iraya for his valuable advice and contribution that have enabled me complete this research project.

I express my special love and gratitude to my loving wife Pamela Koima and son Shawn Kemboi for their support, prayers, understanding and endless love which encouraged and strengthened me all the way.

TABLE OF CONTENTS

LIST OF TABLES

LIST OF ABBREVIATIONS AND ACRONYMS

AOA……………Articles of Association

BOD……………Board of Directors

CEO……………Chief Executive Officer

CMA…………...Capital Markets Authority

ECTs……………Electronic Cargo Tracking System

Fs……………....Financial Statement

KAA…………..Kenya Airports Authority

KRA……………Kenya Revenue Authority

MOA…………..Memorandum of Association

PAYE…………Pay As You Earn

VAT…………..Value Added Tax

ABSTRACT

The effects and contributions of corporate governance by organizations have been on a rise in recent times KRA included. However, the anticipated end results are most often not realized due to governance challenges which include political appointments of board members, inadequate skill personnel in the board and integrity issues from employees.

Kenya Revenue Authority (KRA) embraced corporate governance as an enhancement of revenue collection strategy since its inception. The general research objective was to establish the effect of corporate governance on revenue collection. A case study of Kenya Revenue Authority was conducted. Statistical Package for Social Scientists (SPSS) was used and Spearman Correlation Coefficient and Multiple Regression Analysis to determine the magnitude of the relationship of corporate governance and revenue collection.

The findings revealed that corporate governance variables namely; board size, had a negative effect on revenue collection while board roles, board effectiveness and policy and decision making had a significant positive relationship with revenue collection. Corporate Governance in general had a significant positive relationship with revenue collection.

Corporate governance was found to have effect on 48.4% on revenue collection, thus desirable to study further.

Key words: Corporate Governance, Roles, Contigency, Effectiveness and Revenue collection

CHAPTER ONE:
INTRODUCTION

1.1 Background of the Study

Kenya Revenue Authority (KRA) continues to play a key role in financing Government expenditure by collecting over 96 % of Ordinary Revenues. To meet the rising Government budgetary requirements and in particular implementation of the 2010 Constitution of Kenya and vision 2030, KRA is expected to collect more tax revenues.

This paper investigates the governance effects of overall level and separate elements of corporate governance practices on revenue collection performance. The study examined the relationship between Corporate Governance and Revenue Performance in KRA. The study was prompted by dire need for an increase in tax collection to meet vision 2030.

The study aimed at establishing the relationship between corporate governance, board size, board composition and revenue collection in KRA departments. Corporate Governance had a significant positive relationship on revenue collection. There is need for Kenya Revenue Authority to formulate policies and make decisions that can stand test of time, constitute manageable Board of Directors and Executive Management, understand their roles, manage contingency and improve on board effectiveness to realize improved revenue performance.

1.1.1 Corporate Governance

The Capital Markets Act (Cap 485A) guidelines on corporate governance practices by public companies in Kenya, defines corporate governance as process and structure used to direct and manage business affairs of the company towards enhancing prosperity corporate accounting, with the ultimate objective of realizing shareholders' long-term value while taking into account the interest of other stakeholders.

Corporate governance is referred to the manner in which the power of an organization is exercised in the stewardship of the Corporation's total portfolio of assets and resources with the objective of maintaining and increasing shareholders value with the satisfaction of other stakeholders in the context of its corporate mission (Private Sector Corporate Governance trust, (1999). The committee on the financial aspects of corporate governance (the Cadbury Committee), defines corporate governance as the system by which companies are directed and controlled. Corporate Governance is both about ensuring accountability of management in order to minimize downside risks to shareholders and about enabling management to exercise enterprise in order to enable shareholders to benefit from upside potential of firms Keasey and Wright, (1993), Tricker, (1984). Gedajlovic et al., (2004) extend an agency perspective on governance to suggest that particular blend of incentives, authority relations and norms of legitimacy in founder firms interacts with the external environment to affect the nature and pace of learning and capability development.

Metrick and Ishii (2002) define corporate governance from the perspective of the investor as "both the promise to repay a fair return on capital invested and the commitment to operate a Firm, efficiently given investment". Defining corporate governance this way means that corporate governance has an impact on the Firm's ability to access the capital market. The famous Cadbury Committee (1992) defines corporate governance system as "the systems by which companies are directed and controlled".

1.1.2 Revenue Collection

Kenya Revenue Authority Act (Cap 469) defines revenue as taxes, duties, fees, levies, charges, penalties, fines or other monies collected or imposed under the written laws set out in the First.

Schedule. Revenue collection is the act by which the government collects its taxes. These taxes are PAYE, import duty, excise duty, VAT, Agency Taxes and Exchequer Revenue. The Agency Taxes include Airport Revenue, Petroleum Development Levy, Road Transit

Toll, Sugar Level, Traffic Fees, Petroleum Regulatory Levy, Merchant Shipping Fee and Railway Development Levy. Exchequer Revenue include Stamp Duty and Import Declaration Fees (Kra fs 2010).

Scholars and Researchers have done studies on revenue collection both locally and international with the aim of establishing reasons for poor revenue collection. (Kra fs 2010) highlighted that some of the factors that affect revenue collection are Integrity issues, Politics, Economical issues, Social issues, Technical advancements, Environmental Analysis and Legal Analysis.

Forum Economic Ministries(2009) “A study on improving revenue collection and capacity in Forum Island Countries, with particular reference to addressing the impacts of the global economic crisis and trade liberalization.” Guneratne (1996) "The Tax-Man Cometh: The impact of revenue collection on subsistence strategies in Chitwan Tharu Society." Khattry and Rao (2002) study the use of different kinds of taxes according to the level of development. Ongore (2005) Effects of selected corporate governance characteristics on Firm performance. All these studies in one way or another looked into ways to improve revenue colletion. This therefore indicates clearly that a lot need to be done in looking at ways that revenue collection can be improved.

1.1.3 Effects of Corporate Governance on Revenue Collection

Corporate Governance variables namely; board size has a negative effect on revenue performance while policy and decision making has a significance positive relationship with revenue performance. Board composition, roles and effectiveness has a significant positive relationship with revenue performance. Corporate Governance principles in public sector such as openness, integrity and accountability give stakeholders’ confidence in decision making processes and thus improve revenue collection performance. These principles are reflected in four “dimensions” of public sector governance: standards of behavior (balance of power and authority), organizational structure and processes, control and external reporting.

Further Zahra, (1991) obtained a positive relationship between board effectiveness and organizational performance. A study by Namisi, (2005) revealed that board effectiveness was positively correlated with performance of financial institutions of Uganda. Kale, (2002) revealed that effective teams lead to improvement in organizational performance. Van der Walt and Ingley, (2001) revealed that board effectiveness contributes to the organizational performance.

Kenya's revenue collection has improved tremendously from a total of ksh150 Billion (1995) to ksh800.486 (2013).(kra fs). From the research carried out, 48.4% of the improvement is attributed to corporate governance properties such theories used in recruitment (Agency and Dependency), Monitory and control, board effectiveness and board composition.

1.1.4 Kenya Revenue Authority

The Kenya Revenue Authority was established by an Act of Parliament on July 1st 1995 Cap. 469 for the purpose of enhancing the mobilisation of Government revenue, while providing effective tax administration and sustainability in revenue collection. The Board and Management of KRA have since its inception spent time and resources setting up systems, procedures and the adoption of new strategies aimed at enhancing the operational efficiency of the Authority's processes.

In particular, the functions of the Authority are; To assess, collect and account for all revenues in accordance with the written laws and the specified provisions of the written laws.To advise on matters relating to the administration of, and collection of revenue under the written laws or the specified provisions of the written laws. To perform such other functions in relation to revenue as the Minster may direct.

In order to realise its mandates, the Authority administers the following written laws relating to revenue: -The Income Tax Act (Cap. 470). The Customs and Excise Act (Cap.472). The Value Added Tax Act (Cap.476). The Road Maintenance Levy Fund Act

1993 (No.9 of 1993). The Air Passenger Service Charge Act (Cap. 475). The Entertainment Tax Act (Cap. 479). The Traffic Act (Cap. 403). The Transport Licensing Act (Cap. 404). The Second Hand Motor Vehicle Purchase Tax Act (Cap. 484). The Widows and Children's Pensions Act (Cap. 195). The Parliamentary Pensions Act (Cap.196). The Stamp Duty Act (Cap. 480). The Betting, Lotteries and Gaming Act (Cap.131). The Directorate of Civil Aviation Act (Cap.394).

The written laws administered by the Authority therefore legally constitute the functional departments and sections of Kenya Revenue Authority, which include Domestic Tax Department. Customs and Service Department and Road Transport Department.

KRA's Mission Statement is to promote compliance with Kenya's tax, trade, and border legislation and regulation by promoting the standards set out in the Taxpayers Charter and responsible enforcement by highly motivated and professional staff thereby maximizing revenue collection at the least possible cost for the socio-economic well being of Kenyans.

1.2 Statement of the Problem

Most current financial crisis emphasizes the importance of governance and its roles in preventing future failures (Mehran, Morrison, Shapiro) 2012. Corporate Governance has therefore remained a key foundation in any institutions success. Given that all corporations have boards and that financial performance is key to their sustainability, then corporate governance is vital.

Corporate Governance in Public Sector has continued to be a problem in many developing countries, Kenya being part of it. In 1995, KRA was established to regularize Kenya's tax and customs administrations. It was expected to generate revenue through more efficient tax administration, eliminate corruption and improve tax collection strategies, thereby expanding trade. In the years since its inception, KRA, through a series of corporate strategic plans, has laid out and followed a focused course for reform and modernization.

Year in year out, Kenya's Budget has continued to increase tremendously, leaving KRA with a duty to match the Kenyan Budget. It is for this reason that there is need to look into the effect of Corporate Governance on revenue collection. Issues of corporate governance principles in public sector, KRA included has become wanting, thus hindering the public sector from performing as competitive as private sector. Many Researches on corporate governance has been done in profit making institutions. Smith(1776), Berle and Means(1932), Mace (1971), Jensen and Meckling(1976), Whisler(1984) Lorsch and Maclever(1989), Zahra(1991), Demb and Neubauer (1992), Black(1992), Lipton and Lorsch(1992), Jensen (1993), Kiel and Nicholas(2003), Gavin and Geoffrey(2004), all these studies concluded that there is a significant relationship between Corporate governance and financial performance. Little has been done on the study of corporate governance in the public sector (Robinah) 2006, 1994 (King I), 2002 (King II), and 2009 (King III) Worthington (2003) Sanan(2011) and in all sceneries corporate governance has proved to have some significant positive effect on the performance of various public institutions. There is still a wide gap in performance when public sector is compared to private sector (Equity Bank and Post Bank). It is thus inevitable that researchers should put focus on the effect of corporate governance on public sector.

1.3 Objective of the study

To establish the effect of corporate governance on revenue collection in KRA.

1.4 Value of the Study

The study benefits scholars from different disciplines such as law, economics, finance, sociology, and organizational theory (Kiel and Nicholas, 2003) in analyzing the performance with relevance to the functioning of the Board. As noted by Kiel and Nicholas in their study, the common aim of many of the theories has been to position a link between various characteristics of the Board and Firm performance. The study helps researchers in understanding the effects of dimensions of Corporate governance such as board size, board composition and board committee in firm performance.

CHAPTER TWO:
LITERATURE REVIEW

2.1 Introduction

The literature in this study is reviewed in line with the study objectives and looks into the theoretical review, dimensions of corporate governance and factors influencing revenue collection.

2.2 Theoretical Review

There are a number of studies that have been done which enhance our understanding of the role of Board. The structure, role and impact of Board on Firm performance has been studied by scholars from different disciplines such as law, economics, finance, sociology, and organizational theory (Kiel and Nicholas, 2003) resulting to a number of contrasting theories. The theories with relevance to the functioning of the Board include Agency Theory, Stewardship Theory and Resource Dependence Theory. As noted by Kiel and Nicholas in their study, the common aim of many of the theories has been to position a link between various characteristics of the Board and Firm performance. A review of various theories demonstrate how two theories come out as really contrasting with reference to how Board should be constituted in order to positively impact on performance of a Firm.

2.2.1 Agency Theory

Agency Theory is based on the idea that in a modern corporation, there is a separation of ownership and management, resulting in agency costs associated with resolving the conflict between the owners and the agents (Berle & Means, 1932; Jensen and Meckling, 1976). This implies that management cannot be trusted, thereby calling for strict monitoring by the Board in order to protect shareholders' interest.

The main concern of Agency Theory is effective monitoring which is achieved when Board have majority of outside and ideally independent directors. The position of

Chairman and CEO should be held by different persons. In contrast, Stewardship Theory takes a diametrically different view. It looks at directors and managers as stewards of the Firm. As stewards, they are essentially presumed to be trustworthy individuals and therefore good stewards of the resources entrusted to them, which makes monitoring redundant (Donaldson and Davis, 1991).

The Agency Theory identifies the agency relationship where one party, the principal (The Company), delegates work to another party, the agent (Board of Directors). In the context of corporations and issues of corporate control, Agency Theory views corporate governance mechanisms as being an essential monitoring device in ensuring that any problems that may be brought about by principal – agent relationships are minimized. Agency Theory is the most dominant theoretical framework in corporate governance research (Eisenhardt, 1989; Jensen and Meckling, 1976; Hermalin and Waisbach, 2002). The theory is founded on the assumption that when ownership is separated from the control of a large Firm, the manager is acting as an agent on behalf of the owner-principal is prone to creating moral hazards such as shirking and seizing wealth at the expense of the principal. Hence, the theory suggests that the principal builds appropriate incentive mechanisms to deter the agent from indulging in such behavior therefore, from the view point of shareholders, the agency perspective on the Board composition is primarily concerned with creating independent Boards.

2.2.2 Resource Dependency Theory

The Resource Dependency Theory is the result of studies on Board composition by sociologists who have focused on the study of interlocking directorates and their implication on institutional and societal power (Pettigrew, 1992.) It has its origins in the open system theory as such organizations have varying degree of dependence on the external environment, particularly for the resources they require to operate. Uncertainty and dependence propel an organization to proactively manage the environment (Pfeffer and Salancki, 1978) and the effect this has on financial and customer outcomes when a contextual factor, high Firm power is taken into consideration. Corporate Board are viewed as means to manage external dependency (Pfeffer and Salancik,1978), reduce environmental uncertainty (Pfeffer, 1972) and transaction costs associated with the environmental interdependency (Williamson, 1984).

The implication of this theory is that corporate Boards will reflect the environment of the Firm (Boyd, 1990; Hillman, et al, 2000; Pfeffer, 1972) and that corporate directors will be chosen to maximize the provision of important resources to the Firm. Each director may bring different linkages and resources to a Board. Board composition will thus theorize to reflect a matching of the dependencies facing an organization to the resources acquisition potential of its Board members (Hillman, et al, 2000). From the foregoing discussion, it can be seen clearly that unlike the Agency Theory, Resource Dependency Theory ignores alternative activities of the Board such as providing advice (Westphal, 1999; Lorsch and Maclver, 1989),) and strategizing (Kesner and Johnson, 1990).

2.2.3 Stewardship Theory

Stewardship model or theory, 'Managers are good stewards of the corporations and diligently work to attain high levels of corporate profit and shareholders returns' (Donaldson and Davis 1994). Tricker (1969) points out that "underpinning company law is the requirement that directors show a fiduciary duty towards the shareholders of the company" Inherent in the role of directors having a fiduciary duty is that they can be trusted and will act as stewards over the resources of the company.

Stewardship Theory views agents as stewards who manage their Firm responsibly to improve its performance (Donaldson & Davis, 1991; Muth & Donaldson, 1998). Stewardship Theory suggests that managers should be given autonomy based on trust, which minimizes the cost of monitoring and controlling behaviour of the managers and directors.Underlying the Stewardship Theory perspective is the assertion that since managers are naturally trustworthy there will be no major agency costs (Donaldson and Preston, 1995; Donaldson, 1990). Stewardship theorists go further to argue that senior executives will not disadvantage shareholders for fear of jeopardizing their reputation (Donaldson and Davis, 1994

2.2.4 Stakeholders' Theory

In defining Stakeholder Theory, Clarkson (1994) states; "The Firm is a system of stakeholders operating within the larger systems of the host society that provides the necessary legal and market infrastructure for the Firm's activities. The purpose of the Firm is to create wealth or value for its stakeholders by converting their stakes into goods and services". This view is supported by Blair (1995). This theory states that managers should make decisions that take account of the interest of all the stakeholders in the Firm.

The Theory takes account of a wider group of constituents rather than focusing on shareholders.Chew and Gillan (2006) in their book of articles titled *Corporate Governance at the Cross-roads*, argue that Stakeholder Theory does not provide single corporate objective, but directs managers to serve many "Masters". They went further to point out that without the clarity of mission provided by a single valued objective function; companies embracing stakeholder theory will experience managerial confusion, conflict, inefficiency and perhaps even competitive failure. They conclude that multiple objective is no objective. Neo – institutional Theory asserts the importance of a normative framework and rules in guiding, constraining and empowering behaviour.

Ancient and current works in the area of corporate governance starting with Adam Smith (1776) to different theories viz., Agency, Stewardship and Resource Dependence has highlighted the importance of Board. Adam Smith (1776), in his landmark work, *The Wealth of Nations*, suggested that a manager with no direct ownership of a company would not make the same decisions, nor exercise the same care as would an owner of that company.

2.3 Dimensions of Corporate Governance

2.3.1 Board Size

Jensen (1993) and Lipton and Lorsch (1992) argue that large Board are less effective and are easier for a CEO to control. “Directors of companies being managers of other people’s money, it cannot well be expected that they will watch over it with the same anxious vigilance with which partners in a corporate company watch over their own” (Smith, 1776).

Board size defined as the total number of directors on a board (Panasian et al., 2003), has been regarded as an important determination of effective corporate governance (Bonn et al., 2004). The optimal board size according to Goshi et al., (2002) includes both the executive directors and non executive directors.

Forbes and Daniel (1999) argued that although board size is not truly a demographic attribute, it is unlikely to have effect on board functioning. Despite the considerable amount of effort in research on board size for more than a decade there is still lack of consensus among researchers on its relevancy.

There has been considerable debate on whether large boards perform better than smaller boards. Daily (1995) argue that greater number of directors might increase available expertise and resource pool while Bonn et al., (2004) contends expanding the size of the Board provides an increased pool of expertise, information and advice quality not obtained from other corporate staff. In contrast, the difficulty inherent in coordinating the contributions of many members can be complex, hindering them to use their knowledge and skills effectively (Forbes & Daniel 1999, Epstein et al., 2004).

Large boards have difficulty in building the interpersonal relationships that further cohesiveness, or maintain high board effort norms owing to social loafing that exists in large boards (Forbes & Daniel, 1999). Studies such as Bonn et al., (2004) have also supported previous authors and concluded that when the board size is very large, the disadvantages such as lack of cohesiveness, coordination difficulties and fractionalization are most severe and they became less prevalent as board size decreases.

In contrast very small boards cannot enjoy the advantages of the pool of expertise, information and advice of a larger board and these benefits emerge when the board becomes larger. To date there are still wide views on an optimal board size. According to Leblanc & Gillies (2003), an 8-11 persons board may be considered optimal. In a recent study by Epstein et al., (2004), a board of 9-13 members is typically right for most companies but too small for large ones. Goshi et al., (2002) considered an average of 16 directors (3 within and 13 outside directors) to be appropriate for larger companies, though respondents in this study believed that 12 is the most effective board size. The study by Connelly & Limpaphayom (2003) revealed that the average board size of insurance firms in Thailand was 10 but ranged from a low number of 4 members to a high number of 16 members.

The board should be optimal to avoid being too small or too large. A board that is too small will not have the expertise or human power available to run the company productively while a board that is too large may be inefficient at making and implementing decisions. A board that is too large can also waste resources and diminish individual productivity. Large boards however can be managed by subdividing members into subcommittees.

2.3.2 Board Composition

A board profile is comprised of its size, ratio of independent members, ratio of executive directors, segregation or unification of the chairman and CEO position, and subdivision into committees. In most cases Board Composition is established by the corporation's bylaws (MOA and AOA). No one board profile will fit the need of each and every corporation. Instead the perfect composition of the board will be a direct reflection of the corporation's unique structure and needs. In some cases, the structure of board will have to change in order to accommodate new developments within the corporation such as growth or merger.

A number of studies on outside directors support the Agency Theories recommendations of monitoring and advisory functions to Firm shareholders (Brickley and James, 1987; Weisbach, 1988). The premise for agitating outside directorship is that Board independence is the critical element determining the ability of a Board to monitor. Sheppard (1994) proposes that outside directors “provide an indicator of the Board’s orientation towards its external environment and thus, its ability to respond to change”. The inability to respond to change is one of the major causes of corporate decline. Board dominated by independent directors are more likely to act in the best interest of shareholders and that they will safeguard the interest of owners against managers who will serve their own interests at the expense of the owners (Berle and means, 1932) and Williamson (1935).

2.3.3 Board Committees

The board of directors is normally permitted by the AOA to delegate its functions to committees composed of selected board members or managerial staff. However, the board as a whole still has to accept responsibility for the actions taken and decisions recommended by such groups. Committees are commonly of two types: Standing and ad hoc committees. Some of the Committees include: Audit Committee, Remuneration Committee, Ethics Committee, Nominating Committee and Corporate Governance Committee.

Staff committee is responsible for monitoring and appraising the performance of Senior management, reviewing of human policies, approval of remuneration policy for employees, making recommendations on Senior (Kra fs 2010).

2.5 Empirical Review

Studies both locally (unpublished MBA projects) and internationally on the relationship between corporate governance and Firm performance, have tried to find an empirical answer to the question ‘Does corporate governance affect Firm performance?’ These studies are undertaken in different countries with obviously different economic and cultural settings. To date, a definitive answer to this question has been elusive and thus the reason for continuous academic debate on corporate governance research agenda. Smith (1776) described agency problem as follows, “like the stewards of a rich man, they (managers) are apt to consider attention to small matters as not for their master’s honour, and very easily give themselves a dispensation from having it. Negligence and profusion, therefore, must always prevail, more or less, in the management of such a company”.

Agrawal and Knober (1996) suggest that Boards expanded for political reasons often result in too many outsiders on the Board, which does not help performance. In their paper they surmise that Boards of US Firms may be expanded for political reasons that these outsiders “either reduce performance directly or indirectly by proxy for the underlying political constraints that led to their receiving Board seats”. In the same paper they conducted cross-sectional regression with a sample of 383 large US Firms for which they had Board data for 1987, with Tobin Q as the dependent variable. Initially, they report a significant negative correlation between fraction of outside directors and Tobin Q. However, in their later work of 2001, with same sample and control variables, the significance of the relationship disappears.

Yermack (1996) also showed that outside directors do not significantly affect Firm performance. Lawrence and Stapledon (1999) fail to find consistent evidence that a direct relationship exist between the proportion of independent outside directors and Firm value in a sample of listed Australian Firms.

Mwangi (2004) in his study titled, “Determinants of Corporate Board Composition in Kenya: An Agency Theory Perspective”, reports outside director representation of 71%.

The empirical findings of the study are consistent with implication of the Agency Theory literature. The question that demands an answer is whether such representation translates into better performance.

Previous local studies, mostly the unpublished MBA projects, investigating the link between Board composition and Firm performance are done from one view, the Agency Theory perspective. Such studies have concentrated on the monitoring role of the Board which forms the basis of the variables used in those studies which is largely the impact of 'outside directors' on Firm performance. They include a study by Jebet (2001) in which she set out to determine the existing corporate governance structures in publicly quoted companies in Kenya. Other Researches include; Mwangi (2004), Determinants of Corporate Board Composition in Kenya: An Agency Theory Perspective; Okiro (2006), The Relationship between Board Size and Board Composition on Firm Performance: A Study of Quoted Companies at the NSE; Mululu (2003) A study on The Relationship between the Board activity and Firm Performance of Firms quoted at NSE.

Kerich (2006) undertook a study of 47 listed companies between 2000 and 2005. In this study, the researcher investigated four governance variables which included frequency of Board meetings, Board size, executive compensation and Board composition. The proxy for Board composition in this study was the proportion of outside directors on the Board. Lang'at (2006), found a positive relationship between the ration of outside directors to total directors and Firm performance.

All the studies reviewed have looked at the role of the Board from one theoretical perspective which roots for monitoring role. There are a number of roles that Board of Directors perform and various operationalization of Board composition will capture distinctly different aspects of the Board's roles which include resource dependence, counseling and expertise and control.

2.6 Summary of Literature

These performances related studies remain inconclusive. Scholars and Researchers have done studies on revenue collection both locally and international with the aim of establishing reasons for poor revenue collection. Forum Economic Ministries(2009) "A study on improving revenue collection and capacity in Forum Island Countries, with particular reference to addressing the impacts of the global economic crisis and trade liberalization." Guneratne (1996) "The Tax-Man Cometh: The impact of revenue collection on subsistence strategies in Chitwan Tharu Society." Khattry and Rao (2002) study the use of different kinds of taxes according to the level of development. All these studies in one way or another looked into ways to improve revenue collection. This therefore indicates clearly that a lot need to be done in looking at ways that revenue collection can be improved.

CHAPTER THREE:
RESEARCH METHODOLOGY

3.1 Introduction

This chapter identifies the procedures and techniques that will be used in conducting the study. It presents the research design to be used, the data collection method and instrument and how data will be analyzed and presented. The chapter therefore comprises the following subsections: research design, data collection procedures and data analysis.

3.2 Research Design

This shall be a case study, a design deemed appropriate as it is focusing on only one unit of study, which is Kenya Revenue Authority. (Mugenda and Mugenda 1999)A case study makes a detailed examination of a single subject, group or phenomenon as it is an in-depth investigation of an individual, institution or phenomenon.

Cases studies involve in-depth, contextual analyses of matters relating to similar situations in other organizations. They are useful in understanding certain phenomena, and generating further theories for testing. All corporations have boards and studies have been done on effects of corporate governance attributes on firm performances.

3.3 Data Collection

This study utilized secondary data based on the annual financial statements, KRA Fourth Corporate plan and KRA Fifth Corporate plan. The study focuses on a ten year revenue collection period of KRA between 2003 and 2012 on quarterly basis.

3.4 Data Analysis & Presentation

Mugenda and Mugenda (1999) observe that data analysis is the process of bringing order, structure and meaning of information collected. Analysis was done with the help of Statistical package for social scientists (SPSS version 21). It is preferred because SPSS has an ability to cover a wide range of the most common statistical and graphical data analysis and is very systematic. First, data collected was coded, edited and analyzed. Then, data was entered into the computer, after which analysis was done. Descriptive statistics and chi-square test was used to examine Corporate Governance, board roles and contingence. Spearman correlation was used to measure the relationship between Corporate Governance, board roles, board effectiveness and performance. Regression analysis was performed to examine the level of revenue collection.

3.4.1 Analytical Model

The methodological approach mostly used is examining the relationship between corporate governance aspects and revenue collection is multiple regressions. Mean score, frequencies and percentages for each variable were calculated and tabulated using frequency distribution tables.

$$RC_{it} = \beta_0 + \beta_1 BODSZ + \beta_2 BODRL + \beta_3 BODEFF + \beta_4 POLY\&DEC + \beta_5 BODCONT + e$$

Where RC_{it} is Revenue collection (Actual Collection / Target)

β_0 = Constant Term

β_1, β_2, β_3, β_4 and β_5 = Beta coefficients

BODSZ = Board Size

BODRL = Board Roles

BODEFF =Board Effectiveness

POLY&DEC = Policy & Decision making

BODCONT = Board Contingency

e = stochastic disturbance error term

3.4.2 Test of Significance

To test for the strength of the model and the relationship between corporate governance and revenue collection, the researcher conducted an Analysis of Variance (ANOVA). On extracting the ANOVA statistics, the researcher looked at the significance value. The study was tested at 95% confidence level and 5% significant levels. If the significance number found is less than the critical value (α) set, then the conclusion was that the model was significant in explaining the relationship.

CHAPTER FOUR:

DATA ANALYSIS, FINDINGS AND INTERPRETATIONS

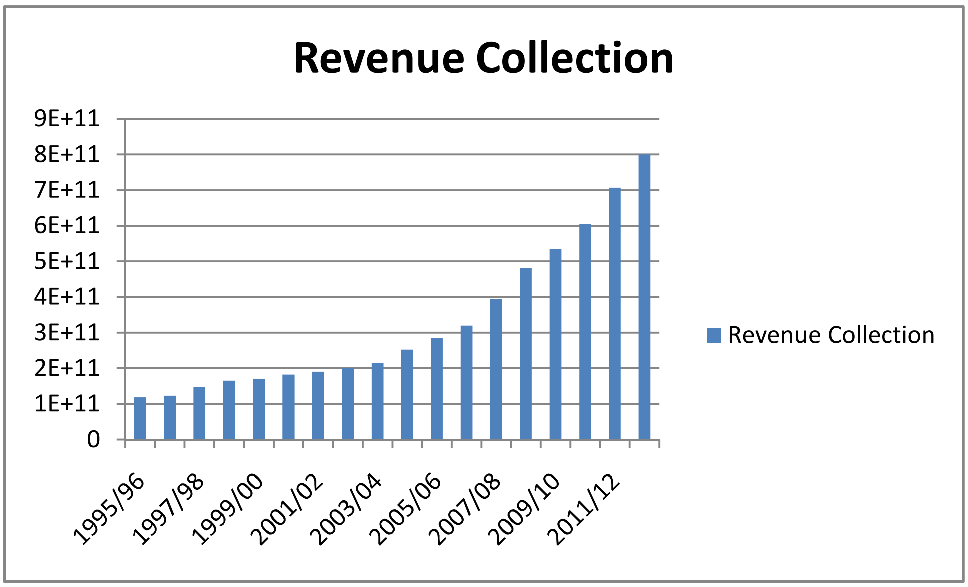
4.1 Introduction

This chapter discusses the interpretation and presentation of the findings. This chapter presents analysis of the data on the relationship between corporate governance and revenue collection. The chapter also provides the major findings and results of the study.

4.2 Data Processing and Analysis

4.2.1 Revenue Collection

Chart 4.1: Revenue collection



Source: Kra fs 2010

From the findings presented in Chart 4.1, revenue collection has tremendously increased from 115 Billion in the financial year 1995/96 to 800 Billion in the financial year 2011/2012

4.3 Research Findings

In this study, a multiple regression analysis was conducted to test the influence among predictor variables. The research used statistical package for social sciences (SPSS V 21.0) to code, enter and compute the measurements of the multiple regressions

Table 4.1: Model Summary

Model	R Square	Adjusted R Square	F	Sig
1	0.490	0.484	4.400	0.000

R-Squared is a commonly used statistic to evaluate model fit. R-square is 1 minus the ratio of residual variability. The adjusted $R^{2,}$ also called the coefficient of multiple determinations, is the percent of the variance in the dependent explained uniquely or jointly by the independent variables. 48.4% of the changes in the revenue collection could be attributed to the combined effect of the predictor variables.

4.3.1 Relationship between Study Variables

Spearman correlation coefficient was used to determine the degree of relationship between the study variables as shown in the table 2 below.

Table 4.2: Spearman's zero order correlation matrix

	1	**2**	**3**	**4**	**5**	**6**
BOARD SIZE (1)	1.000					
POLICY & DECISION MAKING (2)	-.155	1.000				
BOARDROLES (3)	.211*	.358**	1.000			
BOARD	.094	.344**	.455**	1.000		

FFECTIVENESS (4)						
CONTIGENCY (5)	-.193	.185	.139	.225*	1.000	
REVENUE COLLECTION (6)	- .337**	.316*	.113	.411**	..324*	1.000

*

. Correlation is significant at the .05 level (2-tailed).

Correlation is significant at the .01 level (2-tailed).

There was a significant positive relationship between Corporate Governance and board roles (r= 0.212, P-value < 0.05, r = 0.358, P-value < 0.01) respectively in terms of board size and policy and decision making constructs of Corporate Governance as shown in table 2 above. This implies that good Corporate Governance in terms of board size, policy and decision making enhances on the board roles by improving on monitoring and control, access to resources, strategizing, advice and counsel.

Results in table 2 above indicate a significant positive relationship between board roles and board effectiveness (r = 0.455, P-value < 0.01). This implies that well defined and streamlined board roles improved on the board effectiveness in terms of knowledge and skills, committees, delegation and risk management.

The partial correlation coefficient results indicated that there was a significant positive relationship between board roles and board effectiveness while controlling for contingence (r = 0.588, P-value < 0.01). This implies that contingency plays a positive role in moderating the link between board roles and board effectiveness.

The Spearman correlation coefficient table 2 indicates the following relationships; There was a significant negative relationship between board size and revenue collection (r = -0.337, P-value < 0.01). This implies that board size reduces revenue collection. Policy and decision making had a significant positive relationship with revenue collection (r = 0.316, P-value < 0.05). This implies that policy and decision making as measure of Corporate Governance enhanced revenue collection

Table 4.3: Regression Analysis

Model	Unstandardized coefficients		Standardized coefficients		
	B	Std . Error	Beta	T	Sig
Constant	1.692	0.213		2.324	0.000
Board size	-0.456	0.165	-0.472	-4.054	0.000
Board roles	0.455	0.233	0.352	3.167	0.000
Board effectiveness	0.651	0.057	0.543	4.498	0.000
Policy & decision making	0.420	0.431	0.363	3.267	0.000
Contingency	0.562	0.213	0.431	3.687	0.000
R- Square =0.490, Adjusted R- square = 0.484, F= 4.400, Sig = 0.000					

As per the SPSS generated table above, the equation **(RCit = β0 + β1 BODSZ+ β2**

BODRL + β3 BODEFF+ β4 POLY&DEC + β5 BODCONT+ e)

becomes:

RCit = 1.692- 0.456 BODSZ+ 0.455 BODRL + 0.651 BODEFF+ 0.42 POLY&DEC + 0.562 BODCONT

The regression equation above has established that taking all factors into account (board size, board roles, board effectiveness, policy and decision making and board contingency) constant at zero, revenue collection will be 1.692.

The findings presented show that taking all other independent variables at zero, then board effectiveness will be the leading factor with 0.651 in pushing for increase in revenue collection. It will be followed by board contingency (0.562), then board roles (0.455) and finally policy and decision making with 0.420. Board size on the other hand proved to be having a negative effect on revenue collection. This was greatly attributed to wastage of resources and diminished individual productivity.

4.4 Interpretation of Findings

The study sought to establish the effect of corporate governance on Revenue collection in Kenya Revenue Authority. The study found that corporate governance had a significant effect on the revenue collected as shown by the adjusted R Square of 48.4% of the changes in revenue collection could be attributed to the combined effect of the predictor variables. The findings of this study imply that corporate governance needs to be enhanced for the country to meet its vision 2030.

There was a significant positive relationship between corporate governance and revenue collection. This implied that effective boards positively impact on the revenue collection of KRA. Board effectiveness in terms of proper application of skills and knowledge, appropriate committees, delegation of roles and management of risk improves revenue collection. The findings are consistent with Masibo, (2005) where a significant positive relationship between board effectiveness and revenue collection was obtained. Brown, (2004) results revealed that better performance by boards was associated with good performance of organizations. Further the results are consistent with Jackson and Holland, (1998) whose findings showed that improvement in board performance represent an important point of leverage in improving organizational performance. A study by Namisi, (2005) revealed that board effectiveness was positively correlated with performance of financial institutions of Uganda. Kale, (2002) revealed that effective teams lead to improvement in organizational performance. Van der Walt and Ingley, (2001) revealed that board effectiveness contributes to the organizational performance.

CHAPTER FIVE:
SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter is organized into the summary of findings, conclusions of the study, recommendations for policy, limitations of the study and practice and suggestions for further research.

5.2 Summary

The Kenyan budget has continuously been increasing forcing the body authorized to collect revenue on behalf of the government to move fast and cope up with the country's desires. Implementation of the new constitution and subsequently the desire to beat vision 2030 has in essence put KRA on its toes to collect more revenue day in day out.

This study sought to investigate the effect of corporate governance on revenue collection in Kenya Revenue Authority. This study adopted a case study research design. In this study emphasis was given to secondary data which was obtained from the financial statements of Kenya Revenue Authority. The data included the revenue collected by KRA for a period of ten years between 2003 and 2012. Regression analysis was used to test the relationship between the variables.

From the study findings and discussions, the study concludes that corporate governance had a positive and a significant effect on the revenue collected for the period of the study. The study recommends that proper recruitment policy should be laid in selection of board members to ensure that they bring on board skills and knowledge that are relevant to the institution. This will prevent political appointments into the board. Emphasis should be made on the board size to ensure that an optimal number is suggested to avoid lack of expertise or human power in the board and at the same time checking on wastage of human resources and diminishing individual productivity. Board contingency aspect of management experience is key in the productivity of revenue collection.

5.3 Conclusions

The relationship between the corporate governance and revenue collection is evidently critical to promoting growth and development of any developing country. Sustainment of any country's budget fully relies on the domestic revenue collected. This in essence leaves no doubt that key governance principles such as monitoring and control contribute to 96% collection of domestic revenue.

Policy and decision making in KRA is important in contributing to increase in revenue collection. Board roles significantly influenced board effectiveness and this meant that board roles were important in determining the effectiveness of boards. This means that for the board and the executive to be effective they must pay attention to their roles.
Contingency in terms of management experience and institutional lifecycle significantly and positively influenced the impact on board roles and board effectiveness. KRA therefore require use of contingency measures to improve on the effectiveness of the board and top management.

Although there are other factors that affect revenue collection, corporate governance aspects also play a significant role in revenue collection. From the research conducted corporate governance contributes to 48.4% of the revenue collection performance.

5.4 Recommendations for Policy and Practice

In line with the findings and conclusions of the study the following were recommended;
From the findings on the effect of board size on revenue collection which was negative and for the board to be effective in performing their roles, there is need to review their membership to avoid having large boards and ensure that there is observation on Resource Dependency Theory in selecting boards. Politics should not play any role in Board recruitment to ensure board effectiveness.

Policy and decision making should be done in a manner that can stand the test of time whereby different points, ideas and opinions from all the stakeholders are considered.

The board should avoid rubberstamping of top management's recommendations on policy issues. Instead thorough discussions on the recommendations through sub-committees of the board should be made. Measurable objectives should be set that permit monitoring and control of revenue collection in Kenya Revenue Authority. This can be achieved through discussing thoroughly their strategic plans. (4^{th} and 5^{th} KRA Corporate plan).

Boards should be given improved facilitation in form of retainer and sitting and mileage allowances. They should provide frequent advices to the top management of the Authority. At the time of appointment of each employee one should have all policies of the Authority as part of the appointment package which is not the case now. The board should put in place incentive schemes that provide significant rewards for outstanding performance, for instance rewards to best performing executive and to all staffs. The board should appoint employees at top management level who posses vast management experience.

The study also suggests that proper reform policy should be complemented to enable tax payers pay their taxes voluntarily. The cost of tax collection has continued to increase with some tax payers exploiting the tax incentives issued. For instance many big firms have employed Audit firms that identify Tax loopholes and exploit through Tax evasion. For this reason tax payment awareness should be put in place to encourage many people pay their taxes willingly.

5.5 Limitations of the Study

Measuring certain aspects of the corporate governance variables was challenging because the current success of an organization may well originate from decision taken years ago by previous boards. This in turn posed drawbacks in drawing conclusions from the results obtained.

Another limitation is that board members in the public sector are appointed on a long-term contract; making some of the corporate governance variables had to measure. When such variables are included in regression to explain Revenue collection which is dynamic over the years, then no correlation is found.

Measuring individual member performance in the board also posed a great challenge in ascertaining the board effectiveness. This left the researcher with no option other than issuing performance of the board as a whole.

5.6 Suggested Areas of Further Research

The current study was conducted on public sector institution (KRA), which is formed by an Act of Parliament governed by statutory laws; therefore there is need for a similar study to be carried out in other Parastatals such as National Social Security Fund, National Hospital Insurance Fund and others.

Also the research findings should be compared to that of a similar study in Non Profit Making Organizations such as Hospitals, Churches and other charitable organizations. These are institutions that have income generating projects that are managed by boards.
Another study should be done on the effect of political appointments in the board of public sector institutions. Many appointments of board members in the public sector are politically affiliated. Finally, another study should focus on private sector to have a comparison with boards in the public sector.

REFERENCES

Baxt, R. (2002). *Duties and Responsibilities of Directors and Officers*, 17th Edition, Australian Institute of Company Directors, Sydney.

Brown, W.A., (2004). Exploring the association between board and organizational performance in Non – Profit organizations, Arizona state University, available at http://www.public.asu.edu/~willasu/acrobat%20documents/board%20perform%20paper%ver2.pdf

Cadbury Report (1992). Committee on the Financial Aspects of Corporate Governance

Cadbury, A. (1992), Report of the Committee on the Financial Aspects of Corporate Governance, Gee Publishing, London.

Cornforth, C., (2001), What Makes Boards Effective? An examination of the relationships

Coulson, T., (1993). *Developing Directors: Building an effective Boardroom Team*, McGrraw Hill.

Daily, C.M. (1995). An Empirical Evamination of the Relationship between CEO's and Directors. The Journal of Business Strategies 12, No. 1 (Spring 1995):50-68

Fama and Jensen (1983) *Separation of ownership and control*, journal of Law and Economics Vol 88.

Gavin J. Nicholson & G. C. Geoffrey (2004), *Corporate Governance, Break through Board Performance Vol 4.*

Geoffrey, G. & Nicholson, G.J (2003), Boards that Work: a new Guide for Directors, McGraw Hill, Syndey.

Geoffrey, G.C & G.J. Nicholson, (2002), *Real World governance: Driving business success through effective corporate Governance*", Monash Mount Eliza Business Review Volume 5.

Goshi et al., . (2002). Board structure, executive compensation and firm performance. Evidence from India. Indra Ghandi Institute of Development Research, Mumbai, India.

Heracleous, L. (2001) " *What is the impact of corporate governance on organizational performance? Corporate Governance*: An International Review .

Herman, R.D. 2000). Board practices of especially effective and less effective local non profit Organizations. American Review of public Administration, Vol 30 No.2. 146-160.

Higgs D. (2003) *Review of the Role and Effectiveness of Non-Executive Directors*

Huat, C. & David., (2001). Board Structure, Board Process and Board Performance: A review & Research Agenda, Journal of Comparative International Management, Vol. 4 No.1 June, available at http//www.lib.unb.ca.text.jcim/bin/get.cgi:

Hung, H. (1998), "A Topology of the theories of the roles of governing Boards", Corporate Governance: An International review Volume 6.

Jackson, D.K. & J.P. Holland (1998). Measuring the effectiveness of Non-Profit Boards, Non Profit and Voluntary Sector Quarterly, 27,2,159-182.

Jensen, M. C. (1986), Agency Costs of Free Cash Flow, Corporate Finance and Takeovers', *American Economic Review*, 76, 323-329.

Johnson, R.B. (1997), *The Board of Directors over time: Composition and the Organizational cycle*", International Journal of Management, Volume 14.

Keasey and Wright (1993) *Issues in Corporate Accountability and governance* , An editorial Accounting and Business Research, Vol 23.

Keegan, M. & Gilmour., (2001). The Board Agenda. Good Pracrices for Meeting Market Expectations. Price Water HouseCoopers.

Kenya Revenue Auhority Financial Statements (2003 – 2012), available at http//www.kra.go.ke

Kenya Revenue Authority 4th & 5th Strategic Plans, available at http//www.kra.go.ke

Kesner, I.F. and R.B. Johnson, (1990), "An investigation of the relationship between board compensation and stakeholder suits", *Strategic management Journal*, Vol. 11 No.4, 327-36.

Koortz (1967) The Board of Directors and effective management, McGrewhill, New York.

Kosnik (1987) Greenmail: *a study of Board performance in corporate Governance Administrative Science Quarterly* Vol 32.

Krambia and Psaros (2006), The implementation of Corporate Governance Principles in an Emerging Economy: Volume 14 No 2.

Leblanc, R. (2003). The coming Revolution in Corporate Governance. *Ivey Busiess Journal* Sept /Oct 2003.

Lipton, M. & J.W. Lorsch. (1992) *A modest proposal for improved corporate Governance*", Business Lawyer, Volume 48.

Mark, T. (2000). Surveys Reveal Investors will pay for good governance Mckinsey Quarterly survey , World Bank and Korea Yonsei University.

McConville, C. (2001) *Company Law* Dublin, Round Hall.

Namisi, R.N. (2002). Board of Directors Composition, Team processes and Organizational performance of selected financial institutions in Uganda. Unpublished Research Dissertation submitted in partial fulfillment for the award of a degree at Makerere University.

Nichoson, G.J. & G.C. Geoffrey. (2004). Breakthrough board performance: how to harness your board's intellectual capital (1). Corporate governance Vol. No 1 pp5-23.

Novick, D.C. (1997). What is effectiveness?. Position paper presented at Workshop HCI Research and practice Agenda based on human Needs and social responsibility, European Institute of cognitive sciences and engineering (EURISCO) 4 Avenue Edovard Berlin, 31300 Toulouse, France.

OECD (2004) OECD *Principles of corporate governance*, Paris OECD.

Pearce, J.A., and Zahra, S.A (1991), "*The relative power of CEO"s and Boards of Directors: Associations with Corporate performance"*, Strategic Management Journal Volume 12.

Pfeffer, J., and G.R. Salancik, (1978), The external control of Organizations: A resource Dependence Perspective, Harper and Row, New York.

Pfeffer, J. (1973), *Size, composition and function of hospital boards of Directors: a study of organization- environment linkage*, Administration Science Quarterly. Volume 18.

Piesse's. (2005). Corporate Governance and Firm Performance in an International Perspective conflicting Empirical Evidence.

Robinah, A. (2008). Corporate governance and Financial Performance of Public Universities in Uganda

Rossette, N.N. (2002). Board of Directors Composition, Team processes and organizational performance of financial Institutions in Uganda MBA Dissertation (Unpublished) MUBS, Makerere University, Kampala.

Rwegasira,K. (2000), Corporate Governance in Emerging Capital Markets: whither Africa? Corporate Governance: An *international review, 8, 258-267*

Siciliano, J.I. (1996) The *relationship of board member diversity to organizational performance,* Journal of Business Ethics, Volume 15.

Solomon, J.F, Solomon, A., and Park, C. (2002) A conceptual framework for corporate governance reform in south Korea, Corporate governance: An international review, 10, 29- 46.

Solomon, J.F., Shih, W.L Norton, S. D abd Solomon, A (2003) Corportate Governance in Taiwan: Emperical evidence from Taiwanese company Directors, Corporate Governance: An International review, 11, 235-248.

Tricker. (1984), Corporate Governance Ashgate, Aldershot: Brookfield, USA.

Trucker, R.I., (1984), Corporate Governance: Procedures and powers in British Companies and their Boards of Directors, Gower Press London.

Vefas, N. (1999), *The nature of Board nominating committees and their role in Corporate Governance, Journal of Business finance and Accounting* Volume 26.

Wen, Y., K. Rwegasira, and J. Bilderbeek,, (2002), Corporate Governance and Capital Structure Decisions of Chinese Listed Firms‘, *Corporate Governance: An International Review*, 10, 2, 75-83.

Witherell, B. (2004) Corporate Governance Stronger Principles for Better Market Integrity. http://www.oecdobserver.org/news/fullstory.

APPENDICES:

APPENDIX 1: LETTER TO REQUEST ACCESS TO DATA

P.O. BOX 2510 -30100,
ELDORET.
01.10.2013

TO
THE COMMISSIONER GENERAL,
KENYA REVENUE AUTHORITY,
P.O. BOX 48240,
NAIROBI

Dear Sir,

RE: PERMISSION TO ACCESS DATA

I am a post graduate student at the University of Nairobi. I am conducting a research on **"The Effect of Corporate Governance on Revenue Collection in Kenya Revenue Authority"**

Please allow me to access and use KRA information gathered from KRA financial statements and the 4^{th} and 5^{th} Strategy plans. The information collected from the statements will help me meet the research objectives. It is my assurance that the information gathered will be solely used for the purpose of this study.

Thanks a lot for your assistance.

Yours faithfully,

Charles Kibet Kemboi

APPENDIX 11: DATA COLLECTION SHEET

The following documents were the source of my data:

1. Kenya Revenue Authority Annual Report & Financial Statements 2003
2. Kenya Revenue Authority Annual Report & Financial Statements 2004
3. Kenya Revenue Authority Annual Report & Financial Statements 2005
4. Kenya Revenue Authority Annual Report & Financial Statements 2006
5. Kenya Revenue Authority Annual Report & Financial Statements 2007
6. Kenya Revenue Authority Annual Report & Financial Statements 2008
7. Kenya Revenue Authority Annual Report & Financial Statements 2009
8. Kenya Revenue Authority Annual Report & Financial Statements 2010
9. Kenya Revenue Authority Annual Report & Financial Statements 2011
10. Kenya Revenue Authority Annual Report & Financial Statements 2012
11. Kenya Revenue Authority Fourth Corporate Plan (2009/10 – 2011/12)
12. Kenya Revenue Authority Fifth Corporate Plan (2012/13 – 2014/15)